May 3, 2023

The Honourable Chrystia Freeland, P.C., M.P.
Deputy Prime Minister and Minister of Finance
House of Commons
Ottawa, ON K1A 0A6

[sent via e-mail to Chrystia.Freeland@fin.gc.ca]

RE: The general anti-avoidance rule

Dear Deputy Prime Minister Freeland:

The Canadian Chamber of Commerce welcomes the opportunity to share post-budget comments on the general anti-avoidance rule (GAAR).

Written by Steve Suarez, co-chair of the Canadian Chamber's Economics and Taxation Committee and a partner in the Toronto office of Borden Ladner Gervais LLP, our submission:

- Proposes steps to achieve the GAAR that Parliament wants, which would produce "'reasonably predictable result[s]' so that taxpayers can comply with the rule, and the administration and the courts can easily apply it".

- Highlights the practical reality that virtually any commercial transaction done in something other than the least tax-efficient manner possible will come within the definition of GAAR, which contravenes Parliament's original intention.

- Discusses suggestions for better targeting GAAR on those cases of abusive tax avoidance which GAAR is meant to address while minimizing the potential for administrative over-reach, reducing the number of GAAR disputes before the courts, and minimizing the cost and complexity of resolving those that remain.

We look forward to further discussions on the matter. Ultimately, the business community and the government have a shared interest in ensuring that GAAR is robust, effective, and focused exclusively and successfully on those few who engage in abusive tax avoidance.

Sincerely,

Alex Gray
Senior Director, Fiscal and Financial Services Policy
Canadian Chamber of Commerce

The March 2023 GAAR Proposals: Solutions in Search of Problems

Steve Suarez, Borden Ladner Gervais LLP (Toronto)

> . . . [T]he true object and spirit of some provisions of the Act may sometimes appear difficult or even impossible to assess. This, in fact, is the reason why the reference to "a misuse or abuse of the Act" could not practically constitute the basis of the proposed rule and why proposed section 245 relies basically on the non-tax purpose test. But in those cases where it is argued that apparently tax-motivated transactions should nonetheless escape the application of section 245, the most appropriate basis for decision will remain the object and spirit of the relevant provisions of the Act. After all, when one tries to assess the scope of a statutory provision, it is very logical to refer to Parliament's intention when enacting that provision.
>
> David A. Dodge , "A New and More Coherent Approach to Tax Avoidance" 1988 36:1 *Canadian Tax Journal* 1-22 at 21 (the "Dodge Article")

The discussion paper on potential amendments to the general anti-avoidance rule ("GAAR") in s. 245 of the *Income Tax Act* (Canada) ("ITA") released by the Department of Finance in August 2022 (the "Discussion Paper")[1] initiated a rethinking of what GAAR could and should be. More recently, the federal budget of March 28, 2023 (the "March 2023 Budget") advanced the government's thinking by making specific proposals to amend s. 245 ITA (the "March 2023 Proposals"),[2] and inviting comment on them (to be received by May 31, 2023).

The government's concern over GAAR as articulated in the Discussion Paper and (to a lesser extent) the March 2023 Proposals is at once both illuminating and baffling. On the one hand, the broad scope of the changes apparently being considered clearly signal to taxpayers the extent to which the government wishes to tilt the playing field even more in its favour. However, neither the Discussion Paper nor the March 23 Proposals articulate just what it is about the existing state of GAAR that the government feels is so deficient as to warrant essentially re-writing it into something that could apply far more often than is currently the case: rather, the "problem" is simply assumed as a given. For example, nowhere are there specific court cases identified which the government lost but believes it should have won (and why it should have done so) and which would be suitably addressed by the proposed changes, something it was explicitly invited to do in response to the Discussion Paper.[3] As such, both the Discussion Paper and the March 2023 Proposals seem something of a solution in search of a problem. What is truly needed are proposals that focus the application of GAAR on (and only on) those who have clearly obtained

[1] Modernizing and Strengthening the General Anti-Avoidance Rule, Consultation Paper, Department of Finance, August 2022, available at https://www.canada.ca/en/department-finance/programs/consultations/2022/general-anti-avoidance-rule-consultation/modernizing-strengthening-general-anti-avoidance-rule.html .
[2] Tax Measures: Supplementary Information, 2023 Federal Budget, Department of Finance, available at https://www.budget.canada.ca/2023/report-rapport/tm-mf-en.html .
[3] Canadian Chamber of Commerce Submission on GAAR Consultations, September 30, 2022, available at Submission-Canadian-Chamber-of-Commerce-Factum.pdf (herein, "Chamber 2022 Submission").

outcomes demonstrably contrary to Parliament's intent, a result that aligns the interests of the government and the business community, both of whom bear the cost of abusive tax avoidance.

In brief, the principal concerns with the March 2023 Proposals can be summarized as follows:

- the concerns they purport to address are not apparent from a careful review of the GAAR jurisprudence, meaning that the March 2023 proposals proceed upon a flawed premise;
- going further, they are based on the government having drawn the wrong conclusion from those cases the government has lost, i.e., that the government's losses are attributable to a deficiency in the GAAR legislation or the courts' application of it, rather than the government itself over-reaching in applying GAAR and insufficiently articulating Parliament's legislative rationale;
- they meaningfully depart from the original thinking behind GAAR when it was enacted in 1988, without explaining what has changed since those initial policy decisions were made to warrant such departure;
- critically, it is quite unclear what specific impact the government hopes them to have, i.e., what previously-decided cases would be decided differently had these changes been applicable, and (if these changes are enacted) what other situations would now be caught that are not under the principles established in the existing GAAR jurisprudence. In so doing, the government puts the guidance provided by decades of GAAR jurisprudence at immense risk, exposing taxpayers to tremendous uncertainty;
- they rely on vague, ill-defined concepts that are open to wide interpretation and administrative judgment, further moving GAAR towards being a highly discretionary smell test; and
- they ignore the practical reality of GAAR litigation, and encourage the over-reach of tax authorities in applying this most powerful provision beyond cases where the taxpayer's actions are clearly inconsistent with Parliament's evident legislative intent.

The business community is strongly supportive of a robust GAAR that prevents taking steps to reduce taxes that produce outcomes clearly contrary to Parliament's intent: no one wants to pay more to make up for a shortfall caused by those few who engage in abusive tax planning. This indeed was the original intention behind GAAR. However, it does not support a GAAR that treats virtually any step taken with a view to paying no more than the statute requires as *prima facie* unfair tax avoidance, to be invalidated unless the taxpayer is willing to take on the enormous risk and expense of litigating a vaguely-worded smell test against the same deep-pockets government that wrote the legislation in question and has been found incorrect in assessing GAAR roughly half the time it is tested in court. The March 2023 Proposals are a clear step towards the latter and away from the former.

The dialogue prompted by the Discussion Paper represents a genuine opportunity to rethink the role, design and administration of the most powerful provision in the ITA. Since the results a provision produces are measured against its intended role and are determined by both its drafting and the manner in which it is administered, any serious re-examination of GAAR should consider all of these. There is no need to limit the scope of the exercise to the confines of the Discussion Paper, the March 2023 Proposals and the text of the provision, and nor should we.

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Overview

The March 2023 Budget introduces the proposed amendments to GAAR in the following general terms:

> **Strengthening the General Anti-Avoidance Rule**
>
> The General Anti-Avoidance Rule (GAAR) was added to the *Income Tax Act* in 1988 to prevent abusive tax avoidance. If abusive tax avoidance is established, the GAAR applies to deny the tax benefit that was unfairly created. The GAAR has helped to tackle abusive tax avoidance but it requires modernizing to ensure its continued effectiveness. Budget 2023 proposes to release for consultation draft legislative proposals to strengthen the GAAR.

The GAAR is essentially a 2-part test, requiring an "avoidance transaction" (i.e., a transaction whose primary purpose is to obtain a "tax benefit") that results in a misuse of specific provisions of an enactment or an abuse of the enactment as a whole (herein, an "abuse or misuse"). If

enacted, the March 2023 Proposals significantly lower the (already low) threshold what constitutes an avoidance transaction, while also expanding the scope of what constitutes an abuse or misuse (how much is uncertain but potentially quite a bit). By changing in its favour the two principal rules of a game that it already possesses all the advantages in, the government is moving the goalposts on a grand scale, and turning GAAR from the objective exercise it was originally designed to be into a highly discretionary smell test. "Modernization" is perhaps not the first word that comes to mind.

There is certainly nothing wrong with asking whether legislation can be improved. However, the government would be doing all of us (including itself) a great service to better explain what specifically it is about the jurisprudence to date that it perceives to be unfair or deficient, and why, and what specific outcomes its proposed amendments will change. It is difficult to think of many (if any) GAAR cases the government has lost that most people within the tax or business communities think should have gone the other way. Without such concrete examples the very premise of the Discussion Paper and the March 2023 Proposals (i.e., the government isn't winning enough GAAR cases that it should be winning) does not withstand scrutiny and appears somewhat detached from reality. Unless and until the government can articulate why and where it thinks the courts are getting it wrong, and what specific outcomes the government is trying to change going forward, proposed amendments to the GAAR itself to make them get it right are unlikely to achieve their objective.

In fact, the manner in which the government proposes to make what is potentially the most meaningful change to the ITA in a generation risks far worse than unmet objectives. In the 35 years since GAAR's enactment, the courts have produced considerable interpretative guidance, at much effort and expense. All of that judicial guidance is in peril, because the government has not explained which previous cases it thinks are wrongly decided and which ones would be decided differently had the March 2023 Proposals applied. A careful examination of the government's justification for amending GAAR against both the relevant extrinsic aids from 1987-88 and the existing jurisprudence demonstrates little cause for concern - the existing jurisprudence is already making the right choices consistent with Parliament's intention.

The danger posed to the existing GAAR jurisprudence by the March 2023 Proposals is clear and real. One does not need to be clairvoyant to realize that if the March 2023 Proposals are enacted, Crown counsel will use them to implore the courts that Parliament does not act in vain and so *must* have meant to change the law substantively *somehow*. But how, exactly? The government will not tell us. However, since all of the proposed amendments favour the government (couched as they are in vague terms such as "one of the main purposes", "fairness", "economic substance", etc.), we know who cannot lose from this exercise, and who cannot win. If the government's proposed changes were tightly focused on preventing outcomes clearly contrary to Parliament's legislative rationale without overshooting, we would all win. Unfortunately, they are not.

"The courts will figure it all out in future cases" is not a remotely acceptable response. Taxpayers making a *bona fide* good faith effort to determine Parliament's intentions and arrange their affairs accordingly should reasonably be able to do so, rather than being told that no genuine interpretative uncertainty exists and if it does they can either litigate or err on the side of paying more than the statute says they should. The government already holds all the high cards in a GAAR contest. It has the benefit of deciding when to invoke GAAR. Its control of the re-assessment process allows it to largely control the timing of the order cases in which will be heard, so as to use favourable facts in one case to establish a legislative rationale or "object, spirit and purpose" ("OSP") that can later be advanced in subsequent cases where the taxpayer's circumstances are not so conducive to applying GAAR. The deepest roster of full-time, experienced tax litigators in the country is at its disposal. It has vastly greater financial resources than any taxpayer, allowing it pursue litigation without significant fear of the cost constraints and financial risks facing taxpayers. Even a successful taxpayer with the resources to contest a GAAR assessment must do so knowing that it will recoup only a fraction of the costs incurred in winning. In determining OSP, the government has the further advantages of having indisputably greater institutional memory and access to records and personnel when determining what it itself was thinking (i.e., legislative rationale), unlike normal statutory interpretation that focuses on the meaning of the text itself. It also enjoys the ability to spread the cost of establishing OSP over multiple cases dealing with the same provisions in a way that no taxpayer does, as well as a unique perspective on the status and content of GAAR cases by virtue of being a party in all of them. Put simply, GAAR litigation is not a fair fight and never will be, and all that can be hoped for is a process that acknowledges and alleviates the most egregious disparities, with a view to ensuring Parliament's evident choices are respected.

Yet despite all of these advantages, to date the government has won just roughly half of the cases in which GAAR was ultimately the determinative issue. Combined with the further facts that (1) the government has an indisputable advantage in litigating GAAR cases against taxpayers, and (2) the Discussion Paper identifies no cases the government lost but thinks it should have won (and why that is), this reveals an obvious concern: the Canada Revenue Agency ("CRA") is applying GAAR where it shouldn't be. The vast majority of GAAR cases turn on whether the taxpayer has violated the OSP of one or more provisions of the ITA. Without a clearly demonstrated transgression of OSP, GAAR should not be applied and the government should not be able to impose tax in the face of the taxpayer's compliance with the text of the statute as interpreted by the courts on a textual, contextual and purposive basis. If the CRA is losing cases because it is trying to impose tax beyond the OSP of Parliament's statute (as Parliament itself wrote and enacted it) rather than the courts not correctly identifying and respecting that OSP, how can amending GAAR to tilt the playing field further in the CRA's favour be the right answer?

If GAAR was being applied only in cases of abusive tax planning that violates a demonstrable legislative intent, we would logically expect the government's success rate in GAAR cases to be 90% or more. The fact that it isn't is not evidence that GAAR needs to be amended to make it

harder for taxpayers to successfully defend a GAAR re-assessment; rather, it is evidence that GAAR is being applied beyond the scope of Parliament's intent and in cases where it should not be, i.e., where despite all of its advantages in litigating GAAR cases, the government has not shown the existence of a legislative intent that the taxpayer has transgressed. In suggesting the legislative amendments put forward in the March 2023 Proposals, the government is drawing exactly the wrong conclusion from the jurisprudence. If the government wants to win a higher proportion of the GAAR cases it litigates (which seems to be the tacit premise behind the Discussion Paper and March 2023 Proposals), the government should do a better job articulating Parliament's legislative intent in a form that is demonstrable to taxpayers, tax authorities and courts, and administer GAAR consistent with its intended role. If it cannot or will not do this, it should not expect to achieve different results in court, nor (more importantly) should it do so.

Faced with a series of one-sided and vaguely-worded proposals to amend the most powerful provision in the ITA from a government that has not clearly articulated what it thinks the problem with the existing version is, specified what it wished was different about past cases, or provided any examples of how its proposals would change the future, the business community can scarcely be blamed for feeling very uneasy. The March 2023 Proposals constitute major tax policy changes, couched in very general and ill-defined language that can mean whatever a reader wants it to mean, the effect of which is highly uncertain. The government should expect very little support from Canadian taxpayers if it remains on its current course.

Fundamentally, the legislative changes the government is proposing are unwarranted and inequitable, and simply make it more likely that GAAR will apply in circumstances where it shouldn't without doing anything significant to prevent abusive tax avoidance that would not otherwise already be caught. The "avoidance transaction" concept (originally intended as the core determinant for GAAR) is already so broadly interpreted as to rarely constitute a practical impediment to a GAAR assessment. It is difficult to see the justification for expanding it still further based on the rationale provided in the Discussion Paper, and the March 2023 Proposals will largely legislate it out of existence by converting it into a test of "show us either that there was no comparable transaction that would have resulted in more tax payable, or that the tax benefit you achieved was just serendipitous." It will certainly be very difficult to escape an "avoidance transaction" finding whenever a significant tax benefit exists and tax advice has been obtained, a result that perhaps will not displease the government.

The proposed changes relating to the determination of OSP are especially objectionable, as they merely muddy the waters in the government's favour without articulating what they are intended to achieve and how much they are intended to change the results under the existing law (i.e., what will be caught in the future that isn't caught now). The proposed references to economic substance are of greatest concern, since (as discussed below) this nebulous concept is already being considered appropriately in the jurisprudence (what then could the government be changing with this proposal?), can mean anything a reader wants it to mean, and encourages results-oriented OSP analysis rather than the objective determination of legislative rationale

promised in 1988. Instead of providing greater clarity as to how to conduct an OSP analysis that will prevent outcomes contrary to Parliament's legislative intent (this surely being the North Star of s. 245), these elements of the March 2023 Proposals create more questions than they answer and undermine the continuing efficacy of the existing GAAR jurisprudence. The business community will not support initiatives to water down the obligation on the government to conduct a dispassionate, objective OSP analysis and articulate a clear, logically coherent and demonstrable legislative rationale, on the specious basis that anyone the CRA has applied GAAR to is presumptively engaging in "aggressive" or "abusive" tax planning that can only be prevented by lowering the standard for finding an abuse or misuse. This is especially imperative given the practical irrelevance of the "avoidance transaction" test.

Instead, the government should focus on its own very sensible and logical suggestion to make greater efforts to articulate the OSP of the provisions it enacts, including in the manner set out in the Discussion Paper. Indeed, the simplest and most obvious course of action by far for the government to take is to better articulate the legislative rationale of the provisions it enacts, so as to give taxpayers, tax authorities and the courts better guidance as to the OSP of those provisions. Furthermore, the government could very usefully assist these parties by developing interpretative rules that address various elements of how to determine and demonstrate OSP, so that all parties have a better understanding of how to conduct an OSP analysis. Most importantly, the administration of GAAR should be significantly enhanced so as to limit its application to situations of clearly demonstrable abuse (thereby preventing over-reach) and make the resolution of the remaining GAAR controversies faster, cheaper and fairer for everyone.

Fundamentally, the government needs to start over, and undertaken the following:

- Review the jurisprudence carefully, and specify which cases it thinks it should have won, and why the courts got them wrong. This will facilitate an informed exchange of views as to the merits of the government's viewpoint and better understanding of what will (and will not) change going forward. From that, any suggested legislative changes can be drafted and circulated for comment. The government is drawing exactly the wrong conclusions from its success rate in applying GAAR in court cases.
- Share the original thinking on why the decisions that were made in 1988 were made the way they were: why was "primary purpose" determined to be the right standard for an avoidance transaction; why did the government abandon its proposal to impose penalties for GAAR, etc.. That thinking informs the discussion on those same issues in 2023.
- Commit to making publicly available all of the submissions received from the public consultation (in redacted form if need be).
- To preserve the immeasurable value of the existing GAAR jurisprudence where intended, and to make clear to taxpayers, tax authorities and courts what the effect of its proposed amendments to GAAR are:

- clearly describe which principles from the existing jurisprudence the government agrees with and which ones it does not and wants to change. If the government is proposing to change the existing tax policy on GAAR, that needs to be clearly stated as such so that the merits of that can be debated candidly. To the extent proposed changes are said not to be a change of tax policy but are intended to change the current state of the law, the evidence of how they were clearly present in the original tax policy from 1988 must be provided;
- provide more specific examples of how the proposed amendments would change the results of a GAAR analysis from the existing rules; and
- take the opportunity to address a number of other important interpretative GAAR issues still in dispute and not yet addressed definitively by the courts.

- Describe in a concrete manner the specific steps that the government will take (as suggested in the Discussion Paper) towards better articulating its legislative rationale. No one is expecting a complete user's guide for every possible provision and situation, but it can start with the major issues that are the source of frequent GAAR disputes (e.g., surplus stripping, loss utilization, claiming treaty benefits, etc.).
- Be more precise in terminology, to make clearer what is and is not acceptable, i.e., "tax avoidance" versus "abusive tax avoidance", and define what is meant by the latter (i.e., results contrary to what Parliament intended in its legislative rationale).
- Improve how GAAR is currently being administered, in order to reduce the risk of the government over-reaching in applying GAAR and make contesting a GAAR assessment more equitable than is currently the case.

All of this will contribute to the GAAR that Parliament wants, being one that produces "'reasonably predictable result[s]' so that taxpayers can comply with the rule, and the administration and the courts can easily apply it,"[4] and in so doing make it easier for the vast majority of taxpayers who want to stay on the right side of the line to do so, make abusive tax avoidance more difficult to achieve for those who don't, and reduce the time and expense spent on the GAAR controversies that remain.

The discussion that follows refers to the following extrinsic aids with respect to the original enactment of GAAR in 1988:

> Canada, Department of Finance 1987, Supplementary Information Relating to Tax Reform Measures (Ottawa: Department of Finance, December 16, 1987) (the "December 1987 Materials");[5]

[4] Dodge Article, p. 22.
[5] https://publications.gc.ca/collections/collection_2016/fin/F2-77-1987-6-eng.pdf

Canada, Historical Explanatory Notes, Bill C-139; S.C. 1988, C. 55, S. 186 ("1988 Technical Notes");[6] and

David A. Dodge , "A New and More Coherent Approach to Tax Avoidance" 1988 36:1 *Canadian Tax Journal* 1-22 (the "Dodge Article").

The discussion that follows also references various judicial decisions on GAAR, including:

Canada v. Alta Energy Luxembourg S.A.R.L., 2021 SCC 49 ("*Alta Energy*");

Copthorne Holdings Ltd. v. Canada, 2011 SCC 63 ("*Copthorne*");

Lipson v. Canada, 2009 SCC 1 ("*Lipson*");

Canada Trustco Mortgage Co. v. Canada, 2005 SCC 54 ("*Canada Trustco*"); and

Mathew v. Canada, 2005 SCC 55 ("*Mathew*").

1. Where We Are Now

The Primacy of Legal Substance and the Rule of Law

Tax law in Canada is best thought of as an overlay on top of the legal rights and obligations the taxpayer has created under non-tax law: one starts with these, and applies the ITA to them to determine taxes owing. As the Supreme Court of Canada itself has noted, one of the fundamental principles of our system is that "tax consequences flow from the legal relationships or transactions established by taxpayers"[7], and "tax law applies to transactions governed by, and the nature and legal consequences of which are determined by reference to, the common law or the civil law."[8]

This fundamental principle informs any rethinking of GAAR's role: "non-tax" law (e.g., corporate/commercial law) serves as the basis on which we determine taxes owing. Ours is not a tax system based on accounting constructs, "economic substance", "accurate delineation" or anything other than the actual legal rights and relationships the taxpayer has in fact created, which serve as the *terra firma* on which our tax system rests. Unless we are consciously deciding to jettison that objective underpinning for determining taxes payable, a remedy such as GAAR which (where applicable) supersedes that foundation to impose tax on some other basis must indeed apply only in exceptional circumstances where a demonstrably unacceptable result would otherwise occur.

[6] https://publications.gc.ca/collections/collection_2016/fin/F34-40-1988-eng.pdf
[7] *Jean Coutu Group PJC v. Canada*, 2016 SCC 55, para. 41 ("*Jean Coutu*"). In the same paragraph, the Court goes on to note "This tenet is closely related to the Duke of Westminster principle, which is that taxpayers have the right to order their affairs to minimize tax payable".
[8] *Québec v. Service Environnementaux AES Inc.,* 2013 SCC 65, para. 45.

To this core principle of Canada's tax system can be added a few others well-entrenched in our jurisprudence:

- there is nothing *per se* objectionable about undertaking transactions for the purpose of reducing one's taxes owing to no more than the ITA requires, even in the context of a GAAR analysis, as a unanimous Supreme Court stated in *Copthorne* (para. 65):

  > The terms "abuse" or "misuse" might be viewed as implying moral opprobrium regarding the actions of a taxpayer to minimize tax liability utilizing the provisions of the *Income Tax Act* in a creative way. That would be inappropriate. Taxpayers are entitled to select courses of action or enter into transactions that will minimize their tax liability (see *Duke of Westminster*).

  This does not mean that a taxpayer is free to do whatever it wishes to reduce taxes; simply that it is not *per se* acting improperly in so doing, without something more.

- one is taxed on the basis of what one does, not on what a less sophisticated taxpayer might have done. Specifically, in *Shell Canada Ltd. v. Canada*, [1999] 3 SCR 622, para. 45:

  > . . . absent a specific provision to the contrary, it is not the courts' role to prevent taxpayers from relying on the sophisticated structure of their transactions, arranged in such a way that the particular provisions of the Act are met, on the basis that it would be inequitable to those taxpayers who have not chosen to structure their transactions that way. . . . Unless the Act provides otherwise, a taxpayer is entitled to be taxed based on what it actually did, not based on what it could have done, and certainly not based on what a less sophisticated taxpayer might have done.

- a taxpayer's intention to complete a particular transaction or realize a particular tax result will not overcome a failure to create the necessary legal relationships required to achieve that. Again, in *Jean Coutu* (para. 41):

  > Equally, if taxpayers agree to and execute an agreement that produce [sic] unintended tax consequences, they must still be taxed on the basis of that agreement and not on the basis of what they "could have done" to achieve their intended tax consequences, had they been better informed. Tax consequences do not flow from contracting parties' motivations or tax objectives.

The *Duke of Westminster* Principle

Few judicial decisions have been cited in Canadian tax courts as frequently as *Commissioners of Inland Revenue v. Duke of Westminster*, [1936] A.C. 1, invariably for the oft-recited quote that "taxpayers are entitled to arrange their affairs to minimize the amount of tax payable." This so-called *Duke of Westminster* principle has been endorsed by the Supreme Court of Canada in various cases, including *Canada Trustco* (para. 11) and *Alta Energy* (para. 29).

Properly understood, this principle amounts to little more than an admonition to tax authorities that there is nothing *per se* wrong or objectionable in a taxpayer taking some positive step to pay

less tax than would otherwise be the case, and that any challenge to such action requires something more than asserting "you only did that for the purpose of saving tax." It is not a sword entitling a taxpayer to do whatever she wishes to reduce tax. However, it is a shield to the limited extent of ensuring that a tax-reducing purpose in and of itself does not entitle the CRA to ignore the legal rights and obligations the taxpayer has created and change what would otherwise be their tax consequences. Other than in the rare instances in which the ITA itself expressly makes a taxpayer's purpose in doing something relevant to the resulting tax consequences (e.g., the "avoidance transaction" definition), it isn't.

The Role of GAAR

It is important at the outset to reflect on GAAR's intended role. It is a truly exceptional remedy that is intended for use where the taxpayer has complied not merely with the literal wording of the text but with the "unified textual, contextual and purposive"[9] reading of the relevant provisions that normally occurs, and yet nonetheless achieves an outcome clearly contrary to what Parliament demonstrably intends. GAAR performs an important and useful function in this regard. As stated in the 1988 Technical Notes that accompanied the original enactment of GAAR:

> New section 245 of the Act is a general anti-avoidance rule which is intended to prevent abusive tax avoidance transactions or arrangements but at the same time is not intended to interfere with legitimate commercial and family transactions. Consequently, the new rule seeks to distinguish between legitimate tax planning and abusive tax avoidance and to establish a reasonable balance between the protection of the tax base and the need for certainty for taxpayers in planning their affairs. . . . The new rule applies as a provision of last resort after the application of the other provisions of the Act, including specific anti-avoidance measures.

GAAR is but one tool of many for policing compliance with the ITA. It is demonstrably a remedy "of last resort" (as the Discussion Paper itself acknowledges) created to prevent obvious cases of abuse, and was never meant to be an administrative bottle of Liquid Paper allowing the CRA to substitute its own preferences for Parliament's by redrafting the statute to read the way the CRA wishes it would rather than as it actually does. Taxes owing are determined not only by what the taxpayer in fact did rather than what he may have meant to do, but also by the statute Parliament in fact enacted rather than the one it could have enacted or may (or may not) have enacted in hindsight or (as the CRA perceives it) should have enacted. The bar for applying GAAR is and should be high: otherwise the statute ceases to have any meaning and the law becomes whatever the government decides it is at any given time as it goes along and after the fact. No advanced economy operates its tax system in such a capricious and haphazard fashion, and Canada should certainly not become the first.

Taken at face value, the government ostensibly does not propose changing GAAR's role as a remedy of last resort, which for the reasons described above is the right answer. That said, the substance of the changes being proposed, when coupled with the manner in which GAAR is in

[9] *Canada v. Loblaw Financial Holdings Inc.*, 2021 SCC 51, para. 41 ("*Loblaw Financial*").

fact being applied and the distinctly uneven playing field on which GAAR cases are actually contested in practice, could fairly lead an objective observer to conclude that this role would in fact be materially changed if the March 2023 Proposals are enacted. If we take them and the Discussion Paper on their face as not proposing to change GAAR's role, it is necessary to consider the proposed legislative amendments in the context of actually preserving that role in practice.

Existing Principles of GAAR Jurisprudence

The jurisprudence on GAAR to date[10] establishes a number of basic principles for how to approach a GAAR analysis. Foremost amongst these are the ones set out in *Canada Trustco* (para. 66):

> The approach to s. 245 of the *Income Tax Act* may be summarized as follows.
>
> 1. Three requirements must be established to permit application of the GAAR:
>
> (1) A *tax benefit resulting from a transaction* or part of a series of transactions (s. 245(1) and (2));
>
> (2) that the transaction is an *avoidance transaction* in the sense that it cannot be said to have been reasonably undertaken or arranged primarily for a *bona fide* purpose other than to obtain a tax benefit; and
>
> (3) that there was *abusive tax avoidance* in the sense that it cannot be reasonably concluded that a tax benefit would be consistent with the object, spirit or purpose of the provisions relied upon by the taxpayer.
>
> 2. The burden is on the taxpayer to refute (1) and (2), and on the Minister to establish (3).
>
> 3. If the existence of abusive tax avoidance is unclear, the benefit of the doubt goes to the taxpayer.
>
> 4. The courts proceed by conducting a unified textual, contextual and purposive analysis of the provisions giving rise to the tax benefit in order to determine why they were put in place and why the benefit was conferred. The goal is to arrive at a purposive interpretation that is harmonious with the provisions of the Act that confer the tax benefit, read in the context of the whole Act.
>
> 5. Whether the transactions were motivated by any economic, commercial, family or other non-tax purpose may form part of the factual context that the courts may consider in the analysis of abusive tax avoidance allegations under s. 245(4). However, any finding in this respect would form only one part of the underlying facts of a case, and would be insufficient by itself to establish abusive tax avoidance. The central issue is the proper interpretation of the relevant provisions in light of their context and purpose.
>
> 6. Abusive tax avoidance may be found where the relationships and transactions as expressed in the relevant documentation lack a proper basis relative to the object, spirit or purpose of the

[10] Note: at the time of writing, the Supreme Court of Canada had not yet released its decision in *Deans Knight Income Corporation v. The King*, 39869 ("*Deans Knight*").

provisions that are purported to confer the tax benefit, or where they are wholly dissimilar to the relationships or transactions that are contemplated by the provisions.

7. Where the Tax Court judge has proceeded on a proper construction of the provisions of the *Income Tax Act* and on findings supported by the evidence, appellate tribunals should not interfere, absent a palpable and overriding error.

In *Copthorne*, a unanimous court elaborated on the interpretive process of an abuse or misuse analysis, describing the OSP of legislation as "the rationale that underlies the words that may not be captured by the bare meaning of the words themselves," while warning against value judgments that must be left to Parliament and Parliament alone:[11]

> [70] The object, spirit or purpose can be identified by applying the same interpretive approach employed by this Court in all questions of statutory interpretation — a "unified textual, contextual and purposive approach" (*Trustco*, at para. 47; *Lipson v. Canada*, 2009 SCC 1, [2009] 1 S.C.R. 3, at para. 26). While the approach is the same as in all statutory interpretation, the analysis seeks to determine a different aspect of the statute than in other cases. In a traditional statutory interpretation approach the court applies the textual, contextual and purposive analysis to determine what the words of the statute mean. In a GAAR analysis the textual, contextual and purposive analysis is employed to determine the object, spirit or purpose of a provision. Here the meaning of the words of the statute may be clear enough. <u>The search is for the rationale that underlies the words that may not be captured by the bare meaning of the words themselves. However, determining the rationale of the relevant provisions of the Act should not be conflated with a value judgment of what is right or wrong nor with theories about what tax law ought to be or ought to do.</u> [emphasis added]

The Court in *Copthorne* warned of the need to display caution in seeking Parliament's legislative rationale, because of the enormous impact that an OSP determination has on other taxpayers not represented before the court.[12] In an exercise of unifying text, context and purpose, the Court specified that an OSP sufficient to invoke GAAR must have some degree of grounding in the text of the relevant provisions:

> [118] Copthorne submits that such a conclusion could only rest upon a *general* policy against surplus stripping. It argues that no such general policy exists and therefore the object, spirit and purpose of s. 87(3) cannot be to prevent surplus stripping by the aggregation of PUC. This argument is based upon this Court's admonition in *Trustco* that "courts cannot search for an overriding policy of the Act that is not based on a unified, textual, contextual and purposive interpretation of the specific provisions in issue" (para. 41). <u>What is not permissible is basing a finding of abuse on some broad statement of policy, such as anti-surplus stripping, which is not attached to the provisions at issue.</u> <u>However, the tax purpose identified in these reasons is based upon an examination of the PUC sections of the Act, not a broadly stated policy.</u> The approach addresses the rationale of the

[11] Similarly in *Alta Energy*: (para. 48): "Second, it is also important to distinguish what is immoral from what is abusive. . . . Rothstein J. observed that courts should not infuse the abuse analysis with "a value judgment of what is right or wrong nor with theories about what tax law ought to be or ought to do" (para. 70)."

[12] Para. 67: "A court must be mindful that a decision supporting a GAAR assessment in a particular case may have implications for innumerable 'everyday' transactions of taxpayers. . . . Because of the potential to affect so many transactions, the court must approach a GAAR decision cautiously."

> PUC scheme specifically in relation to amalgamation and redemption and not a general policy unrelated to the scheme under consideration. [emphasis added]

It is one thing to "look behind" the text in an OSP analysis, and quite another to ignore or contradict it. The majority in *Alta Energy* paraphrased the correct approach as follows (para. 58):

> "The proper approach is one that *unifies* the text, context, and purpose, not a purposive one in search of a vague policy objective disconnected from the text (*Canada Trustco*, at para. 41)".

With reference to the "unified textual, contextual and purposive approach" mandated in *Canada Trustco*, the Court in *Copthorne* went on (para. 91) to specify that "[t]he consideration of context involves an examination of other sections of the Act, as well as permissible extrinsic aids (*Trustco*, at para. 55)." This statement remains the leading guidance on the meaning of "context."

The Duke of Westminster Principle & GAAR

The interaction of the *Duke of Westminster* principle and GAAR warrants particular mention. In a GAAR analysis, a taxpayer's purpose of reducing taxes is central to whether or not an "avoidance transaction" exists. If so, then an "abuse or misuse" analysis must be undertaken, and the OSP of the relevant provisions must be determined.

However, that OSP analysis must be undertaken objectively, and generally without regard to the fact that taxpayers have taken some step to achieve a tax benefit. As stated by a unanimous Supreme Court of Canada in *Copthorne* (para. 65):

> The terms "abuse" or "misuse" might be viewed as implying moral opprobrium regarding the actions of a taxpayer to minimize tax liability utilizing the provisions of the *Income Tax Act* in a creative way. That would be inappropriate. Taxpayers are entitled to select courses of action or enter into transactions that will minimize their tax liability (see *Duke of Westminster*).

As such, an OSP determination should be conducted without regard to any particular taxpayer or purpose: indeed, the very structure of GAAR pre-supposes that taxpayers will take active steps to reduce taxes owing, since an OSP analysis is only relevant where an avoidance transaction has occurred. The fact that a particular taxpayer may have been motivated by reducing taxes is neither here nor there to what Parliament's legislative rationale is, which in fact pre-supposes that taxpayers will do so. Indeed, in many cases Parliament actively intends for taxpayers to do exactly that (RRSP contributions, for example).

The relevance of the *Duke of Westminster* principle to the "abuse or misuse" element of a GAAR analysis is thus essentially the same as it is in other situations: it stands for the simple proposition that a tax avoidance purpose in and of itself is not something wrong or indicative of aggressive or abusive tax planning.[13] Taxpayers are presumed to be entitled to take steps to pay no more than what the statute says they owe. But in determining what in fact the statute says they owe (i.e., establishing OSP as part of an abuse or misuse analysis), no adverse inference can or should

[13] See for example *Alta Energy*, para. 47: "In addition, tax avoidance should not be conflated with abuse."

be drawn from the fact that a taxpayer has undertaken an "avoidance transaction": OSP is determined objectively, unsupported by the crutch that unless the government's proposed OSP is accepted as valid, abusive tax planning will necessarily result. Such thinking puts the cart before the horse: rather, the correct sequence of events is *first*, the relevant legislative rationale is objectively established (i.e., articulated and evidenced); only *then* is that standard used to determine whether a particular taxpayer's actions in reducing taxes have crossed the line from acceptable to abusive.

The Dodge Article makes plain that when formulating GAAR the government was very much aware and accepting of "arranging one's affairs so as to minimize tax payable," so long as one's actions do not constitute an abuse or misuse, i.e., the latter is determined independently of the former (p. 22):

> Another criticism that has been made is that the proposed rule violates the basic principle that a taxpayer has the right to arrange his affairs so as to minimize his tax payable. This criticism is not valid. Since the new rule will apply only to primarily tax-motivated transactions that represent misuses or abuses of the Act, it will not affect legitimate tax planning.

It thus could not be clearer that when GAAR was enacted, Parliament accepted the legitimacy of taxpayers "arranging [their] affairs so as to attract the least amount of tax" in concept (albeit not without limits), and that such tax avoidance in and of itself did not constitute an abuse or misuse. This was clearly acknowledged by the majority in *Alta Energy*:

> [70] . . . Taxpayers are "entitled to select courses of action or enter into transactions that will minimize their tax liability" (*Copthorne*, at para. 65). The courts' role is limited to determining whether a transaction abuses the object, spirit, and purpose of the specific provisions relied on by the taxpayer.

Properly understood, a court citing the *Duke of Westminster* principle in a GAAR case is saying no more than this, and no court has ever held that something that would otherwise be an abuse or misuse is saved from being so because of the *Duke of Westminster* principle. That principle merely ensures that OSP must be determined objectively and on the premise that Parliament pre-supposes and accepts that taxpayers may and will arrange their affairs to minimize their taxes owing, and that this in and of itself is not indicative of abuse.

The Unspoken Premise

Notwithstanding the lip service the government pays to taxpayers' ability to arrange their affairs so as to pay no more than what the statute requires, there is in fact an unspoken premise that pervades its actions, both in terms of how GAAR is currently being administered and in the March 2023 Proposals. That premise is, in essence, "GAAR is only being applied in cases of abusive behaviour, not in cases of legitimate interpretative dispute or uncertainty, or where we're taking a shot at something we don't like but can't challenge on a technical basis." In effect, the government insists, "trust us, we'll only use GAAR against the bad guys." Would that it were so.

This is evident in the way in which GAAR cases are sometimes argued in court, where taxpayers to whom GAAR has been applied are characterized as "aggressive" and "pushing the envelope" or choosing to "walk near the edge of the cliff." It is evident when questions about legislative rationales advanced by the government that have gaps in logic, contradict the text of the relevant provisions, exhibit inexplicable inconsistencies with CRA administrative policies or subsequent legislative amendments, or are phrased in generalities to the point of being indecipherable are waived away on the premise that courts must overlook these frailties lest abusive tax avoidance result, and that taxpayers wanting to be safe from GAAR can choose to err on the side of overpaying and thereby stay well away from the "cliff's edge." It is particularly evident in the March 2023 Proposals, which:

- impose penalties were GAAR applies, without regard to the reasonableness of the taxpayer's conduct or how close a call the court's decision was;
- effectively collapse the two steps of avoidance transaction/abuse or misuse into a single abuse or misuse test that *de facto* does away with "avoidance transaction" as a meaningful barrier to applying GAAR and formally codifies the CRA's practice of importing a tax-reduction purpose into the abuse or misuse analysis via the economic substance proposal; and
- urge the courts to give more weight to nebulous feel-good, mean-anything concepts such as "fairness" without explaining what "more weight" means or identifying deficiencies in the existing caselaw that indicate insufficient weight is currently being ascribed to them.

In advancing the March 2023 Proposals, the government is proposing to act on a premise that demonstrably is not true: if it was, we would reasonably expect the government to be winning virtually all of the GAAR cases that it litigates rather than roughly just half of them. It therefore needs to either change its proposed actions, or take different actions to make the premise true. The government is looking at the results of the GAAR jurisprudence to date without the necessary introspection and reflection (hence the absence of explanation of which cases they have lost that they shouldn't have, and why), and as a result is drawing exactly the wrong conclusion.

In so doing, the government is effectively using the "avoidance transaction" concept in a way it was never meant to be: as a way of separating "good" taxpayers from "bad" ones (or as the majority in *Alta Energy* describes it, conflating tax avoidance with abuse (para. 47). The "avoidance transaction" concept is not fit for purpose in such manner. This is illustrated by the simple example of someone making an RRSP contribution to get the resulting tax benefit instead of paying down their mortgage, an obviously benign result. The government cannot on the one hand make a pretence of accepting the legitimacy of taxpayers to actively take steps to pay no more than what they owe, while on the other hand infusing tax reduction into the abuse or misuse analysis in a pejorative manner so as to use GAAR to attack transactions based on the existence of an alleged legislative rationale that is neither expressed in the text nor clearly evident and defined. This is not how Parliament intended GAAR to function.

The taxpayer in *Canada Trustco* was not "pushing the envelope": it was simply utilizing a set of provisions in exactly the manner in which they were intended to be used, and the government was the party seeking to conjure up a completely new "economic substance" requirement out of thin air. Similarly, in *Alta Energy* it was the government asking the courts to create out of whole cloth a new condition for entitlement to treaty benefits so as to do for the government what the government would not do for itself: amend the terms of the *Canada-Luxembourg Income Tax Convention*.[14] Nothing undertaken by the taxpayer in *Loblaw Financial* was in fact remotely abusive of any readily-apparent legislative rationale, but it nonetheless found itself fending off a baseless GAAR challenge at considerable expense. Surplus stripping transactions have been a leading source of GAAR controversies for years, for the simple reason that the government has not clearly articulated when as a tax policy matter the realization of share value relating to corporate surplus in a non-dividend transaction should be taxed as a dividend.

These cases and others illustrate the importance of detaching the "avoidance transaction" concept in its entirety from the determination of legislative rationale, and in so doing prevent courts undertaking an OSP analysis from being urged to establish the line wherever it needs to be to "get" the particular taxpayer before it. GAAR as properly interpreted and applied requires the government to undertake an objective, disciplined OSP analysis that prevents GAAR from being applied without first articulating a coherent and logically consistent legislative rationale that is demonstrably indeed Parliament's intent, before turning to the taxpayer's facts and motivations.

2. The March 2023 Proposals

This portion of the discussion turns to specific elements of the March 2023 Proposals.

"Avoidance Transaction"

What Is The Issue?

The Discussion Paper frames the government's concerns with the "avoidance transaction" definition as follows:

> **Statement of Issue**
>
> The GAAR fails to prevent abusive tax avoidance when a tax benefit is achieved in the context of a transaction with a primarily non-tax purpose. As a result, a transaction with significant tax planning objectives may be exempt from the GAAR, even where that transaction results in abusive tax avoidance.
>
> **Background**

[14] For example, the government could have negotiated such a condition in the original treaty or threatened to terminate the treaty unless Luxembourg agreed to amend it, or changed the *Income Tax Conventions Interpretation Act* to create such a requirement for Canadian courts to follow.

> A transaction that results in a tax benefit (or that is part of a series of transactions that results in a tax benefit) is not subject to the GAAR if it "may reasonably be considered to have been undertaken or arranged primarily for *bona fide* purposes other than to obtain the tax benefit". In such a case, it would not be an "avoidance transaction," which is one of the three main components of the GAAR test. The avoidance transaction test is often considered to serve an important gatekeeper function for the GAAR analysis, obviating the need for primarily non-tax-motivated transactions to go through the more complex misuse or abuse analysis.
>
> While the existence of an avoidance transaction is admitted in many cases and not litigated, in approximately 29 per cent of the cases since *Canada Trustco* where the GAAR was found to not apply, it was because the avoidance transaction test had not been satisfied. [footnotes omitted]

The 2023 Budget Proposals describe the specific proposed expansion of the "avoidance transaction" concept as follows:

> **Avoidance Transaction**
>
> The threshold for the avoidance transaction test in the GAAR would be reduced from a "primary purpose" test to a "one of the main purposes" test. This is consistent with the standard used in many modern anti-avoidance rules and strikes a reasonable balance, as it would apply to transactions with a significant tax avoidance purpose but not to transactions where tax was simply a consideration.

<u>What Was Said When GAAR Was Enacted?</u>

When GAAR was enacted, the "avoidance transaction" concept was envisioned as the centrepiece of GAAR rather than a "gatekeeper",[15] with a relieving exception in s. 245(4). The December 1987 Materials characterize the role of the "avoidance transaction" concept as follows:

> The adoption of a business purpose test, as proposed in the White Paper, is designed to restrict the provisions of the Income Tax Act to real economic transactions and to deny their application to tax-motivated transactions designed to utilize them to obtain benefits not intended in the Act.

The Dodge Article (p. 19) elaborates on this point somewhat:

> . . . the test used in the proposed rule is essentially the business purpose test.. . . the business purpose test represents an objective and practical test for ensuring that tax statutes are applied in accordance with the underlying legislative intention that, save exceptional circumstances, tax law is to apply only to transactions that have an underlying non-tax purpose.

Since as a practical matter the ITA must apply in some fashion or another to all transactions, whether tax-motivated or not, presumably these references to tax law applying only to "real" transactions should be interpreted as high-level expressions of intent as to the overall operation of s. 245 rather than being read literally (if not the government could usefully clarify this point).

The 1988 Technical Notes provide further colour as to the "avoidance transaction" concept:

[15] E.g., "proposed section 245 relies basically on the non-tax purpose test": Dodge Article, p. 21.

> Under new paragraph 245(3)(a), a transaction that, but for section 245, would result, directly or indirectly, in a tax benefit is considered to be an avoidance transaction unless the transaction may reasonably be considered to have been undertaken or arranged primarily for bona fide purposes other than for the purposes of obtaining the tax benefit.
>
> New paragraph 245(3)(a) refers to "bona fide purposes other than to obtain the tax benefit" rather than to "bona fide business purposes", as originally proposed, because the latter expression might be found not to apply to transactions which are not carried out in the context of a business, narrowly construed. The vast majority of business, family or investment transactions will not be affected by proposed section 245 since they will have bona fide non-tax purposes.
>
> Where a transaction is carried out for a combination of bona fide non-tax purposes and tax avoidance, the primary purposes of the transaction must be determined. This will likely involve weighing and balancing the tax and non-tax purposes of the transaction. If, having regard to the circumstances, a transaction is determined to meet this non-tax purpose test, it will not be considered to be an avoidance transaction. Thus a transaction will not be considered to be an avoidance transaction because, incidentally, it results in a tax benefit or because tax considerations were a significant, but not the primary, purpose for carrying out the transaction.
>
> . . .
>
> Subsection 245(3) does not permit the "recharacterization" of a transaction for the purposes of determining whether or not it is an avoidance transaction. In other words, it does not permit a transaction to be considered to be an avoidance transaction because some alternative transaction that might have achieved an equivalent result would have resulted in higher taxes. It is recognized 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. If a taxpayer selects a transaction that minimizes his tax liability and this transaction is not carried out primarily to obtain a tax benefit, he should not be taxed as if he had engaged in other transactions that would have resulted in higher taxes. [emphasis added]

Similar to the reference in the 1988 Technical Notes to "the vast majority of business, family or investment transactions" not being avoidance transactions, the Dodge Article also envisioned a relatively high threshold for commercial transactions to come within the "avoidance transaction" definition:

> . . . it is reasonable to assume that for transactions that are primarily carried out for non-tax purposes, the new rule will provide greater certainty. This will surely affect most commercial transactions carried out in Canada.

What Does the Jurisprudence Say?

In *Canada Trustco* the Court reiterated the statement made in the 1988 Technical Notes that finding an avoidance transaction should require more than simply showing that some other transaction with an equivalent commercial result would yield more tax payable:

> 30 The courts must examine the relationships between the parties and the actual transactions that were executed between them. The facts of the transactions are central to determining whether there was an avoidance transaction. It is useful to consider what will not suffice to establish an avoidance transaction under s. 245(3). The Explanatory Notes state, at p. 464:

> Subsection 245(3) does not permit the "recharacterization" of a transaction for the purposes of determining whether or not it is an avoidance transaction. In other words, it does not permit a transaction to be considered to be an avoidance transaction because some alternative transaction that might have achieved an equivalent result would have resulted in higher taxes.
>
> 31 According to the Explanatory Notes, Parliament recognized the Duke of Westminster 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" (p. 464). Despite Parliament's intention to address abusive tax avoidance by enacting the GAAR, Parliament nonetheless intended to preserve predictability, certainty and fairness in Canadian tax law. Parliament intends taxpayers to take full advantage of the provisions of the *Income Tax Act* that confer tax benefits. Indeed, achieving the various policies that the *Income Tax Act* seeks to promote is dependent on taxpayers doing so.

The Court expressed the view that most tax benefits obtained by taxpayers would not be avoidance transactions, stating that "[t]he majority of tax benefits claimed by taxpayers on their annual returns will be immune from the GAAR as a result of s. 245(3)." (para. 21)

However, as a practical matter the "avoidance transaction" threshold has proven to be a very low barrier for the CRA to meet. In this regard, the government's statement in the Discussion Paper that "in approximately 29 per cent of the cases since *Canada Trustco* where the GAAR was found to not apply, it was because the avoidance transaction test had not been satisfied" significantly overstates the prevalence of whatever concern exists. First of all, the *Spruce Credit Union*[16] case cited in the Discussion Paper as an example of this concern was one where the courts expressly declined to engage in an abuse-or-misuse analysis. As such, it cannot fairly be described as an example of "a transaction with significant tax planning objectives [that] may be exempt from the GAAR, even where that transaction results in abusive tax avoidance." The same is true of *McClarty Family Trust v. The Queen*, 2012 TCC 80. In *Evans v. Canada*, 2005 TCC 684, and *McMullen v. The Queen*, 2007 TCC 16, after concluding that no avoidance transaction existed, the courts expressly went on to find that *no* abuse or misuse had occurred either. Finally, while *Loblaw Financial* is also listed as having been decided on the basis of lacking an "avoidance transaction", in fact it also clearly failed on the abuse-or-misuse standard as well: the trial judge's finding on abuse-or-misuse was based entirely on an interpretation of the rationale for the technical provisions[17] that was completely rejected on appeal at both levels. Hence, *Loblaw Financial* stands not as an example of a deficiency in the "avoidance transaction" definition allowing abusive tax avoidance to occur, but rather as an exemplar of administrative over-reach on the part of the CRA in wrongly applying GAAR.

<u>The Proposed Solution</u>

[16] *Spruce Credit Union v. The Queen*, 2012 TCC 357; aff'd, 2014 FCA 143.
[17] 2018 TCC 182, at para. 323: "Having concluded the rationale for the financial institution exemption is grounded in 'competition,' it follows that Loblaw Financial was misusing this exemption as it was not competing in any manner in any international market."

In 1988, the tax policy decision was made that GAAR would not apply where tax considerations were "a significant, but not the primary, purpose for carrying out the transaction." In 2023, the decision has been made that GAAR may "apply to transactions with a significant tax avoidance purpose but not to transactions where tax was simply a consideration." This is a major tax policy change, with no justification offered for it other than being "consistent with the standard used in many modern anti-avoidance rules" and (we are assured) a "reasonable balance." Most tellingly, the rationale behind the original choice in 1988 to use the "primary purpose" standard is not provided, nor the change in circumstances to warrant departing from it.

Despite the original intention of Parliament being that "the vast majority" of transactions will not be subject to GAAR by virtue of not being avoidance transactions,

- the practical reality is that virtually any commercial transaction done in something other than the least tax-efficient manner possible will come within the definition; and
- for some reason the government believes the "avoidance transaction" threshold should be lowered further still (despite typically being conceded in GAAR disputes), notwithstanding the fact that in 1988 the Dodge Article described "proposed section 245 [as] rel[ying] basically on the non-tax purpose test" since determining OSP can be so hard.

The practical result of this proposal in the vast majority of cases where significant tax benefits have been obtained will be to eliminate the "avoidance transaction" element of the GAAR analysis (particularly where any kind of tax advice has been obtained), and turn GAAR completely into an abuse or misuse test.

Given the magnitude of this tax policy change, the government should:

- share the reasoning behind the decision made in 1988 to use "primary purpose" rather than some lower standard as the basis for the "avoidance transaction" definition;
- explain what has changed since then to warrant lowering the bar so dramatically to a "one of the main purposes" test;
- clarify what effect obtaining of tax advice is intended to have on an "avoidance transaction" determination;
- explain which other "modern anti-avoidance rules" the Discussion Paper refers to and why an extraordinary provision such as GAAR should necessarily have the same standard (i.e., "one of the main purposes"); and
- better illustrate the extent of the tax policy change being proposed, and provide examples of situations which it believes would not constitute "avoidance transactions" under the existing definition but would under the proposed one.

As it stands, the proposed amendment to the "avoidance transaction" definition would seem to effectively eliminate it as a requirement to applying GAAR in most circumstances where any serious thought (including normal tax planning advice)is given to meaningful tax consequences.

Misuse or Abuse: Onus

The first of the three issues addressed in the proposed preamble in draft s. 245(0.1) included in the March 2023 Proposals describes GAAR as applying "to deny the tax benefit of avoidance transactions that result directly or indirectly either in a misuse of provisions of the Act (or any of the enactments listed in subparagraphs (4)(a)(ii) to (v)) or an abuse having regard to those provisions read as a whole, while allowing taxpayers to obtain tax benefits contemplated by the relevant provisions". The March 2023 Budget paraphrases this element of the pre-amble as "draw[ing] a line: while taxpayers are free to arrange their affairs so as to obtain tax benefits intended by Parliament, they cannot misuse or abuse the tax rules to obtain unintended benefits." While this sounds innocuous enough at first glance, perhaps there is more here than meets the eye. If not, the government could helpfully dispel these concerns and articulate what it is that this amendment is intended to achieve and how it would change the existing law.

Both the text itself of actual proposed amendment and the supporting explanatory material reference GAAR as allowing "tax benefits contemplated by the relevant provisions" while preventing misuse or abuse to "obtain unintended benefits." The choice of wording is interesting and important, since (as noted) Crown counsel will almost certainly use any legislative amendments to persuade the courts that Parliament must have acted for a reason and that the words used were chosen with that reason in mind. Arguably, they suggest an onus on the taxpayer to show that in enacting the relevant provisions Parliament foresaw the taxpayer's situation and actively intended the tax benefits to be conferred on those facts, and that if the taxpayer cannot show this (i.e., her actions were not foreseen when the provision was enacted) abuse or misuse may be inferred. Put another way, wording such as that included in the first portion of the preamble suggests that the government can discharge the abuse-or-misuse burden on it merely by showing that whatever the taxpayer has done was something different from what Parliament intended when enacting the relevant provisions (and likely unforeseen), as opposed to the further step of going beyond this to show that what the taxpayer did in fact actively frustrates that legislative rationale. If that is correct, it would essentially constitute a reversal of the onus on the government to identify and articulate a legislative regime and demonstrate that the taxpayer's actions constitute an abuse or misuse of that regime

The relevant extrinsic aids from 1988 demonstrate an intention to put a positive onus on the government to show that the taxpayer's actions frustrate or are incompatible with Parliament's legislative rationale. For example, from the Dodge Article (pp. 20-21):

> Where a transaction does not have primarily non-tax purposes, it nonetheless escapes the application of proposed section 245 if, on a normal construction of the Act read as a whole, it may

> reasonably be concluded that the transaction does not represent a misuse of the provisions of the Act or an abuse of the Act read as a whole.
>
> In that context, the words "misuse" and "abuse" are intended to have an objective rather than a subjective meaning. These words are meant to exclude transactions that do not involve a use of the Act that is contrary to its general scheme.
>
> . . .
>
> Subsection 245(4) does not create an alternative test with regard to the definition of avoidance transaction. Instead, it indicates the proper construction of section 245 with respect to transactions that appear to be tax-motivated but that, arguably, do not produce tax results that frustrate the intention of Parliament. [emphasis added]

Similarly, the 1988 Technical Notes state:

> For instance, a transaction structured to take advantage of technical provisions of the Act but which would be inconsistent with the overall purpose of these provisions would be seen as a misuse of these provisions. [emphasis added]

The GAAR jurisprudence takes a similar position, requiring the government to show that the results of the taxpayer's actions are not merely unforeseen by but actively contrary to the relevant OSP. For example, in *Mathew* the Court concluded that "to allow the appellants to claim the losses in the present appeal would defeat the purposes of s. 18(13) and the partnership provisions . . .." [para. 58] The Court in *Copthorne* expressed a similar conclusion in determining that "the sale by Copthorne I of its VHHC Holdings shares to Big City, which was undertaken to protect $67,401,279 of PUC from cancellation, while not contrary to the text of s. 87(3), does frustrate and defeat its purpose."

A unanimous court in *Canada Trustco* similarly expressed the burden on the government as being one requiring it to demonstrate frustration or defeat of the relevant legislative rationale:

> 49 In all cases where the applicability of s. 245(4) is at issue, the central question is, having regard to the text, context and purpose of the provisions on which the taxpayer relies, whether the transaction frustrates or defeats the object, spirit or purpose of those provisions.
>
> . . .
>
> 69 As discussed above, the practical burden of showing that there was abusive tax avoidance lies on the Minister. The abuse of the Act must be clear, with the result that doubts must be resolved in favour of the taxpayer. The analysis focusses on the purpose of the particular provisions that on their face give rise to the benefit, and on whether the transaction frustrates or defeats the object, spirit or purpose of those provisions.

This is consistent with the conclusions of both the majority and the minority in *Alta Energy*:

> [32] The onus rests on the Minister to demonstrate the object, spirit, and purpose of the relevant provisions and to establish that allowing Alta Luxembourg the benefit of the exemption would be a misuse or an abuse of the provisions (*Canada Trustco*, at para. 65). Abusive tax avoidance occurs "when a taxpayer relies on specific provisions of the *Income Tax Act* in order to achieve an outcome

> that those provisions seek to prevent" or when a transaction "defeats the underlying rationale of the provisions that are relied upon" (*Canada Trustco*, at paras. 45; see also para. 57; *Lipson v. Canada*, 2009 SCC 1, [2009] 1 S.C.R. 3, at para. 40). Abusive tax avoidance can also occur when an arrangement "circumvents the application of certain provisions, such as specific anti-avoidance rules, in a manner that frustrates or defeats the object, spirit or purpose of those provisions" (para. 45).
>
> . . .
>
> [118] Once the court has identified the rationale underlying the relevant provisions, the second step of the abuse analysis is "to determine whether the avoidance transaction defeated or frustrated the object, spirit or purpose of the provisions in issue" (*Canada Trustco*, at para. 55).

Part of the business community's wariness was the highly provocative suggestion made in the Discussion Paper that somehow the government that drafted the relevant legislation is no better placed than the taxpayer to identify and demonstrate what it intended in enacting it, and that therefore the government should not bear the burden of establishing abuse or misuse:[18]

> 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. Consideration could be given to changing the burden under the misuse or abuse test in a variety of ways.

The government needs to articulate what it is trying to achieve with this proposed amendment. Unless the government is actively seeking to make a very significant tax policy change (which would certainly require further discussion), it should make clear that it is not changing the established law in this regard, and describe what effect it wants this amendment to have.

Certainty and Fairness

The second issue included in the proposed preamble in draft s. 245(0.1) included in the March 2023 Proposals describes GAAR as "[s]trik[ing] a balance between taxpayers' need for certainty in planning their affairs, and the government of Canada's responsibility to protect the tax base and the fairness of the tax system."

<u>What Is The Issue?</u>

The Discussion Paper described the government's concerns with the role of certainty and fairness with respect to GAAR as follows:

> *Interpretive rule for assessing certainty, predictability and fairness*

[18] For an example of the negative reaction this trial balloon provoked, see Tim Cestnick, "Looming legal changes that will affect Canadians' ability to pay less tax" *Globe & Mail*, August 18, 2022.

> In *Alta Energy*, the Supreme Court of Canada underscored the importance of certainty, predictability and fairness in the tax system. In its decision, the majority linked certainty, predictability and fairness with the right of taxpayers to legitimate tax minimization as the bedrock of tax law. This construction could be interpreted as implying that fairness should be construed individually, such that fairness implies simply an individual's right to rely on their tax minimization strategies.
>
> The dissent however recognized the GAAR as striking a balance between providing certainty to taxpayers and "fairness to the tax system as a whole." As indicated in the *Introduction*, ensuring the fairness of the Canadian income tax system was a prominent goal when the GAAR was introduced. This broader notion of fairness reflects the unfair distributional effects of tax avoidance as the shifting of tax burden from those willing and able to avoid taxes to those who are not. If tax avoidance is perceived to be a significant problem in society, it can undermine attitudes toward tax compliance and more generally the rule of law itself. Viewed this way, a broader notion of fairness is key to maintaining the confidence of all taxpayers in the effective functioning of the tax system. This goal of fairness could be assisted by including an interpretation rule in the GAAR that would help achieve a more appropriate balance with respect to the consideration of fairness. [footnote omitted]

The March 2023 Proposals read as follows:

> A preamble would be added to the GAAR, in order to help address interpretive issues and ensure that the GAAR applies as intended. It would address three areas where questions have arisen.
>
> . . .
>
> As noted in the original explanatory notes accompanying the GAAR, it is intended to strike a balance between taxpayers' need for certainty in planning their affairs and the government's responsibility to protect the tax base and the fairness of the tax system. "Fairness" in this sense is used broadly, reflecting the unfair distributional effects of tax avoidance as it shifts the tax burden from those willing and able to avoid taxes to those who are not.

While this sounds benign and consistent with the existing state of affairs, the question then is, what specifically is this amendment trying to do?

<u>What Was Said When GAAR Was Enacted?</u>

The 1988 Technical Notes explicitly reference certainty as a legitimate tax policy objective that Parliament consciously sought to preserve in enacting GAAR:

> Consequently, the new rule seeks to distinguish between legitimate tax planning and abusive tax avoidance and to establish a reasonable balance between the protection of the tax base and the need for certainty for taxpayers in planning their affairs.

The Dodge Article also makes clear that when enacting s. 245 Parliament viewed maintaining some degree of certainty as a valid and important element in designing GAAR (pp. 21-22):

> A main criticism of proposed section 245 has concerned the high degree of uncertainty that, it has been claimed, will inevitably result from the implementation of the rule and that may seriously affect commercial life in Canada. As shown by the preceding analysis of the current approach to tax avoidance, much uncertainty already exists. . . . In any event, some level of uncertainty must be

seen as inevitable. Since the objective cannot be absolute certainty, it should instead be a "reasonably predictable result" so that taxpayers can comply with the rule, and the administration and the courts can easily apply it.

What Does the Jurisprudence Say?

Given the references in the relevant extrinsic aids to certainty and predictability as being amongst the objectives of s. 245, it is not surprising that the jurisprudence interpreting it takes the same approach. In *Canada Trustco*, a unanimous Supreme Court of Canada made a number of references in its judgment to certainty and variants thereof, as well as fairness, including the following:

> 12 The provisions of the *Income Tax Act* must be interpreted in order to achieve consistency, predictability and fairness so that taxpayers may manage their affairs intelligently. As stated at para. 45 of *Shell Canada Ltd. v. Canada*, [1999] 3 S.C.R. 622:
>
> > [A]bsent a specific provision to the contrary, it is not the courts' role to prevent taxpayers from relying on the sophisticated structure of their transactions, arranged in such a way that the particular provisions of the Act are met, on the basis that it would be inequitable to those taxpayers who have not chosen to structure their transactions that way. [emphasis added.]
>
> . . .
>
> 15 The *Explanatory Notes to Legislation Relating to Income Tax* issued by the Honourable Michael H. Wilson, Minister of Finance (June 1988) ("Explanatory Notes") are an aid to interpretation. The Explanatory Notes state at the outset that they "are intended for information purposes only and should not be construed as an official interpretation of the provisions they describe". They state the purpose of the GAAR at p. 461:
>
> > New section 245 of the Act is a general anti-avoidance rule which is intended to prevent abusive tax avoidance transactions or arrangements but at the same time is not intended to interfere with legitimate commercial and family transactions. Consequently, the new rule seeks to distinguish between legitimate tax planning and abusive tax avoidance and to establish a reasonable balance between the protection of the tax base and the need for certainty for taxpayers in planning their affairs.
>
> . . .
>
> 31 According to the Explanatory Notes, Parliament recognized the Duke of Westminster 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" (p. 464). Despite Parliament's intention to address abusive tax avoidance by enacting the GAAR, Parliament nonetheless intended to preserve predictability, certainty and fairness in Canadian tax law. Parliament intends taxpayers to take full advantage of the provisions of the *Income Tax Act* that confer tax benefits. Indeed, achieving the various policies that the *Income Tax Act* seeks to promote is dependent on taxpayers doing so.
>
> . . .
>
> 42 Second, to search for an overriding policy of the *Income Tax Act* that is not anchored in a textual, contextual and purposive interpretation of the specific provisions that are relied upon for the tax benefit would run counter to the overall policy of Parliament that tax law be certain,

> predictable and fair, so that taxpayers can intelligently order their affairs. Although Parliament's general purpose in enacting the GAAR was to preserve legitimate tax minimization schemes while prohibiting abusive tax avoidance, Parliament must also be taken to seek consistency, predictability and fairness in tax law. These three latter purposes would be frustrated if the Minister and/or the courts overrode the provisions of the *Income Tax Act* without any basis in a textual, contextual and purposive interpretation of those provisions.
>
> . . .
>
> 50 As previously discussed, Parliament sought to address abusive tax avoidance while preserving consistency, predictability and fairness in tax law and the GAAR can only be applied to deny a tax benefit when the abusive nature of the transaction is clear.
>
> . . .
>
> 61 A proper approach to the wording of the provisions of the *Income Tax Act* together with the relevant factual context of a given case achieve balance between the need to address abusive tax avoidance while preserving certainty, predictability and fairness in tax law so that taxpayers may manage their affairs accordingly. Parliament intends taxpayers to take full advantage of the provisions of the Act that confer tax benefits. Parliament did not intend the GAAR to undermine this basic tenet of tax law.
>
> . . .
>
> 75 The appellant suggests that the usual result of the CCA provisions of the Act should be overridden in the absence of real financial risk or "economic cost" in the transaction. However, this suggestion distorts the purpose of the CCA provisions by reducing them to apply only when sums of money are at economic risk. The applicable CCA provisions of the Act do not refer to economic risk. They refer only to "cost". Where Parliament wanted to introduce economic risk into the meaning of cost related to CCA provisions, it did so expressly, as, for instance, in s. 13(7.1) and (7.2) of the Act, which makes adjustments to the cost of depreciable property when a taxpayer receives government assistance. "Cost" in the context of CCA is a well-understood legal concept. It has been carefully defined by the Act and the jurisprudence. Like the Tax Court judge, we see nothing in the GAAR or the object of the CCA provisions that permits us to rewrite them to interpret "cost" to mean "amount economically at risk" in the applicable provisions. To do so would be to invite inconsistent results. The result would vary with the degree of risk in each case. This would offend the goal of the Act to provide sufficient certainty and predictability to permit taxpayers to intelligently order their affairs. For all these reasons, we agree with the Tax Court judge's conclusion that the "cost" was $120 million, not zero as argued by the appellant. [emphasis added]

The Court's inclusion of certainty and predictability as a relevant consideration is well-founded in the extrinsic materials accompanying GAAR's enactment, and hence can hardly be considered objectionable. While in this case the term "fairness" was used with reference to providing taxpayers with a reasonable degree of predictability to allow them to comply with the rule as described in the Dodge Article, a fair reading of the judgment shows that the Court clearly understood and explicitly acknowledged that the protection of the tax base and prevention of "abusive tax avoidance" was to be taken as one of the main objectives of GAAR when conducting an abuse or misuse analysis, whether or not cloaked in the term "fairness." The government is reading too much into the presence or absence of the specific term "fairness" when the concept

is clearly being applied and the courts are demonstrably aware of the importance of protecting the tax base from abuse.

Indeed, in *Lipson* (para. 52) the same Court formally incorporated these anti-abuse concepts into its use of the term "fairness" (as the March 2023 Proposals envision), as follows:

> . . . To the extent that it may not always be obvious whether the purpose of a provision is frustrated by an avoidance transaction, the GAAR may introduce a degree of uncertainty into tax planning, but such uncertainty is inherent in all situations in which the law must be applied to unique facts. 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. [emphasis added]

Both the majority and the minority in *Alta Energy* understood and acknowledged that when enacting an abuse or misuse test, Parliament both (1) valued certainty and intended it to be preserved to the degree reasonably possible, and (2) sought to protect the tax system and prevent abusive behaviour, whether or not framed as "fairness." The majority, for example:

> [2] Section 245 of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) ("*Act*"), known as the general anti-avoidance rule ("GAAR"), acts as a legislative limit on tax certainty by barring abusive tax avoidance transactions, including those in which taxpayers seek to obtain treaty benefits that were never intended by the contracting states.
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> . . .
>
> [30] This established principle was affected by the enactment of s. 245 of the *Act*, also known as the GAAR, which "superimposed a prohibition on abusive tax avoidance, with the effect that the literal application of provisions of the Act may be seen as abusive in light of their context and purpose" (*Canada Trustco*, at para. 1).

The minority is essentially saying the same thing (although coming to a different conclusion in the particular circumstances before the Court), while using the term "fairness" to encompass the same objective of preventing abusive tax avoidance that the majority acknowledges:

> [101] Given that the GAAR can only find application where a taxpayer has complied with the strict requirements of a provision, absolute certainty cannot be achieved, nor was it intended. This is a legislative choice that Parliament made in order to strike a necessary balance between the uncertainty inherent in the GAAR and the fairness of the Canadian tax system as a whole achieved by defeating abusive tax avoidance schemes.
>
> . . .
>
> [123] Consequently, a finding that the GAAR applies to deny the tax benefits conferred by clear provisions where avoidance transactions defeat their underlying rationale does not run counter to the principles of certainty, predictability and fairness. The application of the GAAR in these circumstances upholds the balance Parliament sought to strike between those principles and gives effect to its intent to curb abusive tax avoidance (Department of Finance (1988), at p. 461, cited in *Canada Trustco*, at para. 15).

. . .

> [177] We acknowledge that finding that a transaction structured to claim tax benefits from a treaty can be abusive when a resident lacks economic connections to the state of residence may produce more uncertainty than mechanically applying the words of the Treaty. However, Parliament struck the balance it considered proper between certainty and fairness to the tax system as a whole. [emphasis added]

It seems quite clear from the foregoing that the courts are well aware of Parliament's stated intention of accepting a higher degree of potential uncertainty in order to protect the tax base from abusive avoidance transactions, and have no difficulty conducting a GAAR analysis with this trade-off in mind. Importantly, no court hearing a GAAR case has ever suggested that (1) "certainty" should be the primary or determining consideration in an abuse-or-misuse analysis, or (2) in enacting GAAR Parliament was not consciously choosing to create *some* extra degree of uncertainty as the cost of preventing abusive tax avoidance and thereby protecting the tax base (these are favourite straw-man arguments from tax authorities arguing GAAR cases when seeking to support a weak theory of legislative rationale). The courts are demonstrably weighing certainty, predictability and protection of the tax base in exactly the manner Parliament intends.

The Proposed Solution

The second element of the proposed s. 245(0.1) preamble repeats the objectives of certainty/predictability and prevention of abusive behaviour that are referenced in the 1988 Technical Notes and extensively in the existing GAAR jurisprudence. The courts have already signalled in the clearest possible way that they understand and accept this "reasonable balance." As such, what then is the government seeking to achieve with this element of the pre-amble? If the intent is not to change the existing jurisprudence but merely enshrine it legislatively and not disturb the existing law, it is important for the government to say so explicitly. Conversely, if the government's intent is to move the needle in some way, it should explicitly say that, and articulate how much and in what way it is seeking to do so. As with other proposals, the government has not articulated which cases (if any) it believes would have been decided differently had this pre-amble been in place. Once again, if this amendment is enacted, Crown counsel will soon be urging the courts that Parliament doesn't change the law for no reason, and that of course it must have meant *something* in so doing. Rather than leaving that burden on the courts, the government should say exactly what it is trying to do with this change. Without more, this proposal seems to be little more than an invitation to a tax assessor or court looking for a justification to apply GAAR to go ahead and do so on the tenuous basis of "fairness."

Moreover, the scope of the reference to "fairness" seems quite selective in favour of the government. That term, "in the sense used broadly", should properly be interpreted in its fullest sense. "Fairness" towards the tax system as a whole is not limited to ensuring some taxpayers are prevented from paying less than what the statute says they owe via abusive tax planning; it also includes ensuring that others (potentially very many others) are not forced to pay *more* than what Parliament intends in order to be reasonably safe from re-assessment because the

government that holds the pen has not articulated the OSP of the legislation it writes in a way consistent with its own stated objective of generating "reasonably predictable outcomes." If the government is truly concerned with fairness to the tax base as a whole, it will not act on the basis that causing many to pay too much is an acceptable price for ensuring that a few do not pay too little.

Indeed, appeals to nebulous concepts such as "fairness" should inherently be viewed with suspicion. In the context of an abuse or misuse analysis, "fairness" is a red herring: everyone agrees that "fairness" includes not allowing people to get away with paying less than what the statute (including its OSP) requires of them, but tells us nothing about exactly what that is. "Fairness" also includes not requiring taxpayers to pay more than what Parliament intends them to due to the government's failure to articulate what it meant clearly enough: someone making a good faith *bona fide* attempt to determine where the line is should be able to do so reasonably confidently, without be told that the onus is on them to just pay more if they don't have the stomach or the pocketbook to risk litigating against the government. "Fairness" as a concept does little or nothing to inform us as to Parliament's legislative rationale in any given case, and as such would seem to have little or no probative value in conducting an OSP analysis.

The "certainty" that courts and the 1988 Technical Notes refer to isn't only for the benefit of the particular taxpayer whose case is being re-assessed or a small group of taxpayers who seek to avoid taxes unfairly as the Discussion Paper suggests, but rather for the vast majority who simply want to know where the line is in order to be governed by it. The government has stated that consistency and predictability are legitimate objectives to strive for as part of undertaking a GAAR analysis. A taxpayer, tax authority or court making an objective *bona fide* effort to determine what the relevant OSP behind a particular set of provisions is and measuring a specific series of transactions against that standard should be able to do so with a reasonable degree of confidence that it will come to the correct outcome. There is nothing "unfair" about that.

Unfortunately, this concept appears lost on many tax authorities. The low-water mark in this regard is found in the factum of the Province of Ontario in the *Deans Knight* case, which included the following statements (which thankfully the federal Crown did not adopt): [19]

> Uncertainty resulting from the GAAR arises where taxpayers are testing the boundaries between acceptable tax planning and abusive tax avoidance.
>
> . . .
>
> Such uncertainty should properly act as a deterrent to engaging in aggressive tax planning.

Undoubtedly aggressive tax planning can be a source of uncertainty. But uncertainty is also caused by aggressive administrative over-reach in seeking to apply GAAR without a clear legislative rationale having been articulated and evidenced. And uncertainty is also caused by aggressive legislative amendments to GAAR using vague, ill-defined terms capable of meaning

[19] *Deans Knight*, Factum of the Intervener, Attorney General for Ontario, Paragraph 22.

anything, where the deficiency in the existing law has not been explained and a reader cannot reasonably predict the impact of the proposed changes in future cases or how decades of existing jurisprudence is affected. Statements such as these reveal the unspoken premise that in selecting when and to whom to apply GAAR, tax authorities always limit their actions to abusive behaviour, and that since no legitimate interpretational uncertainty can possibly exist as to Parliament's legislative rationale those thus re-assessed are by definition "aggressive" tax avoiders undeserving of Parliament's safeguard of interpreting s. 245(4) so as to yield "reasonably predictable results." Those who would jettison certainty and predictability as relevant criteria in an abuse or misuse analysis are simply seeking (without saying so) to relieve the government of its obligation to articulate and establish a coherent, logically consistent and objectively-determined legislative rationale that does not depend on demonizing anyone who undertakes an avoidance transaction the CRA does not like as "aggressive."

Almost invariably, when a tax authority arguing a GAAR case appeals to "fairness" or tells a court that "some uncertainty is inevitable", this can generally be decoded as "please don't ask us to explain the logic gaps in our suggested OSP, or why there isn't clear and convincing evidence of that OSP as being Parliament's intent, or why the CRA has previously said something completely different, or why a subsequent legislative amendment completely undermines it." Once recent pronouncement is particularly revealing of the mindset, which is completely detached from the commercial reality faced by the business community:[20]

> Tax risks can be assessed by obtaining expert tax advice, and reduced or eliminated through a variety of methods, including by obtaining advance tax rulings from the Canada Revenue Agency, or even through the purchase of tax insurance. [footnote omitted]

"Expert tax advice" is not free, often not capable of being expressed at a high degree of confidence, or uniformly correct. The "variety of methods" offered to taxpayers to reduce or eliminate uncertainty consists of two, one of which simply shifts the risks to a different party at the cost of paying an insurance premium rather than reducing it, and the other of which is completely impractical as a general solution (the CRA is not staffed for more than the several hundred advance tax rulings issued each year, with 6-12 months being the typical turnaround time). These are not real-world solutions to the *bona fide* interpretative uncertainty created by governments that do not sufficiently explain their legislative rationale and do not administer GAAR in a measured way to avoid over-reaching on re-assessments.

In any event, the choice between certainty and protection of the tax base (whether or not labelled as "fairness") is ultimately a false one. It is not necessarily the case that one can only be achieved at the expense of the other. It is almost entirely within the government's power to provide more certainty by better articulating legislative rationale as the Discussion Paper itself proposes, without diminishing GAAR's effectiveness in preventing abusive tax behaviour.

[20] *Ibid.*, para. 21.

Certainty need not be sacrificed in pursuit of other objectives and is in fact enhanced along *with* fairness if it is achieved by better articulating legislative rationale.

The *Alta Energy* case is a glaring example of exactly this false choice. Imagine the challenge faced by Crown counsel in explaining to the courts why a government which allegedly believed its tax treaties reserved its right to protect the tax base by taxing gains unless a non-resident seller had substantial economic connections with its country of fiscal residence never took a single step towards articulating that position, either in the treaty itself or otherwise. Having not bargained to include such requirement in the text of the treaty (which that counterparty would surely have objected to), nor tried to renegotiate the treaty, nor cancelled it, nor amended the *Income Tax Conventions Interpretation Act* to include such a requirement in interpreting Canada's tax treaties, nor prepared its own model income tax convention technical interpretation, the government can hardly be surprised that the courts declined to find such a principle inherent in the treaty. The government did not lose *Alta Energy* because the majority decided "certainty" trumped protection of the tax base from abusive planning; rather, it lost because the majority carefully examined the text, context and purpose of the relevant treaty and its OSP, and determined that based on the available evidence of the parties' intent, no abusive tax planning had occurred because there was no indication that the result was anything other than what the government had in fact bargained for and agreed to. The government had a number of options open to it for achieving its definition of "fairness," and consciously chose none of them.

Incidentally, it is noteworthy that the GAAR references in the 2023 Budget Materials (which almost certainly will be cited as an interpretive aid in its own right as to the meaning of these changes) dealing with this specific element of the proposed pre-amble contain no reference to "abuse." Rather, the text refers only to the unfair distributional effects of "tax avoidance," and to the targets of GAAR as "those willing and able to avoid taxes". Compare this with the corresponding portion of the 1988 Technical Notes referencing certainty:

> New section 245 of the Act is a general anti-avoidance rule which is intended to prevent abusive tax avoidance transactions or arrangements but at the same time is not intended to interfere with legitimate commercial and family transactions. Consequently, the new rule seeks to distinguish between legitimate tax planning and abusive tax avoidance and to establish a reasonable balance between the protection of the tax base and the need for certainty for taxpayers in planning their affairs. [emphasis added]

The lack of distinction between tax avoidance (which despite the pejorative connotations is perfectly permissible and well-acknowledged as such by Parliament) and abuse (which is not and is indeed the deserving target of GAAR) is likely merely an oversight, but if so then the government should identify it as such and correct it. Again, words matter in these extrinsic aids that will inform an OSP analysis, and counsel will be carefully examining each nuance in these legislative changes and supporting materials for every advantage and inviting the courts to draw conclusions that may (or may not) reflect Parliament's intentions.

Foreseeability

The final element of the proposed pre-amble in draft s. 245(0.1) of the March 2023 Proposals makes clear that GAAR "can apply regardless of whether a tax strategy is foreseen." While the statement itself is unobjectionable (at least when read literally), again, the purpose of this amendment is unclear: there would not appear to be any court decision refusing to apply GAAR just because the taxpayer's actions were foreseeable. What then could the government be getting at with this proposal, and what outcome is it seeking?

Notwithstanding the comment by the majority in *Alta Energy* that "The GAAR was enacted to catch unforeseen tax strategies" (para. 80), a fair reading of the complete judgment makes clear that the Court was merely stating the eminently logical proposition that foreseeability of a particular course of action is a factor to be considered in divining Parliament's true intent:

> [82] I acknowledge that the absence of specific anti-avoidance rules that would have prevented the situation is not necessarily determinative of the application of the GAAR (see *Copthorne*, at paras. 108-11). Of course, one could always imagine a potential anti-avoidance rule that would have pre-empted the tax strategy at issue. If that were the standard, I agree that it would provide a full response in every case and gut the GAAR. In this case, the absence of specific anti-avoidance provisions represents, however, an enlightening contextual and purposive element as it sheds light on the contracting states' intention. This is not a case where Parliament did not or could not have foreseen the tax strategy employed by the taxpayer. Options to remediate the situation were available and known by the parties, but they made deliberate choices to guard some benefits against conduit corporations and to leave others unguarded. Had the parties truly intended to prevent such corporations from taking advantage of the carve-out, they could have done so. Combined with Canada's preference at the time of the *Treaty* for taking advantage of economic benefits yielded by foreign investments rather than higher tax revenues (as will be discussed below), this makes the rationale of the carve-out even clearer. In my opinion, Canada and Luxembourg made a deliberate choice to leave the business property exemption unguarded.

When seeking to discern Parliament's legislative rationale in a situation where the text of the provisions in question does not specifically address the taxpayer's particular circumstances (hence the need for recourse to GAAR), surely as a matter of simple logic and common sense the foreseeability of whatever the taxpayer has done must be a relevant factor (although by no means determinative) in whether any inference should be drawn from the absence of specific text. That GAAR *may* apply to foreseeable tax planning is not disputed – if that is all the third element of the proposed preamble is intended to enshrine, then it would be helpful for the government to make that clear. Conversely, if the government is proposing something more than this (i.e., that foreseeability is not something courts should be considering when determining Parliament's legislative intent), it should say so clearly, as that would be a very different proposition. What exactly is the government's complaint in *Alta Energy* on this point?

By definition, a GAAR case involves a situation where the statute does not directly address the taxpayer's circumstances: hence the need to conduct an OSP analysis. This is exemplified by

Copthorne, where the taxpayer argued that the absence of an explicit paid-up capital grind in the ITA on its facts indicated that no abuse or misuse had occurred:

> [108] Copthorne argues that Parliament has enacted a number of PUC provisions which are intended to prevent taxpayers from inappropriately increasing or preserving PUC. It argues that the detail of the PUC provisions, such as s. 87(3), suggests that where the taxpayer's actions are not caught by a provision, the actions cannot abuse the purpose of the provision. I interpret this argument as what Professor Sullivan calls "implied exclusion". In essence the argument is that "there is reason to believe that if the legislature had meant to include a particular thing within its legislation, it would have referred to that thing expressly" (Sullivan, at p. 244). Section 89(1) is a definition section. . . .
>
> . . .
>
> [111] However, the implied exclusion argument is misplaced where it relies exclusively on the text of the PUC provisions without regard to their underlying rationale. If such an approach were accepted, it would be a full response in all GAAR cases, because the actions of a taxpayer will always be permitted by the text of the Act. As noted in *OSFC*, if the Court is confined to a consideration of the language of the provisions in question, without regard to their underlying rationale, it would seem inevitable that the GAAR would be rendered meaningless (para. 63).

Upon going beyond the text (without contradicting it) and examining the *context and purpose* of the relevant provisions, the Court had no difficulty in determining that notwithstanding the absence of explicit text, ". . . the taxpayer's 'double counting' of PUC was abusive in this case, where the taxpayer structured the transactions so as to 'artificially' preserve the PUC in a way that frustrated the purpose of s. 87(3) governing the treatment of PUC upon vertical amalgamation." (para. 127)

Conversely in *Alta Energy*, the majority's extensive examination of context and purpose "[i]n the face of a complete absence of express words" (para. 58) referencing substantial economic connections as a requirement for claiming treaty benefits led it to the conclusion that the relevant OSP did not include such:

> [82] I acknowledge that the absence of specific anti-avoidance rules that would have prevented the situation is not necessarily determinative of the application of the GAAR (see *Copthorne*, at paras. 108-11). Of course, one could always imagine a potential anti-avoidance rule that would have pre-empted the tax strategy at issue. If that were the standard, I agree that it would provide a full response in every case and gut the GAAR. In this case, the absence of specific anti-avoidance provisions represents, however, an enlightening contextual and purposive element as it sheds light on the contracting states' intention. This is not a case where Parliament did not or could not have foreseen the tax strategy employed by the taxpayer. Options to remediate the situation were available and known by the parties, but they made deliberate choices to guard some benefits against conduit corporations and to leave others unguarded. Had the parties truly intended to prevent such corporations from taking advantage of the carve-out, they could have done so. Combined with Canada's preference at the time of the *Treaty* for taking advantage of economic benefits yielded by foreign investments rather than higher tax revenues (as will be discussed below), this makes the rationale of the carve-out even clearer. In my opinion, Canada and Luxembourg made a deliberate choice to leave the business property exemption unguarded.

> [83] The parties agreed to exclude Luxembourg holding companies from their *Treaty* (art. 28(3)). However, as explained above, the parties did not follow the OECD's suggestion to include a "look-through" provision combined with a provision safeguarding *bona fide* business activities. Doing so would have excluded conduit corporations that were owned by residents of a third country and that conducted few "substantive business activities" in Luxembourg.
>
> [84] Moreover, Luxembourg and Canada added provisions reserving the benefits of the *Treaty* to the beneficial owners of certain income, but only in respect of dividends, interest, and royalties, not capital gains (arts. 10 to 12). If the parties had applied the concept of beneficial ownership to the carve-out, it would have prevented conduit corporations from taking advantage of this benefit where their beneficial owners were residents of a third country (see, e.g., *Prévost Car*). . . . [emphasis added]

The courts are already getting it right on the issue of foreseeability. If the government wishes to proceed with this proposal, it should articulate what its complaint with the analysis in *Alta Energy* is, what it is trying to achieve with this amendment, and clarify that foreseeability is a relevant (but not determinative) criterion in determining legislative rationale.

Economic Substance

One of the most alarming amendments contained in the March 2023 Proposals is the concept of adding "economic substance" to the abuse or misuse element of GAAR. Under this proposal (contained in new s. 245(4.1)), "if an avoidance transaction is significantly lacking in economic substance, that tends to indicate" that it results in a misuse or abuse. For this purpose, "factors that tend – depending on the circumstances – to establish that a transaction or series of transactions is significantly lacking in economic substance include" three specific criteria. Those three criteria are as follows:

- substantially all of the taxpayer's risk of gain or loss remaining unchanged;
- the expected value of tax benefits exceeding the expected value of other economic returns (excluding for this purpose Canadian and foreign tax benefits); and
- "the entire, or almost entire" purpose of the transactions being to obtain the tax benefit.

<u>What Is The Issue?</u>

The Discussion Paper frames the concern with economic substance as follows:

> **Statement of Issue**
>
> The GAAR does not sufficiently take into consideration the economic substance of transactions.
>
> **Background**
>
> In *Canada Trustco*, the Supreme Court of Canada expressly precluded the consideration of the economic substance of what was purported to be an ordinary sale-leaseback transaction in the application of the GAAR's misuse or abuse test in the context of an avoidance transaction that relied upon the capital cost allowance rules<u>. It went on to say that economic substance is relevant only if,</u>

and to the extent that, the text of the law says that it is relevant. As a result, courts do not regularly or expressly apply an "economic substance" test when determining if an avoidance transaction is an abuse or a misuse of a particular provision of the Act.

Canada Trustco established a limited role for economic substance at the stage in the GAAR analysis involving the factual inquiry into abusive tax avoidance; however, the Supreme Court of Canada effectively precluded a role for economic substance in the determination of the object, spirit and purpose of the relevant provisions (absent express legislative language) and any finding that transactions could be found to be abusive merely because they were lacking economic substance. This limitation on the role of economic substance in the GAAR analysis may not align completely with the government's statement in the lead-up to enacting the GAAR that "the new rule would not supplant other provisions of the Act but would apply together with these other provisions to require economic substance in addition to literal compliance with the words of the Act".

Together with the limited role accorded economic substance in non-GAAR cases, the exclusion of, or limitations on, economic substance as a relevant consideration in the GAAR analysis have had a pervasive impact on the tax system. However, a review of the case law does not yield many instances, after the decision in *Canada Trustco*, where a lack of economic substance has led to a conclusion that a transaction is abusive. Given the Supreme Court of Canada's guidance in *Canada Trustco* on the limited role of economic substance in the GAAR analysis, it is not surprising that the argument is rarely made by the Crown (and cases are not pursued).

Some cases may suggest that economic substance is a factor that is given weight in GAAR decisions. However, other cases tend to minimize the role and weight accorded economic substance. Moreover, those cases that show some deference to economic substance usually involve some type of attribute duplication, preservation or manipulation and are found to be abusive on that basis. In any event, this limited or *ad hoc* role for economic substance is unsatisfying from a policy perspective.

It should be noted that the avoidance transaction test is, in a sense, a form of economic substance test. By looking to whether the primary purpose of a transaction is to obtain a tax benefit, purely tax motivated transactions that are devoid of economic substance will be considered avoidance transactions. However, the "misuse or abuse" exception in subsection 245(4) does not explicitly attribute significance to the economic substance of a particular transaction. Even though the commentary accompanying the introduction of the GAAR explicitly contemplated economic substance, the precise role of economic substance in the interpretive process was not established. As discussed above, 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. This judicial approach suggests that if a factor (such as economic substance) is to form part of the misuse or abuse analysis, it should be as part of a clear and explicit test. [emphasis added] [footnotes omitted]

The March 2023 Proposals say the following:

Economic Substance

A rule would be added to the GAAR so that it better meets its initial objective of requiring economic substance in addition to literal compliance with the words of the *Income Tax Act*. Currently, Supreme Court of Canada jurisprudence has established a more limited role for economic substance.

> The proposed amendments would provide that economic substance is to be considered at the 'misuse or abuse' stage of the GAAR analysis and that a lack of economic substance tends to indicate abusive tax avoidance. A lack of economic substance will not always mean that a transaction is abusive. It would still be necessary to determine the object, spirit and purpose of the provisions or scheme relied upon, in line with existing GAAR jurisprudence. In cases where the tax results sought are consistent with the purpose of the provisions or scheme relied upon, abusive tax avoidance would not be found even in cases lacking economic substance. To the extent that a transaction lacks economic substance, the new rule would apply; otherwise, the existing misuse or abuse jurisprudence would continue to be relevant.
>
> The amendments would provide indicators for determining whether a transaction or series of transactions is lacking in economic substance. These are not an exhaustive list of factors that might be relevant and different indicators might be relevant in different cases. However, in many cases, the existence of one or more of these indicators would strongly point to a transaction lacking economic substance. These indicators are: whether there is the potential for pre-tax profit; whether the transaction has resulted in a change of economic position; and whether the transaction is entirely (or almost entirely) tax motivated.
>
> The transfer of funds by an individual from a taxable account to a tax-free savings account provides a simple example of how the analysis could apply. Such a transfer could be considered to be entirely tax motivated, with no change in economic position or potential for profit other than as a result of tax savings. Even if the transfer is considered to be lacking in economic substance, it is clearly not a misuse or abuse of the relevant provisions of the *Income Tax Act*. The individual is using their tax-free savings account in precisely the manner that Parliament intended. There are contribution rules that specifically contemplate such a transfer and, perhaps more fundamentally, the basic tax-free savings account rules would not work if such a transfer was considered abusive.
>
> The proposal would not supplant the general approach under Canadian income tax law, which focuses on the legal form of an arrangement. In particular, it would not require an enquiry into what the economic substance of a transaction actually is (e.g., whether a particular financial instrument is, in substance, debt or equity). Rather, it requires consideration of a lack of economic substance in the determination of abusive tax avoidance.

The foregoing materials reveal a variety of concerns on the government's part with respect to economic substance, which can be summarized as follows:

- "The GAAR does not sufficiently take into consideration the economic substance of transactions";
- *Canada Trustco* "effectively precluded a role for economic substance in the determination of the object, spirit and purpose of the relevant provisions (absent express legislative language)";
- the limited role for economic substance is inconsistent with the statement in the December 1987 Materials that "the new rule would not supplant other provisions of the Act but would apply together with these other provisions to require economic substance in addition to literal compliance with the words of the Act";

- "the exclusion of, or limitations on, economic substance as a relevant consideration in the GAAR analysis have had a pervasive impact on the tax system";
- "this limited or *ad hoc* role for economic substance is unsatisfying from a policy perspective"; and
- "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."

For the most part, the foregoing seem capable of being fairly collapsed into two main complaints:

- whatever weight the courts are currently giving to economic substance is not enough (whatever "enough" is); and
- the extrinsic aids accompanying the enactment of GAAR in 1988 provide for a larger role for GAAR than the courts are currently ascribing to it.

What Does the Jurisprudence Say?

The government's complaint with the jurisprudence starts with *Canada Trustco*. The specific portions of that judgment cited by the Discussion Paper on this point are paras. 56-60:

> 56 The Explanatory Notes elaborate that the provisions of the *Income Tax Act* are intended to apply to transactions with real economic substance. Although the expression "economic substance" may be open to different interpretations, this statement recognizes that the provisions of the Act were intended to apply to transactions that were executed within the object, spirit and purpose of the provisions that are relied upon for the tax benefit. The courts should not turn a blind eye to the underlying facts of a case, and become fixated on compliance with the literal meaning of the wording of the provisions of the *Income Tax Act*. Rather, the courts should in all cases interpret the provisions in their proper context in light of the purposes they intend to promote.
>
> 57 Courts have to be careful not to conclude too hastily that simply because a non-tax purpose is not evident, the avoidance transaction is the result of abusive tax avoidance. Although the Explanatory Notes make reference to the expression "economic substance", s. 245(4) does not consider a transaction to result in abusive tax avoidance merely because an economic or commercial purpose is not evident. As previously stated, the GAAR was not intended to outlaw all tax benefits; Parliament intended for many to endure. The central inquiry is focussed on whether the transaction was consistent with the purpose of the provisions of the *Income Tax Act* that are relied upon by the taxpayer, when those provisions are properly interpreted in light of their context. Abusive tax avoidance will be established if the transactions frustrate or defeat those purposes.
>
> 58 Whether the transactions were motivated by any economic, commercial, family or other non-tax purpose may form part of the factual context that the courts may consider in the analysis of abusive tax avoidance allegations under s. 245(4). However, any finding in this respect would form only one part of the underlying facts of a case, and would be insufficient by itself to establish abusive tax avoidance. The central issue is the proper interpretation of the relevant provisions in light of

> their context and purpose. When properly interpreted, the statutory provisions at issue in a given case may dictate that a particular tax benefit may apply only to transactions with a certain economic, commercial, family or other non-tax purpose. The absence of such considerations may then become a relevant factor towards the inference that the transactions abused the provisions at issue, but there is no golden rule in this respect.
>
> 59 Similarly, courts have on occasion discussed transactions in terms of their "lack of substance" or requiring "recharacterization". However, such terms have no meaning in isolation from the proper interpretation of specific provisions of the *Income Tax Act*. The analysis under s. 245(4) requires a close examination of the facts in order to determine whether allowing a tax benefit would be within the object, spirit or purpose of the provisions relied upon by the taxpayer, when those provisions are interpreted textually, contextually and purposively. Only after first, properly construing the provisions to determine their scope and second, examining all of the relevant facts, can a proper conclusion regarding abusive tax avoidance under s. 245(4) be reached.
>
> 60 A transaction may be considered to be "artificial" or to "lack substance" *with respect to specific provisions* of the *Income Tax Act*, if allowing a tax benefit would not be consistent with the object, spirit or purpose of those provisions. We should reject any analysis under s. 245(4) that depends entirely on "substance" viewed in isolation from the proper interpretation of specific provisions of the *Income Tax Act* or the relevant factual context of a case. However, abusive tax avoidance may be found where the relationships and transactions as expressed in the relevant documentation lack a proper basis relative to the object, spirit or purpose of the provisions that are purported to confer the tax benefit, or where they are wholly dissimilar to the relationships or transactions that are contemplated by the provisions. [emphasis added]

It is frankly difficult to see anything in the foregoing text that is objectionable (and rather odd that the government has waited almost 20 years to raise those objections). The Court does not say that "economic substance is relevant only if, and to the extent that, the *text* of the statute says that it is." Nor does the Court say that economic substance is limited to "the factual inquiry into abusive tax avoidance" so as to " effectively preclude[e] a role for economic substance in the determination of the object, spirit and purpose of the relevant provisions (absent express legislative language)." Even if references to "economic . . . purpose" are taken as references to "economic substance," to say that economic substance may be part of the second-stage factual element of an abuse or misuse analysis is not to say that it is necessarily irrelevant to the first stage of determining OSP: it may or may not be, depending on the provisions and legislative rationale in question. If something about the text, or the *context or purpose*, of particular provisions is such as to make economic substance relevant to their legislative rationale, reference may be had to it in establishing OSP. Read properly and in context, the Court is saying nothing more than the relevance of economic substance, both as regards both the first step of establishing OSP and the second step of considering whether the taxpayer's actions produce an abuse or misuse, depends on the provisions in question and the facts at hand. Economic substance is neither universally relevant or irrelevant.

This was plainly evident in the manner in which a unanimous Court disposed of the particular case before it, concluding as follows:

> 75 The appellant suggests that the usual result of the CCA provisions of the Act should be overridden in the absence of real financial risk or "economic cost" in the transaction. However, this suggestion distorts the purpose of the CCA provisions by reducing them to apply only when sums of money are at economic risk. The applicable CCA provisions of the Act do not refer to economic risk. They refer only to "cost". Where Parliament wanted to introduce economic risk into the meaning of cost related to CCA provisions, it did so expressly, as, for instance, in s. 13(7.1) and (7.2) of the Act, which makes adjustments to the cost of depreciable property when a taxpayer receives government assistance. "Cost" in the context of CCA is a well-understood legal concept. It has been carefully defined by the Act and the jurisprudence. Like the Tax Court judge, we see nothing in the GAAR or the object of the CCA provisions that permits us to rewrite them to interpret "cost" to mean "amount economically at risk" in the applicable provisions. To do so would be to invite inconsistent results. The result would vary with the degree of risk in each case. This would offend the goal of the Act to provide sufficient certainty and predictability to permit taxpayers to intelligently order their affairs. For all these reasons, we agree with the Tax Court judge's conclusion that the "cost" was $120 million, not zero as argued by the appellant.
>
> 76 The appellant's submissions on this point amount to a narrow consideration of the "economic substance" of the transaction, viewed in isolation from a textual, contextual and purposive interpretation of the CCA provisions. It did not focus on the purpose of the CCA provisions read in the context of the Act as a whole, to determine whether the tax benefit fell outside the object, spirit or purpose of the relevant provisions. Instead, it simply argued that since there was (as it alleged) no "real economic cost", the GAAR must apply. As discussed earlier, the application of the GAAR is a complex matter of statutory interpretation in which the object, spirit and purpose of the provisions giving rise to the tax benefit are assessed in light of the requirements and wording of the GAAR. While the "economic substance" of the transaction may be relevant at various stages of the analysis, this expression has little meaning in isolation from the proper interpretation of specific provisions of the Act. Any "economic substance" must be considered in relation to the proper interpretation of the specific provisions that are relied upon for the tax benefit. [emphasis added]

The Court was clearly willing to consider economic substance as potentially relevant "at various stages of the [GAAR] analysis" where the relevant provisions in question made doing so appropriate: for example, where determining the OSP of the relevant provisions. The absence of text referencing economic substance combined with its use in other provisions was part of the context of the CCA rules in question, as was the fact that "'Cost' in the context of CCA is a well-understood legal concept." The government's position failed because it "did not focus on the purpose of the CCA provisions read in the context of the Act as a whole." The relevance of economic substance depends on the provisions in question and Parliament's true intention in enacting them. It is difficult to see what possible complaint the government could have with this, in the context of a rule centred around applying the statute with reference to Parliament's true intent. Once again, the government is proposing to act on a demonstrably incorrect premise.

The other case specifically cited in the Discussion Paper as an example of cases that "tend to minimize the role and weight accorded economic substance" is *Damis Properties Inc. v. The Queen.*[21] The paragraph of that case that is specifically referenced reads as follows:

[21] 2021 TCC 24.

> [290] The second step requires close examination of the factual context in which the avoidance transaction occurs to determine whether the transaction defeated or frustrated the object, spirit or purpose (rationale) of the provision(s) in issue. Whether a provision requires a particular circumstance to apply (such as the existence of "economic substance") is determined by reference to the proper interpretation of the provision. Consequently, a finding that there is an absence of a particular circumstance (such as "economic substance" or an economic or commercial purpose to a transaction) is merely part of the factual context and does not in and of itself lead to a conclusion that an avoidance transaction results in abusive tax avoidance. [footnotes omitted (all are citations to *Canada Trustco*)]

This excerpt is entirely consonant with the foregoing analysis from *Canada Trustco*, and characterizing it as minimizing the role and weight accorded to economic substance is baffling, unless the government is taking the position that economic substance is universally relevant and important in all circumstances. Is the government truly saying that *Canada Trustco* was wrongly decided, and that the March 2023 Proposals are intended to produce a different outcome?

Put simply, the jurisprudence simply does not bear out the premise that courts are "not sufficiently tak[ing] into consideration the economic substance of transactions." There are many examples of courts using economic substance in GAAR cases where appropriate, in addition to the cases which the Discussion Paper itself acknowledges as doing so.[22] For example, *Copthorne* was essentially an economic substance case, even if that specific term was not used:

> [122] Having regard to the text, context and purpose of s. 87(3), I would conclude that the object, spirit and purpose of the parenthetical portion of the section is to preclude preservation of PUC of the shares of a subsidiary corporation upon amalgamation of the parent and subsidiary where such preservation would permit shareholders, on a redemption of shares by the amalgamated corporation, to be paid amounts as a return of capital without liability for tax, in excess of the amounts invested in the amalgamating corporations with tax-paid funds. [emphasis added]

In this case, a unanimous Court determined that the OSP of the relevant provisions should be determined with reference to amounts *actually invested* in a corporation (i.e., economic substance), by looking past the text of the provisions in question (again, without contradicting it) and focusing on their context and purpose.

The manner in which the Court in *Lipson* disposed of that case can similarly be viewed as an application of economic substance to defeat tax planning designed to take advantage of a specific anti-avoidance rule attributing to one taxpayer income earned by another:

> [32] Finally, the attribution rules in ss. 74.1 to 74.5 are anti-avoidance provisions whose purpose is to prevent spouses (and other related persons) from reducing tax by taking advantage of their non-arm's length status when transferring property between themselves. The most common example of such a benefit is one derived from income splitting, but it is not the only example. In Canada, the unit of taxation is the individual: "Each individual is a taxpayer in his or her own right" (Krishna, at p. 16; see also *Thibaudeau v. Canada*, [1995] 2 S.C.R. 627, at para. 93). Thus, s. 74.1(1) is designed

[22] "See for example, *Canada v. Global Equity Fund Ltd.*, 2012 FCA 272 at paragraphs 67 and 68; and *Magren Holdings Ltd. v. The Queen,* 2021 TCC 42 at paragraph 255."

> to prevent spouses from benefiting from their non-arm's length relationship by attributing, for tax purposes, any income or loss from property transferred to a spouse back to the transferring spouse.
>
> . . .
>
> [42] As I mentioned above in para. 32, the purpose of s. 74.1(1) is to prevent spouses from reducing tax by taking advantage of their non-arm's length relationship when transferring property between themselves. In this case, the attribution to Mr. Lipson of the net income or loss derived from the shares would enable him to reduce the dividend income attributed to him by the amount of the interest on the loan that financed his wife's purchase of those shares. However, before the transfer, when the dividend income was in Mr. Lipson's hands, no interest expense could have been deducted from it. It seems strange that the operation of s. 74.1(1) can result in the reduction of the total amount of tax payable by Mr. Lipson on the income from the transferred property. The only way the Lipsons could have produced the result in this case was by taking advantage of their non-arm's length relationship. Therefore, the attribution by operation of s. 74.1(1) that allowed Mr. Lipson to deduct the interest in order to reduce the tax payable on the dividend income from the shares and other income, which he would not have been able to do were Mrs. Lipson dealing with him at arm's length, qualifies as abusive tax avoidance. It does not matter that s. 74.1(1) was triggered automatically when Mr. Lipson did not elect to opt out of s. 73(1). His motivation or purpose is irrelevant. But to allow s. 74.1(1) to be used to reduce Mr. Lipson's income tax from what it would have been without the transfer to his spouse would frustrate the purpose of the attribution rules. Indeed, a specific anti-avoidance rule is being used to facilitate abusive tax avoidance. [emphasis added]

In this case (and very similar to the manner in which proposed s. 245(4.1)(a) asks whether the combined economic position of the taxpayer together with non-arm's-length persons has changed), the Court determined that a series of largely circular transactions between parties not dealing at arm's length and effectively constituting a single economic unit were abusive of provisions enacted by Parliament specifically to police circumstances where economic substance is frequently lacking.

Mathew provides a further example of *de facto* application of economic substance as part of establishing OSP, in this case in the context of the partnership rules:

> [51] The partnership rules under s. 96 are predicated on the requirement that partners in a partnership pursue a common interest in the business activities of the partnership, in a non-arm's length relationship. Although, on its face, s. 96(1) imposes no restriction on the flow of losses to its partners, except for the treatment of foreign partnerships under s. 96(8), it is implicit that the rules are applied when partners in a partnership carry on a business in common, in a non-arm's length relationship.
>
> [52] The purpose for the broad treatment of loss sharing between partners is to promote an organizational structure that allows partners to carry on a business in common, in a non-arm's length relationship.
>
> . . .

> [55] Section 18(13) relies on the premise that the partners in the transferee partnership pursue a business activity in common other than to transfer the loss and that the partnership and the transferor deal in a non-arm's length relationship with respect to the property.
>
> . . .
>
> [60] The backdrop to the impugned transactions was the failure of STC, leaving non-performing mortgages in its wake. STC transferred $52 million in unrealized losses to Partnership A in a notionally non-arm's length transaction. Partnership A was to serve as a holding tank for the unrealized losses and STC planned from the outset to sell its interest in Partnership A after the application of s. 18(13) so that the losses preserved in Partnership A could be transferred to arm's length parties through a substitution of partners in Partnership A. The subsequent transactions involving Partnership B were executed "in contemplation of" the transactions between STC and Partnership A.
>
> [61] By these subsequent transactions, the losses preserved in Partnership A were transferred to Partnership B which sold units to the appellants, who dealt with STC at arm's length. The new partnership, Partnership B, was relatively passive. From its inception, the purpose of Partnership B was simply to realize and allocate the tax losses, without any other significant partnership activity. Nor are these conclusions negated by the fact that (1) the underlying properties to the mortgages were appraised and sold or written off, (2) the appellants paid substantial amounts in order to acquire their interests in Partnership B, or (3) the appellants sought to minimize their exposure to risk, should the tax losses not be accepted by the authorities.
>
> 62 The abusive nature of the transactions is confirmed by the vacuity and artificiality of the non-arm's length aspect of the initial relationship between Partnership A and STC. A purposive interpretation of the interplay between s. 18(13) and s. 96(1) indicates that they allow the preservation and sharing of losses on the basis of shared control of the assets in a common business activity. In this case, the absence of such a basis leads to an inference of abuse. Neither Partnership A nor Partnership B ever dealt with real property, apart from STC's original mortgage portfolio. Nor was STC ever in a partnership relation with either OSFC or any of the appellants, having sold its entire interest to OSFC. The only reasonable conclusion is that the series of transactions frustrated Parliament's purpose of confining the transfer of losses such as these to a non-arm's length partnership. [emphasis added]

In this case, the provisions in question pre-supposed the genuine carrying on of business in common (beyond the minimal threshold needed to actually create a partnership at law), so as to form part of their legislative rationale. In the absence of such economic substance, the preservation and transfer of losses offended that legislative rationale, thus constituting an abuse or misuse and rightfully supporting the application of GAAR.

Conversely, the majority in *Alta Energy* considered at length the question of whether the text, context and purpose of the *Canada-Luxembourg Income Tax Convention* included a requirement to have economic substance in the residence state as a general pre-condition for entitlement to treaty benefits, and concluded on the evidence before the Court that it did not:

> [58] It is worth noting that the words "sufficient substantive economic connections" are conspicuous by their absence in the text of both arts. 1 and 4. Although the GAAR invites courts to

> go beyond the text to understand the object, spirit, and purpose of the provisions, there are limits to this exercise, especially when attempting to discern the intent of bilateral treaty partners. In the face of a complete absence of express words, the inclusion of an unexpressed condition must be approached with circumspection. It must be remembered that the text also plays an important role in ascertaining the purpose of a provision. The proper approach is one that *unifies* the text, context, and purpose, not a purposive one in search of a vague policy objective disconnected from the text (*Canada Trustco*, at para. 41).
>
> . . .
>
> [62] Given this broad international acceptance of formal residency, if the drafters had truly intended to include only corporations with "sufficient substantive economic connections" to their country of residence within the scope of the *Treaty*, they would have clearly signalled their intention to depart from a well-established criterion like the "place of incorporation" or "legal seat" rule. They would not have simply incorporated arts. 1 and 4(1) of the OECD *Model Treaty*, which reflect an international consensus, with no alteration. This indicates, in my view, that the object of arts. 1 and 4(1) is not to exclude all corporations with minimal economic connections to their country of residence, such as those whose residence is established solely on the basis of a formal, legal attachment. Access to the benefits of the *Treaty* by virtue of a domestic law definition of residence like the "legal seat" rule is therefore entirely consistent with the spirit of these provisions.
>
> . . .
>
> [66] Pursuant to the principle of implied exclusion, this choice made by the parties in favour of the exclusion approach — one that favours form over substance — should be understood as a rejection of the relevance of economic ties for delineating which corporations should be entitled to benefits and which should not. This leads me to conclude that the drafters intended to exclude a corporation with minimal economic connections to one of the contracting states *only* where the corporation is a holding company benefiting from Luxembourg's international tax haven regime. In light of this clear intention to reject only Luxembourg holding companies and not every company with limited economic ties to its country of residence, I am even more persuaded that the spirit of arts. 1 and 4(1) was *not* to limit access to the benefits of the *Treaty* to corporations with "sufficient substantive economic connections" to their country of residence.
>
> [67] In sum, the object, spirit, and purpose of arts. 1 and 4(1) are to allow all persons who are residents under the laws of one or both of the contracting states to claim benefits under the *Treaty* so long as their resident status could expose them to full tax liability (regardless of whether there is actual taxation). They are broadly consistent with international norms. This is normally the case for corporations that are residents by virtue of the "place of incorporation" or "legal seat" rule, unless they fall within the exclusion provided for in art. 28(3). As a result, I conclude that the spirit of these provisions is *not* to reserve the benefits of the *Treaty* to residents that have "sufficient substantive economic connections" to their country of residence. [emphasis added]

Courts are entirely open to including economic substance in the determination of OSP where they are satisfied that doing so accords with Parliament's intent for the relevant provisions. The jurisprudence makes clear that lower courts have understood the message from these cases: that economic substance can certainly be relevant to (and in some cases indeed determinative of) the

OSP of the provisions in question. The Federal Court of Appeal decision in *594710 British Columbia Ltd.*[23] provides an excellent example:

> [68] The question is whether the allocation of the partnership's income for tax purposes to Nuinsco, which became a partner one day before the end of the partnership's fiscal period, frustrates the object, spirit or purpose of paragraph 96(1)(*f*). There are no doubt many situations in which an allocation of taxable income and loss to persons who are partners at the fiscal year end is not abusive, but this is not one of them. In this case, the allocation frustrates the object, spirit or purpose of the provision as historically understood and as set out in *Mathew*, above. It does this by divorcing the economic consequences of the arrangement from the allocation of taxable income.
>
> [69] Under the partnership agreement that was in effect throughout the series of transactions, allocations of income and loss (determined under generally accepted accounting principles) and taxable income and loss (determined under the Act) were to be made to persons who were partners at year end. Distributions could be made at any time in the discretion of the general partner.
>
> [70] The allocation of taxable income to Nuinsco pursuant to the partnership agreement notionally complies with the text of subsection 96(1)(*f*) because it conforms with Nuinsco's entitlement to profit under private law. However, the allocation frustrates the purpose of this provision because Nuinsco's allocation, and its participation in the partnership in general, in no way facilitates an "organizational structure that allows partners to carry on business in common" (*Mathew*, at para. 52). The allocation facilitates only one thing — avoidance of liability under the Act. This is starkly illustrated by considering the overall results of the series of transactions:
>
> - From an economic perspective, the sole benefit to Nuinsco was receipt of an amount equal to 10 percent of the taxable income allocated to Nuinsco. This was in essence a deal fee for enabling the Onni Group to access Nuinsco's tax losses and deductions.
>
> - Except for the amount of the "deal fee", the entire earnings of the partnership from the Marquis Grande development ended up in the hands of the Holdcos. Part of this, roughly two-thirds, was loaned by the partnership to the Partnercos which then distributed it to the Holdcos. The other one-third was received by the Holdcos from Nuinsco as consideration for the shares of the Partnercos. Nuinsco recouped this payment from the earnings of the partnership.
>
> - Although the partnership made a distribution in the amount of $12,041,997 to Nuinsco once it became a partner, the distribution is misleading because the majority of the partnership's profit had already been distributed to the Holdcos prior to the sale to Nuinsco.
>
> - From an operations perspective, the partnership conducted minimal business operations after Nuinsco acquired the Partnercos. At the time of the acquisition, the real estate development was nearing completion, with just a few strata units remaining to be sold. Two weeks after the acquisition, the partnership exercised an option that allowed it to sell the remaining strata units to the Onni Group at a fixed price. And two weeks after that, the partnership was dissolved.
>
> - From the time of the acquisition of the Partnercos, Nuinsco had virtually no economic interest or risk in the real estate development. In carefully crafted arrangements, all

[23] 2018 FCA 166, appeal to the Supreme Court of Canada refused at 2019 CarswellNat 434.

> economic interest and risk had been passed on to the Onni Group. The documents gave the appearance that Nuinsco had a potential further economic interest if it failed to exercise the option, but this right was illusory. From a practical standpoint, Nuinsco was going to exercise the option, and receive a pre-determined amount for the unsold strata units. It did not intend to leave itself vulnerable to risk by retaining a real economic interest, as evidenced partly by the fact that legal title to the real estate and ongoing operations had already been put in the hands of the Onni Group.
>
> [71] The result of the series of transactions was that the De Cotiis family had shifted the entire taxable income from the development to an unrelated party which had virtually no economic interest or risk, except for a 10 percent "deal fee". I agree with the Crown that this defeats the object, spirit or purpose of subsection 96(1) and therefore there is an avoidance transaction that is abusive. [emphasis added]

It may be noted that the courts have even been willing to have recourse to economic substance in order to ensure that Parliament's intent is respected in circumstances where the government's attachment to the concept somewhat selective. See for example Chief Justice Noël in *Canada v. Oxford Properties Group Inc.*:[24]

> [116] For the same reason, subsection 97(2), insofar as it was used to defer tax on this part of the increase in the value of the depreciable property, was not abused. In contrast with the deferred recapture, the deferred capital gain did not simply vanish. Rather, it was offset by adding real costs to the capital cost of the depreciable property. The failure to recognize a cost that has been actually incurred but which would disappear on a vertical amalgamation or a partnership dissolution goes against the integrity of the capital gains system because it allows for the subsequent realization of a capital gain in circumstances where there has been no economic gain. Preventing this outcome is the reason why the bump provisions were enacted.
>
> [117] In the end, the only basis on which the Minister could refuse to give the bumps this limited application is by insisting on a construction of the bump provisions which focuses on the meaning of the words, specifically on the unqualified and express disqualification of depreciable property. However, the Crown cannot have it both ways. In a GAAR context, the same interpretative approach must be applied to both the determination of the abuse and the consequential adjustments required in order to counter it. [emphasis added]

As such, the government's premise that economic substance is not being accorded sufficient weight by courts considering GAAR cases does not appear accurate. What it is about how the GAAR caselaw treats economic substance that the government finds "unsatisfying from a policy perspective" is a mystery that has yet to be explained, as is the "pervasive impact on the tax system" to which the government refers. Economic substance as a relevant factor in s. 245(4) analysis (including the determination of OSP) is very much alive and well.

What Was Said When GAAR Was Enacted?

Both the Discussion Paper and the March 23 Budget characterize the formal inclusion of economic substance within an abuse-or-misuse analysis as something that was always intended

[24] 2018 FCA 30, appeal to the Supreme Court of Canada refused at 2018 CarswellNat 7871.

since the initial enactment of GAAR, rather than a change in tax policy. The Discussion Paper makes two such references:

> Even though the commentary accompanying the introduction of the GAAR explicitly contemplated economic substance, the precise role of economic substance in the interpretive process was not established.
>
> . . .
>
> This limitation on the role of economic substance in the GAAR analysis may not align completely with the government's statement in the lead-up to enacting the GAAR that "the new rule would not supplant other provisions of the Act but would apply together with these other provisions to require economic substance in addition to literal compliance with the words of the Act".

The March 23 Budget makes one such reference:

> A rule would be added to the GAAR so that it better meets its initial objective of requiring economic substance in addition to literal compliance with the words of the *Income Tax Act*. Currently, Supreme Court of Canada jurisprudence has established a more limited role for economic substance.

The extrinsic aids produced at the time of GAAR's enactment definitely include references to and contemplate a role for economic substance. However, the extent of that role is unclear. The principal references to economic substance are found in the December 1987 Materials, which make the following statements:

> The adoption of a business purpose test, as proposed in the White Paper, is designed to restrict the provisions of the Income Tax Act to real economic transactions and to deny their application to tax-motivated transactions designed to utilize them to obtain benefits not intended in the Act. Generally, the rule as proposed in the White Paper provided that an avoidance transaction, as defined, would be ignored for tax purposes and that the tax situation of a taxpayer would then be determined as is reasonable in the circumstances. (p. 99-100)
>
> . . .
>
> The government proposes elimination of the "notwithstanding" provision in the revised text, to clarify that the new rule would not supplant other provisions of the Act but would apply together with these other provisions to require economic substance in addition to literal compliance with the words of the Act. (p. 101)
>
> . . .
>
> [With respect to the introduction of s. 245(4),] [t]o clarify and to emphasize that the new rule is not intended to affect genuine transactions with economic substance that are consistent with the object and purpose of the Act, a specific provision is made in the revised text with respect to transactions that may reasonably be considered not to result in a misuse or abuse of the Act read as a whole. (p. 102)

The 1988 Technical Notes make only one such reference:

> Subsection 245(4) recognizes that the provisions of the Act are intended to apply to transactions with real economic substance, not to transactions intended to exploit, misuse or frustrate the Act to avoid tax. It also recognizes, however, that a number of provisions of the Act either contemplate or encourage transactions that may seem to be primarily tax-motivated. The so-called "butterfly" reorganization is a good example of such transactions.

A further reference in the 1988 Technical Notes appears to include the same concept without using those particular words, in the context of defining an "avoidance transaction":

> Ordinarily, transitory arrangements would not be considered to have been carried out primarily for bona fide purposes other than the obtaining of a tax benefit. Such transitory arrangements might include an issue of shares that are immediately redeemed or the establishment of an entity, such as a corporation or a partnership, followed within a short period by its elimination.

The Dodge Article does not refer to "economic substance" at all.[25]

The references to economic substance in the extrinsic aids are thus quite inconsistent and somewhat all over the map. Some of them are made with reference to s. 245(3), others to s. 245(4) and a couple could be read as applying with reference to either. Two of them state the truism that the ITA's provisions are intended to apply to "real" economic transactions, which is certainly correct. However, by definition ITA provisions need to apply in some form or another to *all* transactions, including those without economic substance (however that may be defined). The *manner* in which the ITA applies to those without economic substance may conceivably be different than to those with it, although the extrinsic aids do not say that.

Similarly, nothing in the extrinsic aids says that transactions without economic substance are thereby abusive (quite the opposite, as shown by the example mentioned of butterfly reorganizations), or even that lack of economic substance (borrowing from proposed s. 245(4.1)) "tends to indicate that the transaction results in" an abuse or misuse. Most importantly, nothing in the extrinsic aids says that the ITA is intended to apply to the economic substance of transactions; rather, it says that the ITA is intended to apply to "transactions with real economic substance": a very different thing. Certainly the government has no qualms about levying tax on transactions that create income or gain for ITA purposes but *without* accompanying economic substance. The government's affection for economic substance is somewhat complicated.

Ultimately, the strongest statement as to the role of economic substance is that from the December 1987 Materials cited in the Discussion Paper that "the new rule would not supplant other provisions of the Act but would apply together with these other provisions to require economic substance in addition to literal compliance with the words of the Act". Interestingly, this statement was made with reference to the removal of the notwithstanding clause rather than with specific reference to the discussion elsewhere in the same document of s. 245(3) or s.

[25] Within the Dodge Article, there are a couple of references to substance over form, as being "too broad and elusive to be a good basis for a legislative anti-avoidance rule" (page 15), but this does not appear to be quite the same as how the term "economic substance" is used in the March 23 Proposals.

245(4). It is also a very high-level description of GAAR generally, and is not replicated in the 1988 Technical Notes or the Dodge Article. Quite likely the reference in the December 1987 Materials to GAAR "requir[ing] economic substance in addition to literal compliance with the words of the Act" is best understood as requiring economic substance even in the absence of text saying so *where the relevant legislative rationale includes economic substance*, *viz.*, as the courts have done. As such, even if interpreted literally this statement would appear to be a very slender reed upon which to rest a claim that economic substance was somehow generally a pre-condition or indicator of non-abusive transactions. In reaching back to the 1988 extrinsic aids on economic substance for a crutch to support the March 2023 Proposals on economic substance, the government is clearly trying to do the best with what it has, but what it has isn't much.

The Proposed Solution

Ultimately, the principal objection to the proposed introduction of economic substance into the text of s. 245(4) via proposed draft s. 245(4.1) is twofold:

- it is based on a demonstrably incorrect premise as to how the courts are using and applying economic substance in GAAR cases to the effect that they do "not sufficiently take into consideration the economic substance of transactions" (unless "sufficiently" means "all the time, no matter what"); and
- it is completely unclear what result the government is trying to achieve with this proposed amendment, *viz.* what results different from current law are sought.

Is the government telling us that *Canada Trustco* is bad law and should be decided differently were it heard again today post-amendment? What other GAAR cases would have been decided differently were this amendment applicable? What examples can the government give us of situations in which this proposed amendment would change the result compared to the current law?[26] What is a court supposed to do with a determination that an absence of economic substance "tends to indicate" abuse or misuse? We do not know.

This amendment would appear to be trying to make economic substance a relevant criterion for conducting an abuse-or-misuse analysis in *all cases*, rather than only where relevant to Parliament's legislative rationale for the provisions in question. If the ultimate objective of a GAAR analysis is to ensure that a taxpayer's actions are not inconsistent with Parliament's legislative rationale, the justification for such a sweeping generalization seems quite dubious.

Especially noteworthy is the inclusion of proposed s. 245(4.1)(c), which prescribes that where "the entire, or almost entire, purpose" of a transaction is to obtain a tax benefit, this indicates a lack of economic substance. It is not clear why this is so, nor do the March 2023 Proposals meaningfully explain why. The taxpayer's purpose for the transactions in question already

[26] The Discussion Paper provided only one example, which involved a case where the proposed amendment would not have any effect and in any case was so clearcut as to have no probative value.

determines the avoidance transaction analysis. That purpose has no obvious relevance to whether or not the *result* of those transactions is abusive (i.e., via a supposed lack of economic substance), yet as with many of the other proposed amendments, this is presented as somehow being self-evident. It is admittedly consistent with the overall theme of the March 2023 Proposals of effectively collapsing s. 245 into a single abuse or misuse test infused with the presumption that taking steps to reduce one's taxes (i.e., a tax reduction purpose) is an inherently suspicious exercise likely to result in not paying one's "fair share."

As with other elements of the March 2023 Proposals, the suggested amendment to GAAR further in favour of the government is to be accomplished via vague, ill-defined concepts, designating the "significant" absence of "economic substance" (defined inclusively) as "tend[ing to indicate" abuse or misuse, notwithstanding the fact that this would include many common and accepted transactions such as intra-group loss consolidations. Unless and until the government can better explain what specifically the courts are getting wrong in their use of economic substance in GAAR cases, what it is that the government is trying to change as a result of this proposed amendment, and what these various ambiguous terms mean, fairness to the tax system as a whole requires that this proposal be withdrawn.

Penalties

What Is The Issue?

The Discussion Paper raises the interesting topic of whether a GAAR-specific penalty is desirable, in order to discourage abusive tax planning. The March 2023 Proposals include just such a penalty, unless the relevant transaction is specifically disclosed. The Discussion Paper frames the proposal to create a new penalty to apply whenever GAAR is successfully re-assessed as follows:

> **Statement of Issue**
>
> The GAAR does not have a sufficient deterrent effect on abusive tax planning.
>
> **Background**
>
> If a transaction's potentially abusive nature is not detected, the taxpayer enjoys the tax benefit. However, as noted in the previous section of this paper, even when the GAAR does apply, it only seeks to apply the "reasonable" tax consequences to a taxpayer in order to deny the tax benefit sought. In most situations, this would put the taxpayer back in the position they would have been in if they had not carried out the tax planning arrangement. Thus, it would appear that, under the current GAAR, the economic downside to taxpayers may be limited to the professional fees incurred for implementing the transactions plus the non-deductible interest on the taxes owing. In contrast, the upside can be significant.
>
> While the application of existing penalty provisions should be considered in the context of GAAR assessments, including the potential application of the gross negligence penalty (particularly in cases where the taxpayer has undertaken a transaction similar to one in which the courts have found the GAAR to apply or where the taxpayer has a history of undertaking transactions that have

> been found to be subject to the GAAR), there appears to be some judicial reticence to impose a penalty in the context of a rule that only the Minister can apply.[27]

The March 2023 Budget frames the proposed penalty in the following terms:

> **Penalty**
>
> A penalty would be introduced for transactions subject to the GAAR, equal to 25 per cent of the amount of the tax benefit. Where the tax benefit involves a tax attribute that has not yet been used to reduce tax, the amount of the tax benefit would be considered to be nil. The penalty could be avoided if the transaction is disclosed to the Canada Revenue Agency, either as part of the proposed mandatory disclosure rules or voluntarily. This would build upon the mandatory disclosure rules and ensure that the Canada Revenue Agency has early access to the information it needs to respond quickly to tax risks through informed risk assessments, audits and changes to legislation. As such, a consequential amendment would be made to the proposed reportable transaction rules to permit voluntary reporting.

What Was Said When GAAR Was Enacted?

The original version of GAAR proposed to include a specific penalty for when GAAR was applied. This decision was ultimately reconsidered and reversed, as the December 1987 Materials note:

> The White Paper had raised the possibility of penalties for abusive avoidance transactions. The government will not proceed with a penalty provision.

Not only was the decision to impose a GAAR-specific penalty consciously rejected in 1988, it is noteworthy that nothing in the extrinsic aids from 1988 references "deterrence" as an objective of GAAR, as distinct from simply denying tax benefits in circumstances where obtaining them would be contrary to Parliament's legislative rationale. It would appear that a conscious decision was made at the time to focus the objective of GAAR on denying tax benefits, and leaving the issue of a penalty to be governed separately by existing penalty provisions.

What Does the Jurisprudence Say?

The only case cited in support of the proposed GAAR penalty is the Tax Court decision in *Copthorne*, which involved a penalty for non-withholding under s. 227(8) rather than broader-based penalties such as those for gross negligence under s. 163(2). No other GAAR jurisprudence has been put forward that the government feels supports its assertion of "judicial reticence to impose a penalty," whether in respect of s. 163(2) or otherwise. This single case cited by the government as evidencing the "judicial reticence" to apply penalties and offered as a basis for reversing the decision made in 1988 not to create a GAAR-specific penalty is very thin gruel indeed.

The Proposed Solution

[27] "*Copthorne Holdings Ltd. v. The Queen,* 2007 TCC 481 at paragraph 77. The Tax Court of Canada did not uphold the application of a penalty pursuant to subsection 227(8). Neither the Federal Court of Appeal nor the Supreme Court of Canada modified this aspect of the decision."

It is very difficult to discern the justification for a new GAAR-specific penalty as being desirable or necessary to discourage abusive tax planning. The Discussion Paper does not explain how the thinking from 1988 not to have a GAAR-specific penalty has since changed so as to warrant a different conclusion today. The jurisprudence offered in support of the suggested "judicial reticence" against penalties in GAAR consists of one case, which does not deal with the primary penalty for abusive tax planning (s. 163(2)). No evidence is offered as to other GAAR cases in which penalties have been sought (let alone sought and denied).

Beyond that, there is no logical rationale for a penalty to be automatically applied on successful GAAR re-assessments. As noted earlier, the assumption underlying such proposal is that GAAR is only applied in cases of abusive tax planning rather than legislative opacity or close calls, which a review of the GAAR caselaw (and the CRA's middling success rate in GAAR cases) shows is demonstrably incorrect. A GAAR assessment is made against a taxpayer who has by definition complied with the provisions of the statute, interpreted not merely literally but on a textual, contextual and purposive basis, and in many cases that assessment is made due to interpretive uncertainty as a result of the government not adequately articulating OSP. Given this, the circumstances warranting a penalty for applying GAAR seem fairly narrow, particularly where the government has other tools at its disposal already (e.g., the notifiable transaction regime).

The government seems to be sending mixed messages to the tax community. On the one hand, the diligence defence to gross negligence penalties under s. 163(2) encourages taxpayers to obtain professional tax advice, which is surely the right answer from a compliance perspective. On the other hand, a GAAR penalty levied without regard to whatever advice the taxpayer received or how clear-cut any abuse or misuse was sends the opposite message (and is notably consonant with the proposed lowering of the "avoidance transaction" threshold to include any transaction where obtaining a tax benefit was a significant consideration, effectively penalizing those who seek tax advice). The government needs to decide what its position is on whether taxpayers should be encouraged to obtain professional advice on planning and compliance, and approach any legislative amendments consistent with that position.

It would be helpful for the government to explain why it believes a penalty should apply where GAAR is successfully re-assessed in circumstances where the pre-conditions of s. 163(2) are not met so as to allow that existing penalty to apply. The application of a penalty without regard to the reasonableness of the taxpayer's position or conduct is fundamentally unfair, particularly where by definition the taxpayer has met the requirements of the statute interpreted on a textual, contextual and purposive basis and is being challenged on the grounds of some omission in the statute's text. For example, if an appeals court was divided on the taxpayer's case, or if the taxpayer received suitable advice on GAAR from qualified counsel, it becomes even harder to justify the proposed penalty. A new GAAR-specific penalty will likely also to be used by the CRA as a lever to incentivize taxpayers to settle disputes on a technical (non-GAAR) basis, since it will raise even further the taxpayer's risk of contesting a GAAR assessment. The government needs to rethink and explain the need for this proposal.

3. Where We Should Go

This portion of the paper discusses suggestions for better targeting GAAR on those cases of abusive tax avoidance which GAAR is meant to address while minimizing the potential for administrative over-reach, reducing the number of GAAR disputes before the courts and minimizing the cost and complexity of resolving those that remain.

Determining OSP: An Opportunity

An examination of the GAAR jurisprudence reveals that the primary reason the government loses GAAR cases is when it cannot demonstrate a compelling legislative rationale that the taxpayer has transgressed. As most GAAR controversies turn on correctly identifying and establishing what Parliament's legislative rationale is, any review of how GAAR can be improved logically starts with this issue.

An examination of prior Supreme Court GAAR cases is instructive. In *Copthorne*, the Crown was successful on the basis of establishing a fairly simple and obvious proposition: paid-up capital (PUC) is based on actual value invested into a corporation in exchange for its shares (i.e., economic substance), and as a result Parliament did not intend a $1 investment to generate $2 (or more) of PUC in a corporation via a sequential duplication of PUC derived from the same $1 of invested capital. Similarly in *Mathew*, the Crown succeeded on the basis of demonstrating a fairly clear principle plainly evident in the ITA: except where provided otherwise in the statute, Taxpayer A may not use a loss generated by arm's-length Taxpayer B. In both cases, the OSP found to exist was easily expressed and understood in relatively specific terms, readily apparent from an objective reading of the statute as a whole, and hard to argue with as a matter of common sense. The government's proposed legislative rationale was clear and convincing, and it deservedly won both cases.

Conversely, in *Canada Trustco*, the government alleged the existence of an OSP premised on some vague and undefined concept of purportedly general application not only absent from the text of the statute as a general principle but directly contrary to the long-established meaning of the relevant term ("cost") and inconsistent with the ITA's use of economic substance in other relevant provisions. Similarly, in *Alta Energy*, the Court was presented with two relatively clear choices: the extension of treaty benefits based on fiscal residence (i.e., as the text of the treaty read) or based on fiscal residence and some indeterminate degree of economic connection. The government's version (i.e., the latter) was a vaguely-expressed concept of uncertain meaning ("substantial economic connection") that was inconsistent with both explicit choices made elsewhere in the treaty and the treaty counterparty's position (i.e., context and purpose), and a position that would have been very simple for the government to express had it chosen to do so (and hence difficult to explain the absence of). As such, the government's proposed legislative rationale was not the most likely expression of Parliament's true intent, and it properly lost both cases.

The takeaway is not complicated. When the OSP is clear, the government wins GAAR cases; when it is not, it doesn't. Since the clarity of a particular legislative rationale is almost exclusively in the government's hands to articulate (for the benefit of all concerned), the government can win a higher proportion of its GAAR cases by expending more effort to set out the legislative rationale. While doing so is not a costless exercise, the government is the party by far best-placed to do this and to bear the cost, and when compared against the government's cost of auditing, re-assessing and litigating GAAR cases, the overall impact of better expressing its OSP must certainly be a net cost savings to the government alone, quite apart from the vast savings that would be enjoyed by taxpayers. Tax advisors and litigators would be the only disadvantaged parties. There is nothing a government interested in preserving the "fairness" of the tax system could do that would have a greater and more beneficial impact than this.

In urging greater effort to express legislative rationale, the business community should not be understood to be seeking perfection or "certainty." However, there are clearly areas of recurring GAAR controversies such as surplus stripping and loss utilization that can be targeted first, as priority areas where the government can achieve greater clarity and have immediate impact without being asked to prepare a user's guide for the entire statute. Similarly, amendments to the *Income Tax Conventions Interpretation Act* and/or the preparation of model tax treaty resources can address the government's heightened interest in treaty abuse. The reasonable and attainable objective is "better", not "perfect", i.e., a reduction in the number of abusive tax schemes and GAAR controversies (and the cost of auditing and resolving the remaining ones). Or put another way by the government itself in 1988 (the Dodge Article, p. 22), "'reasonably predictable result[s]' so that taxpayers can comply with the rule, and the administration and the courts can easily apply it."

Beyond better expressing OSP when enacting legislation, there are further steps the government can take to help taxpayers, tax authorities and courts identify and establish legislative rationale. It is remarkable how 35 years after the enactment of GAAR, a number of fairly fundamental points remain unresolved, and the current initiative to improve GAAR is a chance to address them. Some of these are before the Supreme Court of Canada in the *Deans Knight* case, but irrespective of how (or if) the Court chooses to address them, the government can resolve them definitively if it so chooses.

<u>Legislative Rationale: Clear and Unambiguous?</u>

For example, taxpayers and the Crown disagree on whether the OSP the government must establish to support a GAAR re-assessment must be "clear and unambiguous." The taxpayers' position is put eloquently by no less than the greatest Canadian tax jurist of his generation, the Honourable Mr. Justice Rothstein:[28]

[28] Rothstein J., "A Judge's Perspective on the General Anti-Avoidance Rule," in *The General Anti-Avoidance Rule*, Brian Arnold (Canadian Tax Foundation, 2021), at p. 559 and p. 563.

> Before turning to the misuse and abuse analysis, I noted that the GAAR was an "unusual duty" that required the court to "proceed cautiously" and "that to deny a tax benefit where there has been strict compliance with [the letter of] the Act, on the grounds that the avoidance transaction constitutes a misuse or abuse, requires that the relevant policy be clear and unambiguous.[29] The requirement for the policy to be clear is justified because for the GAAR to apply, that necessarily means the taxpayer has complied with the Act. Any departure from the application of the provisions enacted by Parliament, as permitted by the GAAR, must still be grounded in and justified by the Act itself and not outcome-oriented reasoning or moral judgment. In my view, all of the statements in *OSFC* to that effect remain applicable today.
>
> . . .
>
> In *Canada Trustco*, the Supreme Court emphasized that "the GAAR can only be applied to deny a tax benefit where the abusive nature of the transaction is clear." [para. 50] This requirement implies that, as I had written in *OSFC*, the object, spirit and purpose of the provision or provisions in question must themselves be clear in order for the abusive nature of the transaction to also be clear.

In *Deans Knight*, the Crown took the contrary position, arguing that *Canada Trustco* in fact stands for the opposite of what Mr. Justice Rothstein says:[30]

> 13. The Chamber also goes astray by arguing that the "unstated policy" that forms the basis for applying the GAAR should be "clear and unambiguous". This Court has previously rejected that threshold for identifying an OSP of the legislative provisions, and the Chamber provides no reason why this Court should revisit that aspect of the GAAR abuse framework.
>
> 14. In particular, in *Trustco*, this Court held only that the abusive nature of a transaction must be clear having regard to the OSP of the legislative provisions. This Court was referring to step two of the abuse analysis, not to step one. Indeed, in *Trustco* this Court rejected the taxpayer's invitation to extend the clear and unambiguous threshold to step one.[31]
>
> 15. A "clear and unambiguous" standard for the OSP is an inappropriate threshold given that the OSP is identified through interpretation. Even if ambiguity exists (if the text, context, and purpose of a provision could admit of more than one reasonable interpretation), a court's role is to find and delineate the more plausible OSP. This process is not fundamentally different from how courts resolve ambiguity in traditional statutory interpretation. Where a statute admits of more than one reasonable interpretation, a court must use contextual and purposive factors to give the statute its proper effect. There is no suggestion that ambiguity is ever a reason not to give a statutory provision effect. Nor is it a reason in the GAAR analysis. Therefore, even if it is difficult to identify the OSP of a provision, this does not mean that an OSP cannot be identified through a careful textual, contextual, and purposive analysis. Taxpayers and courts are not excused from the obligation, under the GAAR, to consider whether transactions accord with or defeat, frustrate, and circumvent that OSP. And, at the second step of the abuse analysis, an abuse of that OSP must be "clear" in order for the GAAR to apply.

[29] *OSFC Holdings Ltd. v R,* 2001 FCA 260 at para. 69.
[30] *Deans Knight*, Reply of the Respondent, His Majesty The King, to the Interveners' Facta.
[31] *Canada Trustco* at paras. 9, 44, 50 and 62.

None of the paragraphs in *Canada Trustco* so referenced by the Crown appear to actually support the Crown's conclusion contrary to that advanced by Mr. Justice Rothstein, and the issue of what constitutes the "the more plausible OSP" is different from the tax policy question of whether applying GAAR should be limited to where that OSP is not merely "the most plausible" one but rather "clear and unambiguous." However, in any event the government can resolve the issue once and for all by way of legislative pronouncement.

Legislative Rationale: Onus

Historically the courts have taken the position that the Crown bears the burden of establishing what Parliament's legislative rationale is, for the obvious reason that the party who wrote the law is best-placed to identify and provide evidence of any "rationale that underlies the words that may not be captured by the bare meaning of the words themselves."[32] As stated by the Court in *Canada Trustco* (paras. 65 and 69):

> The taxpayer, once he or she has shown compliance with the wording of a provision, should not be required to disprove that he or she has thereby violated the object, spirit or purpose of the provision. It is for the Minister who seeks to rely on the GAAR to identify the object, spirit or purpose of the provisions that are claimed to have been frustrated or defeated, when the provisions of the Act are interpreted in a textual, contextual and purposive manner. 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.
>
> . . .
>
> 69 As discussed above, the practical burden of showing that there was abusive tax avoidance lies on the Minister. The abuse of the Act must be clear, with the result that doubts must be resolved in favour of the taxpayer. The analysis focusses on the purpose of the particular provisions that on their face give rise to the benefit, and on whether the transaction frustrates or defeats the object, spirit or purpose of those provisions.

Similarly in *Alta Energy*, para. 32:

> [32] The onus rests on the Minister to demonstrate the object, spirit, and purpose of the relevant provisions and to establish that allowing Alta Luxembourg the benefit of the exemption would be a misuse or an abuse of the provisions (*Canada Trustco*, at para. 65).

Interestingly, in the *Deans Knight* case the government seemed to dispute that it bears the onus of establishing the OSP of the relevant provisions in a GAAR case:[33]

> The OSP of a statutory provision in the GAAR analysis is not a question of fact to be proved with evidence. There is no burden of proof on any party to a GAAR case to "prove" the OSP of a provision.

[32] *Copthorne*, para 70.
[33] *Deans Knight*, Reply of the Respondent, His Majesty The King, to the Interveners' Facta, para. 10.

It seems difficult to envision how the government can meet the burden of demonstrating abuse or misuse without "proving" what the relevant OSP is, but again, the government can legislate a clear answer to this point whether or not the Court in *Deans Knight* addresses it.

Legislative Rationale: Objectively Determined, Distinct from Avoidance Transaction

In discussing the introduction of the abuse-or-misuse test as a response to criticism that "the business purpose test cast too broad a net", the Dodge Article explained the rationale behind s. 245(4) as follows (pp. 20-21):

> Subsection 245(4) is intended to be a relieving provision. Where a transaction does not have primarily non-tax purposes, it nonetheless escapes the application of proposed section 245 if, on a normal construction of the Act read as a whole, it may reasonably be concluded that the transaction does not represent a misuse of the provisions of the Act or an abuse of the Act read as a whole.
>
> In that context, the words "misuse" and "abuse" are intended to have an objective rather than a subjective meaning. These words are meant to exclude transactions that do not involve a use of the Act that is contrary to its general scheme. This appears clearly in the technical notes where the examples involving the application of subsection 245(4) refer constantly to the scheme and to the object and spirit of the provisions of the Act.
>
> Subsection 245(4) does not create an alternative test with regard to the definition of avoidance transaction. Instead, it indicates the proper construction of section 245 with respect to transactions that appear to be tax-motivated but that, arguably, do not produce tax results that frustrate the intention of Parliament. Thus, subsection 245(4) is a complement to the non-tax purpose test and is consistent with the general approach of a modern, as opposed to a literal, interpretation of the Act. [emphasis added]

The manner in which the government not infrequently infuses the OSP analysis with pejorative elements of a tax reduction purpose has been described above. The importance of an objective determination of legislative rationale that separates the taxpayer's purpose from the abuse or misuse analysis is critical to fulfilling Parliament's intent for s. 245(4) to function as a relieving provision: as the Dodge Article observes, "section 245 relies basically on the non-tax purpose test." (p. 21) By ensuring that "[s]ubsection 245(4) does not create an alternative test with regard to the definition of avoidance transaction", Parliament intended that tax authorities are obliged to first establish where Parliament has drawn the line and only then measure the taxpayer's conduct against that line, rather than seeking to draw the line wherever it needs to be in order to successfully apply GAAR to someone the CRA believes has not paid their fair share. Because an OSP established in one case effectively constitutes a precedent for all other taxpayers with respect to the same provisions of the ITA, it is particularly important to ensure the exercise of determining legislative rationale is conducted without regard to any particular taxpayer whose bad facts could otherwise create bad law. As noted, s. 245(4) already pre-supposes the taxpayer has taken positive steps to reduce tax; there is no logical role for it to play when determining Parliament's legislative rationale. The government could usefully clarify this to the benefit of all parties. As a unanimous Court held in *Copthorne*, "determining the rationale of the relevant

provisions of the Act should not be conflated with a value judgment of what is right or wrong nor with theories about what tax law ought to be or ought to do." (para. 70)

Legislative Rationale: Other Factors

The government could use the current exercise of rethinking GAAR to address a number of other interpretational issues relating to how OSP is determined and what factors may be relevant. These include (but are not limited to) the following:

- what forms of extrinsic aids may be referred to? For example, should an article by someone who worked on an issue while in government but is no longer there be considered? Perhaps the government can tell us who speaks for it and who does not.
- should it be made clear that the sophistication (or not) of the taxpayer's planning or the retaining of professional tax advice is irrelevant to s. 245(4)? These were clearly matters that troubled the minority in *Alta Energy*, notwithstanding the Court's previous holding in *Shell Canada* (as endorsed in *Canada Trustco*) that "a taxpayer is entitled to be taxed based on what it actually did, not based on what it could have done, and certainly not based on what a less sophisticated taxpayer might have done": see for example para. 177 and especially para. 121 of *Alta Energy*:

  > . . . Sophisticated taxpayers who can afford tax professionals have access to planning strategies that lower or eliminate their tax burden through what may cross the line into abusive tax avoidance territory. Not applying the GAAR to those abusive schemes is deeply unfair not solely because only this select group of taxpayers may have access to such professionals, but also because the tax burden avoided by the select group falls back on the taxpayers who do not . . .

- does the government take issue with the courts' determination that inferences may fairly be drawn from the extensiveness and specificity of the relevant ITA provisions, as in cases such as *The Queen v. Landrus*;[34] and
- does the government accept the principle of implied exclusion established by a unanimous Court in *Copthorne* (para. 111) that inferences may be drawn from the absence of text denying a tax benefit where those inferences are based on more than just that absence of text but are supported further by the relevant context and purpose? The majority and minority in *Alta Energy* appear divided on this point.[35]

This is where grasping the nettle to undertake a careful and introspective review of the jurisprudence to determine why certain cases were won or lost and the reasoning behind the judgments is the essential starting point of any rethinking of and amendment to GAAR. The government can achieve its own objectives and provide meaningful certainty to taxpayers, tax authorities and courts by identifying exactly which interpretational questions it truly takes issue

[34] 2009 FCA 113, paras. 45-47.
[35] Compare *Alta Energy* at paras. 58 and 66 versus 143 and 145.

with (and which ones it agrees with) rather than making sweeping generalizations such as attributing losses in court to "too much emphasis on 'certainty'" and "not enough emphasis on protecting the tax base (aka 'fairness') and 'economic substance'" (whatever that means). Truly ensuring the "fairness of the tax system" demands the hard but necessary work that this exercise entails, and there is nothing but upside in such an undertaking.

The Administration of GAAR

Finally, any review of GAAR designed to achieve better results must necessarily consider the manner in which it is administered in practice. As noted earlier, the fundamental reason the government is not winning a higher proportion of its GAAR cases is because it is choosing to apply GAAR in situations where the basis for doing so (i.e., a clear OSP that the taxpayer has demonstrably contravened) is not present. It is in no one's interests for this situation to continue.

As the Discussion Paper acknowledges, the courts have determined that the abuse-or-misuse element of GAAR is a two-step process: first, objectively establish the OSP of the relevant provisions without reference to any taxpayer, and then apply the taxpayer's facts against that standard to determine if an abuse or misuse has occurred. Unfortunately, how the government interprets and applies GAAR in practice is sometimes different. Both the jurisprudence and day-to-day practice reveal the CRA sometimes applying (or proposing to apply) GAAR in a variety of circumstances where the legislative rationale alleged to be offended is dubious at best and certainly nowhere near the "clear and unambiguous" standard that Mr. Justice Rothstein suggests as appropriate and that logically corresponds with GAAR's role as a provision of last resort that justifies superseding the legal substance of the taxpayer's actions as the basis for imposing tax. However well-intentioned this may be on the facts of a particular case the CRA perceives as objectionable, it is simply not the way in which Parliament intended GAAR to function, and any rethinking of GAAR must include safeguards that ensure the intended process is consistently and rigorously followed. It is one thing for the CRA to find something objectionable, and quite another for the CRA's response to be to apply GAAR to it. The fact that the government doesn't "like" something is not an adequate basis for applying GAAR as its reaction to it. Bending the line to catch a particular taxpayer creates unfairness for the remainder.

<u>The GAAR Committee</u>

Presently the GAAR Committee functions as the government's primary decision-making body for approving the application of GAAR and ensuring consistency. Logically changes in the work of the GAAR Committee are one way (but by no means the only way) for ensuring consistency and equity in the administration of GAAR.

There can be little doubt that the GAAR Committee would benefit from a broader perspective in its deliberations: in particular from the business community. Some degree of private-sector representation on the Committee to provide broader perspective on normal commercial practices and what is or is not abusive would help focus the government's time and attention on

those cases most deserving of being challenged and away from those that are not. Obviously confidentiality considerations restrict who can be on this body, but there are several highly-accomplished tax professionals who have joined the government after decades of private practice or who would be willing to serve post-retirement in such a limited capacity. Regardless of whether or not their views prevail in any given case, the tax system would benefit greatly from having more and different voices in the GAAR Committee's deliberations.

Similarly, the time has come to allow taxpayers facing a proposed GAAR re-assessment to make in-person *viva voce* representations before the GAAR Committee. Written representations simply do not have the same impact as an oral presentation, and do not allow for a meaningful back-and-forth exchange between decision-makers and those affected by their decisions. A provision of last resort should not be treated in the same way as other tools available to tax authorities, and there is no reason why the process employed for determining whether or not to use it cannot have more and better safeguards to allow these extremely consequential decisions to be made in the most equitable and best-informed manner. The proposed extension of the re-assessment period for applying GAAR exacerbates the exposure to taxpayers from these decisions and further elevates the need for safeguards in applying GAAR. Fairness should properly trump administrative convenience.

Consideration should also be given to publicizing the results of the GAAR Committee's decisions so that taxpayers have a better understanding of tax authorities' thinking and what they consider to be objectionable to the level of applying GAAR . While obviously confidentiality concerns must be observed, there is no obvious reason why a process similar to the release of redacted advance income tax rulings could not be followed to protect taxpayer information while providing greater transparency into both the process and the substantive issues before this body. A government seeking to encourage greater transparency and demanding ever-greater reporting from taxpayers can make the courageous choice to lead by example.

<u>Determining Legislative Rationale</u>

The objective of an OSP analysis is to determine what Parliament truly intended based on all of the available evidence as to what this might be, not to posit what the CRA thinks Parliament *should* have intended as a matter of tax policy and then hope to convince a court to use GAAR to make a different tax policy choice. For this reason, establishing a clear and demonstrable legislative rationale should be an absolute pre-condition to applying GAAR in practice. Taxpayers are entitled to a clear understanding of the case the government is making against them. Since most GAAR cases turn on abuse or misuse, this means first and foremost requiring the government to clearly articulate the legislative rationale it alleges to be contravened.

When seeking to go beyond the text of the statute to impose tax on a basis that prevails over the legal substance of the taxpayer's actions using a remedy of last resort, the government should be required to clearly pick a story and stick to it. A taxpayer litigating what the government's legislative rationale really was above and beyond the usual textual, contextual and purposive

reading of the ITA should not be required to incur the time and cost of playing litigation whack-a-mole as the government tries one OSP theory on for size after another in the hopes that one sticks. If the government cannot or will not articulate in clear and precise terms (i.e., without using vague and undefined concepts such as "insufficient economic substance" that can mean anything) what *it itself meant* when *it itself wrote* the text the taxpayer has met the terms of, no reasonable basis exists for ignoring the legal substance of the taxpayer's actions. Taxpayers should not be served up one indecipherable OSP word salad after another when trying to respond to the case raised against them on a GAAR re-assessment.

The government should have completed the work of researching and establishing what its proposed OSP is by the time it approaches the GAAR Committee for approval to apply GAAR, and should thereafter be confined to that as the case proceeds. Not only does this ensure that a decision to pursue GAAR is made by the GAAR Committee on a best-informed basis (and cannot stray onto other unauthorized terrain thereafter), requiring the CRA to (1) clearly articulate *exactly* what the legislative rationale is that the taxpayer is alleged to have transgressed and what evidence the government can point to supporting the existence of that alleged OSP, and then (2) be constrained to that, is a simple matter of basic fairness. The CRA should be limited to litigating against any particular taxpayer on the basis of whatever OSP the government puts forward before the GAAR Committee in support of its re-assessment, and not others. Going beyond the text to establish legislative rationale is unlike the normal back-and-forth of statutory interpretation of the text, and warrants its own unique rules.

Taxpayers facing a GAAR assessment and deciding whether or not to incur the cost and risk of litigating it deserve to know as early as possible what the case against them is. Requiring the government to do the hard work to identify and prove the existence of a legislative rationale not found on the usual interpretation of Parliament's text at the GAAR Committee stage, in a manner that will serve as the basis on which any subsequent litigation is contested, creates various advantages. First of all, the rigour of this exercise will separate strong cases from weak ones early in the process, so that resources can be concentrated on truly abusive situations that require action (whether litigation or legislative amendment) and not wasted on mediocre cases. It also facilitates early resolution (whether by settlement or concession) by giving taxpayers a clear picture of the case against them to allow a more informed choice to be made whether to incur the costs and risks of litigating. It will create valuable work product for use in cases with similar issues, and allow the GAAR Committee to make a go/no go decision on the basis of the best possible information. When arguing what the government meant but didn't actually put in the text of the statute, there is no unfairness in requiring the government to pick a lane early in the controversy on this specific issue and then stay in it.

<u>Litigating GAAR Cases</u>

The issues in GAAR cases are different than those when other provisions are at play. Consideration should be given to ensuring that the litigation process appropriately reflects those

differences and is as equitable as possible such that Parliament's will is accurately identified and acted upon.

For example, ensuring an expanded role for intervenors on the narrow issue of determining legislative rationale would be very beneficial. It is highly likely that an OSP established in one GAAR case will effectively serve as the standard by which taxpayers, tax authorities and courts interpret and apply GAAR in other cases dealing with the same or similar provisions. The courts would undoubtedly benefit from a broader range of perspectives on something that goes beyond the simple interpretation of a statutory provision, and the stakes are considerable: the impact of an incorrectly determined legislative rationale is profound. Intervenors in a GAAR case are essentially indifferent as to the outcome of the specific case before the court and the taxpayer's particular facts, but will care deeply about ensuring that OSP is correctly determined for the benefit of helping the business community and taxpayers generally understand where the lines are between legitimate and abusive tax planning. Again, there is nothing but upside if the point of the exercise is truly to determine what Parliament actually means.

The government should also consider making it obligatory for its counsel to share with the taxpayer the entirety of its OSP research and work product. Presumably the government should be motivated by ensuring that Parliament's true legislative rationale is identified and respected: if so, there is no obvious reason why all of the sources consulted, research conducted and inquiries made by the government's counsel in the course of its OSP analysis as part of a GAAR case should not be made available to all litigants (including intervenors). The objective of an OSP analysis is to get the right answer, rather than for one party or another to "win."

Deterrence

Currently there is no cost to the government in raising the stakes and levying a GAAR assessment. Many taxpayers will have neither the resources nor the stomach for that fight, and will choose to fold their tent, something the government is well aware of. Those who are willing to litigate face a daunting task, against the ultimate deep-pockets litigant who has nothing but upside to pursuing the issue in court, backed by the deepest roster of tax litigators in the country. If the government loses, it pays part of the taxpayer's costs and moves on to the next opportunity. If it wins, it collects taxes, interest and potentially penalties, and establishes a useful precedent for re-assessing other taxpayers.

Given that GAAR litigation involves the government seeking to overcome the normal interpretation of the text it drafted to change the tax consequences otherwise resulting, perhaps some form of deterrent is properly directed towards the government for cases in which it unsuccessfully advances GAAR (or at least where the court determines the OSP to be something different than the one the government puts forward). As noted above (and indeed by the Discussion Paper itself), GAAR litigation is highly resource-intensive: in particular the added cost of determining OSP, an exercise in which the government has every advantage. Where a taxpayer prevails on the basis that it complied not only with the letter of the law but also the

unwritten legislative rationale, it has good reason to feel aggrieved at the financial burden of having been put to the cost and effort of showing the government that the taxpayer understands the statute better than the government who wrote and enacted it. While it may be doubtful that any cost sanction will really deter a litigant capable of printing as much money as it likes, perhaps the act of reimbursing a successful taxpayer in a GAAR case its entire costs will focus the mind a little more in terms of how frequently the fire alarm is pulled to engage the provision of last resort. In any case, requiring the government to reimburse 100% of a successful taxpayer's legal fees and disbursements in a GAAR case would have the equitable result of leaving such a litigant whole from the added burden that was foisted upon it.

Conclusion

The business community and the government have a shared interest in ensuring that GAAR is robust, effective and focused exclusively and successfully on those few who engage in abusive tax avoidance. The opportunity for continued dialogue and collaboration towards securing this objective and improving the design and administration of GAAR is very much welcome.