



Canadian Chamber of Commerce – GAAR Submission on August 4, 2023 Draft Legislation

In August 2022, the Department of Finance (“Finance”) released a discussion paper (the “Discussion Paper”)¹ on potential amendments to the general anti-avoidance rule (“GAAR”) in s. 245 of the *Income Tax Act (Canada)* (“ITA”), soliciting feedback on these possible changes. The Chamber responded with a submission making various suggestions.² This was followed by the federal budget of March 28, 2023 (the “March 2023 Budget”), which included specific proposals to amend s. 245 ITA (the “March 2023 Proposals”),³ and invited comment on them. The Chamber provided a very detailed submission⁴ making numerous suggestions on these proposed amendments as well as further suggestions on the administration of GAAR, which was supplemented by a short further submission⁵ as a result of the Supreme Court of Canada’s decision on GAAR in *Deans Knight Income Corporation v. The King*.⁶ This letter is written in response to the subsequent release of revised draft amendments to GAAR issued by Finance on August 4, 2023 (the “August 4 Amendments”),⁷ which solicited comment by no later than September 8, 2023.

The essence of the proposed changes in the August 4 Amendments is the following:

- eliminate whatever residual impediment the “avoidance transaction” requirement posed to applying GAAR: going forward, from a practical perspective any transaction in which tax was a meaningful consideration will be an “avoidance transaction”;
- specify certain criteria as being indicative of a lack of “economic substance,” that will create a rebuttable presumption of misuse or abuse; and
- impose an automatic penalty whenever GAAR is applied, without regard to the reasonableness of the taxpayer’s conduct and avoided only where a formal notification and reporting process is met.

Avoidance Transaction

As discussed in the May 3 Submission, the “avoidance transaction” concept has not proven to be a practical barrier to applying GAAR very often. The proposed lowering of the threshold to a “one of the main purposes” standard will essentially eliminate it. The May 3 Submission (p. 22)

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 Canadian Chamber of Commerce Submission on GAAR Consultations, September 30, 2022, available at [Submission-Canadian-Chamber-of-Commerce-Factum.pdf](#) (herein, “Chamber 2022 Submission”).

³ Tax Measures: Supplementary Information, 2023 Federal Budget, Department of Finance, available at <https://www.budget.canada.ca/2023/report-rapport/tm-mf-en.html>.

⁴ Herein, “May 3 Submission”, available at <https://chamber.ca/canadian-chamber-shares-post-budget-comments-on-the-general-anti-avoidance-rule-gaar/>.

⁵ Herein, “May 31 Submission”, available at <https://chamber.ca/wp-content/uploads/2023/06/CCC-GAAR-Addendum-230531.pdf>.

⁶ <https://decisions.scc-csc.ca/scc-csc/scc-csc/en/item/19939/index.do> (herein, *Deans Knight*).

⁷ <https://www.canada.ca/en/department-finance/news/2023/08/government-consults-canadians-on-budget-2023-measures-to-grow-the-clean-economy-close-tax-loopholes-and-deliver-tax-relief-for-canadians.html>



expresses the concern that no explanation is being offered for what has changed since the government's choice of a "primary purpose" test in 1988, "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." One would have thought that transforming GAAR from "basically . . . a non-tax purpose test"⁸ to one in which purpose is essentially irrelevant as a practical matter would warrant some explanation.

In any event, as Finance appears resolved to enact this amendment, no further submissions on this point will be made. However, since the result is to essentially make GAAR cases turn entirely on a misuse or abuse analysis, this makes both clarity of legislative rationale when Finance drafts legislation and rigour and consistency in how the Canada Revenue Agency ("CRA") applies GAAR in practice absolutely critical to the business community's confidence in the fairness of the tax system. Such a lowering of the bar on "avoidance transaction" makes it that much more important to ensure that the procedure for determining misuse and abuse is both clear and fair.

Economic Substance

The Chamber's previous submissions review in great deal how the existing GAAR jurisprudence frequently employs economic substance in interpreting and applying s. 245(4), as well as the limited extent to which the original GAAR documents released by the government in 1987-88 refer to economic substance. This was supplemented by the discussion in the May 31 Submission highlighting the manner in which the majority of the Supreme Court in *Deans Knight* employed economic substance both in determining what Parliament's legislative rationale was in and whether the taxpayer's conduct constituted a misuse or abuse.

Nothing in the materials accompanying the August 4 Amendments challenged or took issue with our earlier analysis, to the effect that the existing GAAR jurisprudence clearly shows that the courts are already applying economic substance as part of a misuse or abuse analysis where appropriate (or as the August 4 Amendments say, "depending on the particular circumstances"). This being so, and in the absence of any clear statement by the government that these amendments are intended to or will effect a significant substantive change in the outcome of GAAR cases (i.e., a moving of the goalposts), Finance should expect the business community to proceed on the basis that these proposed amendments simply codify the existing jurisprudence.

If that is not the case, it is imperative that government clearly say so, articulating what substantive impact the "economic substance" amendments would have relative to existing GAAR caselaw and which cases would be decided differently. The business community's confidence in the fairness of the tax system requires that the government clearly, specifically and explicitly identify any element of the guidelines established in three decades of GAAR jurisprudence that can no longer be relied upon. If the government fails to do so, it will be

⁸ "Admittedly, however, the 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." David A. Dodge, "A New and More Coherent Approach to Tax Avoidance" (1988) 36:1 *Canadian Tax Journal* 1-22.



generating more of the very uncertainty it purports to be addressing by codifying the role of economic substance in a misuse or abuse analysis, rather than “provid[ing] clarity and consistency in the economic substance test under the GAAR.”

Penalty

With respect to the proposed penalty provision, the Chamber’s prior submissions discuss at some length the policy and practical concerns it raises. The August 4 Amendments do not acknowledge or respond to these concerns, nor identify why the existing penalty provisions of the ITA have proven inadequate, nor explain what has changed since the 1988 decision to rule out a GAAR-specific penalty. It is thus apparent that Finance is not open to further input on this substantive change in law. This is unfortunate, as the imposition of what is effectively an automatic GAAR penalty will inevitably lead to an increased number of GAAR cases going to litigation and decrease the prospects for settlement. At a bare minimum, the CRA must be enjoined to employ very significant administrative discretion not to apply the penalty in appropriate circumstances to facilitate settlement.

As noted in the May 3 Submission, the CRA has applied GAAR both where a taxpayer is choosing to test the limits of a legislative rationale that is reasonably evident (i.e., a consciously assumed risk), and where the government has not sufficiently articulated its legislative rationale when enacting legislation such that legitimate interpretational uncertainty exists even amongst well-informed readers making a *bona fide* effort to determine what is and is not permissible (e.g., tax treaty planning or surplus stripping). The proposed automatic penalty fails to distinguish between the two, and as such does not meet the basic fundamental test of “fairness” that the government itself cites in draft s. 245(0.1)(b). This is highly regrettable, as a self-assessing system is premised and dependent on taxpayers believing the tax system is “fair,” which is undermined when the government lowers the bar for applying GAAR at the same time it is increasing the consequences of GAAR applying irrespective of the reasonableness of the taxpayer’s conduct or how close a call the misuse or abuse decision is (e.g., divided success before the courts).

The proposed penalty exclusion for transactions “identical or almost identical” to favourable conclusions reached in existing caselaw or CRA administrative policy is of no practical significance, as it encompasses a very narrow range of scenarios where (one can only hope) the CRA would not even contemplate trying to apply GAAR, let alone do so successfully (and far less where any form of penalty could possibly be justified). As the only defence to a penalty when GAAR applies is the disclosure mechanism, and since virtually any transaction in which tax was meaningfully considered will now be an “avoidance transaction”, the government should expect a large number of precautionary disclosures for ordinary commercial transactions from taxpayers concerned with the risk of the CRA’s aggressively applying GAAR in circumstances where it is not warranted.⁹ It is difficult to see the benefits of this for anyone, including the government.

⁹ See in this regard the May 3 Submission, page 16 *et seq.*



Other

In response to the government's invitation to bring forward "other issues with the GAAR that people believe have lead to inappropriate outcomes", the Chamber's previous submissions (in particular the May 3 Submission) identified various areas where the administration of GAAR can and should be significantly improved, to the benefit of all parties. As the May 3 Submission discusses at some length, the government's proposed amendments to GAAR appear to be founded on an incorrect premise, and thus likely increasing the frequency of GAAR over-reaching to ensure that a relative few do not escape paying their fair share. Legislative amendments to GAAR are at best an incomplete and imperfect response to perceived deficiencies in the actual outcomes it produces in practice, and thus can only ever be part of a solution (particularly to a problem of which little evidence exists, as outlined in prior submissions). If the goal is truly a "fair" tax system in which the business community can have confidence, the government should commit to reviewing and improving all aspects of the legislative and administrative process.

For this reason, the Chamber reiterates the comments made in its previous submissions and strongly encourages the government to improve the effectiveness of GAAR without over-reaching in order to do so for the benefit of all parties by:

- following through on the government's own suggestion for better articulating the legislative rationale of the provisions it enacts;
- clarifying the process for determining object, spirit and purpose in a manner that brings greater certainty and rigour to that process; and
- working with the CRA to improve the administration of GAAR in a way that better focuses time and resources on those cases of greatest concern, articulates the CRA's view of the relevant legislative rationale as early as possible in any dispute, and makes for a fairer and more consistent process for applying GAAR.

If the government wants the business community to have confidence in the fairness and effectiveness of Canada's tax system, it should act on these suggestions in a visible and substantive way.

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