GAAR:
Reconciling Legal Certainty with Laudable Public Policy Objectives

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ABSTRACT

This paper provides an overview of the Canadian General Anti-Avoidance Rule ("GAAR") including its history, legislative intent, implementation, resulting policy issues and judicial treatment. It argues that GAAR is vague, contrary to the doctrine of legal certainty and grants broad discretion to the government bodies tasked with its review and enforcement. While judicial treatment of GAAR to date has provided some direction, it has failed to provide certainty. This paper argues that the courts should presume Parliamentary ability and foresight with respect to the application of GAAR, including the misuse and abuse provisions, to effectively reconcile legal certainty and the individual's right to be free from arbitrary appropriation of property with the provision's otherwise laudable public policy objectives.

Keywords: GAAR, General Anti-Avoidance Rule, Tax Avoidance, Anti-Avoidance, Statutory Interpretation, Literal, Purposive, Modern Rule

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1. Introduction

This paper provides an overview of the General Anti-Avoidance Rule ("GAAR"), including its legislative history and judicial treatment. It argues that the courts should presume a high degree of Parliamentary ability and foresight when applying GAAR, including the misuse and abuse provision. This approach most appropriately balances individual rights against the threat of uncertain, inconsistent and unjust state appropriation of private property and the need for government to protect the tax base to generate funds for laudable public policy initiatives.

GAAR was a 1988 amendment to the former Section 245(1) of the *Income Tax Act*[1] (the "Act") designed to prevent the erosion of tax revenue resulting from tax avoidance. It was motivated by two cases: first, the 1935 House of Lords case *Commissioners of Inland Revenue v. Duke of Westminster*,[2] which asserted that a literal approach to statutory interpretation should be adopted for tax avoidance; and, second, the 1984 Supreme Court of Canada case *Stubart Investments Ltd. v. R*,[3] which ruled against the use of a common law business purpose test. The business purpose test disallows tax benefits accrued by business structures and transactions that are not adopted for *bona fide* business purposes and are instead motivated primarily by the reduction of tax liability. GAAR enshrined a purposive approach to statutory interpretation *and* the business purpose test into Canadian law, thereby in part, overruling *Duke of Westminster* and *Stubart*. It provides a broad tool to combat tax avoidance transactions carried out without a *bona fide* business purpose resulting in a misuse or abuse of applicable tax laws.[4]

GAAR's implementation generated much controversy due in part to different philosophical outlooks on the rights of the individual and the appropriate role of the state when it comes to

taxation. Critics warned that the section was too vague and would result in improper government overreach;[5] while its proponents asserted that the provision was necessary to protect the tax system and stop the increased complexity resulting from the implementation of specific tax avoidance provisions in the Act.[6] Since the implementation of GAAR, the courts have sought to clarify how the section is to be interpreted and applied. Despite attempts, including four Supreme Court of Canada decisions, the provision continues, frustratingly, to provide for a significant amount of latitude and discretion in its application. Alan M. Schwartz, Q.C. in his work "GAAR Interpreted: The General Anti-Avoidance Rule," lays out the pre-GAAR history and doctrine, which follows.[7]

2. Tax Avoidance Prohibitions Prior to GAAR

Prior to the implementation of GAAR, there were a number of tax avoidance provisions designed to protect the tax base. They included general anti-avoidance provisions, specific anti-avoidance provisions, judicial anti-avoidance doctrine, and approaches to tax avoidance statutory interpretation.

2.1 General Anti-Avoidance Provisions

Since the implementation of the Canadian income tax under the *Income War Tax Act* of 1917,[8] the Federal government has sought to limit income tax avoidance. Ideally this is accomplished by drafting legislation to perfectly align the text's literal interpretation with its spirit and intent, but the nature of language and the legislative process makes such perfect clarity a lofty if not impossible goal. Taxpayers, seeking to minimize tax liabilities, are incentivized to

avoid tax by acting in a manner that puts them inside the literal interpretation of the law but outside of its spirit or *vice versa*.[9] Such behavior frustrates legislative intent, resulting in:

a) loss of government revenue;

b) wasted effort in economically unproductive tax disputes;

c) feelings of injustice by those that do not benefit from tax avoidance; and,

d) unfair tax shifting from those that avoid taxes to those that do not.[10]

To address these issues the *Income War Tax Act* contained a prohibition against "artificial transactions," which stated that "[i]n computing income for the purposes of this Act, no deduction may be made in respect of a disbursement or expense made or incurred in respect of a transaction or operation that, if allowed, would unduly or artificially reduce the income."[11] This provision was also included in the pre-1988 *Income Tax Act*[12] but was considered inadequate by its critics in both instances because the wording did not address transactions that impacted the reduction of taxable income or the amount of tax payable, and because it involved a test for "artificiality" that had been narrowly interpreted by the courts.[13]

2.2 Specific Anti-Avoidance Provisions

The modern Act also contains specific anti-avoidance provisions that prohibit identified avoidance transactions. These provisions are effective in prohibiting certain avoidance transactions, but they significantly increase the complexity of the Act resulting in increased opportunity for new tax avoidance transactions. They can also only retroactively prohibit a transaction resulting in loss of revenue until the provision is inserted into the Act.[14] Examples of the numerous specific anti-avoidance provisions in the Act include the anti-income-shifting rules

(e.g. Sections 56(2)-56(5), 74.1 to 75.1 and 120.4), the surplus stripping rules (e.g. Sections 84 and 84.1); and the stop-loss rules (e.g. Section 40(2)(g)(i) and 18(13)).[15] Because GAAR is considered as a measure of last resort, it will only be invoked where no specific anti-avoidance provisions apply to a tax avoidance transaction.[16]

2.3 Judicial Anti-Avoidance Doctrine

Judicial doctrine has also been developed with respect to tax avoidance. Notable doctrines include sham transaction, substance over form, incomplete or legally ineffective transaction, step transaction and the business purpose test.

2.3.1 Sham

The sham doctrine was defined in the English Court of Appeal case of *Snook v. London & West Riding Investments Ltd*.[17] It involves acts with an element of deceit intended to give the appearance of creating legal rights and obligations between parties different from the actual rights and obligations, if any, that the parties intended to create.[18] Because the doctrine has been given different interpretations by different cases, there is a degree of ambiguity regarding its application. Additionally, the element of deceit makes it difficult to use in cases where parties carry out a transaction *transparently* for the purpose of reducing tax exposure, as is often the case in tax avoidance transactions.[19]

2.3.2 Substance Over Form

The doctrine of substance over form holds that the true legal effect or relationship with respect to a transaction is to be recognized over the description used to characterize it. Once the true character of a transaction is identified, the applicable legal analysis is then conducted. Though the intent of the doctrine is to accurately characterize and address transactions, critics of this approach argue that this doctrine is used as justification for reclassifying transactions as something they are not in order to prevent otherwise lawful tax avoidance.[20]

2.3.3 Incomplete or Legally Ineffective Transaction

Incomplete or legally ineffective transaction is another judicial doctrine used by the court. The doctrine was explained in *Queen v. Daly*[21] in the following way:

> In a case of this kind, where it is acknowledged that what is sought by a certain course of action is a tax advance, it is the duty of the court to examine all of the evidence relating to the transaction in order to satisfy itself that what was done resulted in a valid, completed transaction.[22]

The doctrine requires that each step of a transaction be examined to ensure that what is being claimed as complete was in fact *legally* completed. Where the court finds the requisite steps of the transaction have not in fact been completed, it will make a tax assessment based on what was actually completed, rather than what was claimed to have been or intended to be completed.[23] Notably, only with respect to tax avoidance transactions will such a standard be used in assessing

the completeness of a transaction.[24] The uncertainty of the doctrine's interpretation and application has made it an inconsistent tool when opposing tax avoidance transactions, however.[25]

2.3.4 Business Purpose

The business purpose doctrine holds that transactions should be disregarded for tax purposes if they do not have a genuine, *bona fide* business purpose other than the reduction of tax liability. The business purpose test, frequently combined with other judicial tax avoidance doctrine, has been successfully used to challenge tax avoidance transactions. After adverse Canadian case law like *Stubart*, the legislature deemed it necessary to enshrine the business purpose doctrine into statute with GAAR.[26]

2.3.5 Step Transaction

Step transaction is a doctrine also enshrined into GAAR. It holds that a series of transactions can be characterized as a single composite transaction, when doing so accurately characterizes what took place. This doctrine was developed in response to tax avoidance transactions where the final step has a *bona fide* business purpose other than tax avoidance but preliminary transactions do not. This doctrine has been used to include related and contemporaneous transactions in a tax avoidance analysis where doing so is material to the court's ruling. Prior to GAAR enshrining the step transaction doctrine in statute, it had only been used sporadically in Canada and it was unclear to what extent it applied in Canadian law. The first step of the application of the doctrine is to examine the tax consequences of a series of

transactions, viewing them as a single transaction, to assess whether or not the series is in fact a single composite transaction. If found to be so, the court would then apply one of two tests. The first, the doctrine of substance over form, was explained in the context of a step transaction in *Furniss (Inspector of Taxes) v. Dawson* in the following way:

> When one moves[…] from a single transaction to a series of independent transactions designed to produce a given result, it is, in my opinion, perfectly legitimate to draw a distinction between the substance and the form of the composite transaction without in any way suggesting that any of the single transactions which make the whole are other than genuine[…]. I do suggest that the distinction between the form and substance is one which can usefully be drawn in determining the tax consequences of composite transactions and one which will help to free the courts from the shackles which have for so long been thought to be imposed on them by the *Westminster* case.[27]

The second option is the business purpose doctrine. In this scenario, the step transaction doctrine will ignore a composite transaction where there is no business purpose to any one of the transaction's steps. The business purpose test with respect to step transactions was also outlined in *Furniss (Inspector of Taxes) v. Dawson*:

> First, there must be a pre-ordained series of transactions; or, if one likes, a single composite transaction. This composite transaction may or may not include the achievement of a legitimate commercial (i.e. business) end[…]. Secondly, there must be

> steps inserted which have no commercial (business) *purpose* apart from the avoidance of a liability to tax - not *"no business effect."* [28]

The combination of the step transaction and business purpose doctrines was considered to be a coherent and effective combination. Consequently, each was legislated in GAAR.[29]

2.4 *Duke of Westminster*, Literal Interpretation & Form Over Substance

Statutory interpretation also plays an important role in assessing, challenging and defending tax avoidance transactions. Canadian law with respect to tax avoidance is founded on the previously mentioned 1935 House of Lords case of *Commissioners of Inland Revenue v. Duke of Westminster*.[30] In the case, the Duke had a deed drawn stating that members of his staff would receive annuity payments that were in practice in lieu of regular wages. The annuity payments were tax deductible but the wages were not. In response, the Commissioner of Inland Revenue argued that in substance the employees were still receiving wages and thus the amounts were not deductible. Rejecting the substance over form argument, Lord Tomlin notably remarked: "[e]very man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be."[31] With respect to statutory interpretation, Lord Tomlin added that "[t]he subject is not taxable by inference or by analogy but only by the plain words of a statute applicable to the facts and circumstances of his case."[32] This ruling affirms a literal approach to tax avoidance statutory interpretation. Such an interpretation arguably finds its basis in the notion that the inherent appropriative nature of taxation warrants special consideration to protect against government overreach and infringement upon an individual's right to the fruits of his or her labour. In contrast, others contend that principles of

equity, basic morality and good citizenship demand that substance take primacy over form and that statute be interpreted purposively to give effect to inferred legislative intent.[33]

2.5 The 'Modern Rule' & *Stubart*

In *Stubart*, the Supreme Court of Canada upheld the premise of *Duke of Westminster* while overruling its approach to statutory interpretation. At issue was whether a corporate taxpayer, for the purpose of reducing taxes, is permitted to route future profits through a subsidiary to benefit from the subsidiary's loss carry-forward. Beetz, Estey and McIntyre JJ. found that "[a] transaction *cannot* be disregarded for tax purposes *solely* on the basis that it was entered into by the taxpayer without an independent or *bona fide* business purpose."[34] *Stubart* therefore rejected the business purpose test for assessing the legitimacy of a transaction with tax consequences, explicitly precluding it as a judicially created general anti-avoidance rule.[35]

Stubart affirmed the *Duke of Westminster* finding that "the longstanding principle that a person might order his affairs to as to attract the least tax liability… [is]… too deeply entrenched in Canadian law to be rejected in the absence of clear statutory authority."[36] However, and rather confusingly, it simultaneously rejected the use of literal statutory interpretation with respect to tax avoidance and affirmed the "modern rule" of interpretation: "[t]oday there is only one principle or approach, namely, the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament."[37] Some have argued that *Stubart's* upholding form over substance while rejecting literal interpretation is inconsistent because literal interpretation is the justification for form over substance.[38] However, from another point of view, *Stubart* strikes a

balance between recognizing established precedent (*Duke of Westminster*), while acknowledging that the increased complexity of modern tax planning requires a more expansive and purposive approach to statutory interpretation to meet government public policy objectives. Despite the Court's concession of overturning literal interpretation, in large part because of its rejection of the business purpose test, the ruling did not satisfy the legislature.

3. The General Anti-Avoidance Rule

3.1 *Income Tax Act* Section 245

In response to *Stubart*, GAAR was introduced in 1987 and implemented in 1988 in order to combat what the government characterized as abusive tax avoidance. GAAR is found in Part XVI, Section 245 of the *Income Tax Act*[39] (included in full herein as Appendix A). Section 245(2) broadly states that in an avoidance transaction, the tax consequences shall be calculated "as is reasonable in the circumstances." Section 245(3)(a) adopts the business purpose test rejected by the courts in *Stubart*, stating that GAAR does not apply where "the transaction may reasonably be considered to have been undertaken or arranged primarily for *bona fide* purposes other than to obtain a tax benefit." Section 245(3)(b) states that a part of a series of transactions must have a *bona fide* purpose other than a tax benefit in order for the transaction to be exempt from the application of GAAR, thereby legislating against the step transaction mechanism for tax avoidance. Section 245(4) adds that subsection Section 245(2), allowing for a calculation of tax "as is reasonable in the circumstances," only applies where: (a) there is *misuse* of the Act, Regulations, Rules, tax treaties or any other enactment relevant in computing tax; and (b) there is a resulting *abuse*. Section 245(5) allows for tax consequences of an avoidance transaction to be allowed, disallowed, recharacterized and recalculated. Sections 245(6) and (7) outline the

process for the application of GAAR by way of notice and assessment. Section 245(8) states that the Minister with "all due dispatch" shall make an assessment or reassessment with respect to the person in relation to the transaction at issue.

3.2 *Excise Tax Act* & Provincial GAAR Provisions

Other pieces of legislation including Provincial income tax acts and the *Excise Tax Act*[40] have also enacted equivalently worded GAAR provisions to address tax avoidance transactions that fall outside of the scope of the Federal *Act* and related law. For example, both the *Alberta Personal Income Tax Act*[41] and the Ontario *Income Tax Act*[42] contain provisions substantively similar to GAAR in the Federal Act.

3.3 GAAR Features

The wording of GAAR results in features not explicitly detailed in its text. Specifically, its broad scope, lack of penalty provision, necessary purposive interpretation and defensive last resort application are all noteworthy characteristics.

The breadth and vagueness of GAAR grants broad Ministerial discretion to its application. While such ambiguity is a concern for those engaging in tax planning, two factors mitigate against the inherent uncertainty of the scope of the application of the provision. Firstly, as discussed in greater detail in the following section, a Canada Revenue Agency ("CRA") GAAR Committee oversees the application of the provision in an attempt to ensure consistency of enforcement.[43] Secondly, the lack of a penalty provision in the section means that if a taxpayer is

found to be in contravention of GAAR, the taxpayer will only be liable for accrued interest. This less than severe repercussion for running afoul of GAAR undoubtedly, at least in part, alleviates taxpayer concern.

GAAR Section 245(4) necessitates a purposive interpretation with its 'misuse' and 'abuse' provisions. Because the test requires the court to look at the purpose of the sections in question, a purposive approach to statutory interpretation is required. Historically, given the *Duke of Westminster,* literal statutory interpretation has been the norm for tax avoidance. However, the modern rule, for tax avoidance, as asserted in *Stubart*, has been purposive interpretation. GAAR Section 245(4) removes any ambiguity that may exist by the competing findings in *Duke of Westminster* and *Stubart* on statutory interpretation.

Lastly, the defensive nature of GAAR is a notable feature. The provision has been characterized as a "shield" that is meant to protect the tax base from avoidance transactions rather than a "sword" to be used as a penal provision.[44] GAAR's lack of a penalty coupled with its use as a provision of last resort is consistent with its purpose of ensuring that the object, spirit and purpose of the Act is upheld when its other provisions are unsuccessful in achieving their anti-avoidance policy goals.[45]

3.4 GAAR Committee

In response to concern about the consistent application of GAAR, upon its implementation, a non-statutory advisory committee of the CRA was created to review instances where GAAR was to be applied in advance rulings and audit reassessments. The GAAR Committee consists of

members from the Department of Justice, Department of Finance and the CRA. CRA representatives from Income Tax Rulings, Legislative Policy and Tax Avoidance sit on the Committee. The Department of Justice has lawyer representatives from Tax Advisory and Tax Litigation practices and a legal advisor housed within the CRA. The Department of Finance has representatives from its Tax Policy branch. As a non-statutory body, the Committee is only able to make non-binding recommendations on the application of GAAR. When first formed, every GAAR matter came before the Committee. But now only matters that have not already been ruled on do. Likewise, matters where GAAR forms only a secondary basis for an assessment are no longer reviewed. The Committee meets every other week in Ottawa at the office of the CRA Rulings Directorate. Neither taxpayers nor their representatives are permitted to attend.[46]

4. GAAR Controversy

The introduction of GAAR has been met with controversy. Some argue that GAAR is overly vague (even unconstitutionally so)[47] and that this is contrary to the doctrine of legal certainty. Others argue that a broadly applicable provision is necessary to protect the tax base as business structures and tax avoidance transactions become increasingly complicated. At its root, the debate is a tension between competing philosophical frameworks: on the one hand, the classical liberal conception of individual self-ownership, autonomy and freedom from unwarranted interference as elucidated in the tax avoidance context in *Duke of Westminster*; and, on the other hand, a socialist conception of collective ownership justifying the appropriation of the fruits of individual labour and infringement of certain individual freedoms to benefit the collective.

In his 2004 Canadian Tax Journal article, "The Long Slow, Steady Demise of the General Anti-Avoidance Rule,"[48] Arnold, B.J. argues that the polarizing nature of the debate has resulted in exaggerated and unhelpful judicial commentary. Some judges have found that "GAAR is not to be imposed lightly" and is to be applied only with the "utmost caution,"[49] that it is a "powerful tool" that should not be used to "force taxpayers to structure their transactions in the manner most favourable to the tax authorities,"[50] and that the "court will proceed cautiously in carrying out the unusual duty imposed upon it [by GAAR]."[51] In contrast, the court has also stated that:

> [GAAR] itself must not be read in a disjointed way[…]. Tests suggested [to limit the application of GAAR…] are of little assistance and are not justified by the language of section 245 [GAAR] read as a whole. To accept such tests would undermine the object and spirit of section 245 and run counter to the teleological approach mandated by the Supreme Court of Canada[…]. The *telos* of section 245 is the thwarting of abusive tax avoidance transactions.[52]

Notably, some judges always ruled against the application of GAAR and others always in favour.[53] Former Associate Chief Justice Donald Bowman of the Tax Court of Canada, who presided on a number of GAAR cases, is reported to have acknowledged this issue in 2010 after his retirement, asserting that "[t]he first thing that is absolutely certain in my view, is that whether you win or lose a GAAR case depends on the judge you get in the first instance."[54] Arnold, B.J. argues that the positions taken by many judges are exaggerated and not reflective of the reality of GAAR. He attempts to advance a pragmatic approach to GAAR interpretation and application, asserting i) that the enactment of GAAR was socially necessary after the Supreme

Court's rejection of the business purpose test in *Stubart*; ii) that GAAR is an extraordinary provision of last resort but not an extreme sanction; and, iii) that the CRA applies GAAR in a very restrained and responsible manner.[55] This tension between competing philosophical outlooks and those that seek to find a pragmatic middle ground becomes increasingly apparent when examining applicable case law.

5. Judicial Treatment & Interpretation

5.1 *McNichol & RMM*

The Canadian Tax Court first considered GAAR in the 1997 cases of *RMM Canadian Enterprises Inc. v. R.*[56] and *McNichol et al. v. R.*[57] *McNichol et al.* was the first case to decide on GAAR. It involved the former partners of a law firm in Moncton, New Brunswick. While working together those former partners set up a holding corporation to build and rent their law firm office building. After selling the building, the holding company retained approximately $314,000 CAD in cash in its bank account from rental income. Rather than disbursing the funds as dividends and winding up the company, the shares of the corporation were sold to a third party at a discount and the shareholders relied on their capital gains exemptions to avoid paying tax on the distributions, a process referred to as "surplus stripping". The Minister reassessed the shareholders' returns characterizing the monies as taxable deemed capital gains. The shareholders appealed to the Tax Court.

Bonnor T.C. J. dismissed the appeal, finding in favour of the CRA and against the shareholders relying on the newly enacted GAAR. In doing so he rejected a narrow interpretation of misuse in subsection (4) proposed by the appellants, instead opting for a broader application

and purposive interpretation to the section, stating "[f]or [the] purposes of section 245, the characterization of a transaction cannot be taken to rest on form alone."[58]

Shortly after *McNichol*, the Tax Court heard *RMM Canadian Enterprises Inc*. In this case, an American company, Equilese Corporation, sold the shares in its Canadian subsidiaries, Equilese Limited and Equilese Canada Limited to co-defendant Canadian corporation RMM Canadian Enterprises Inc. ("RMM"). The assets of the subsidiaries consisted of approximately $3,000,000 CAD in cash, $1,500,000 CAD in outstanding tax refunds and equipment lease agreements estimated to be valued at approximately $100,000 - $150,000 CAD. After the purchase and sale, Equilese Limited was wound up into RMM and Equilese Canada Limited was amalgamated with RMM. Under the Canada-US tax treaty this transaction resulted in the characterization of the payment to Equilese Limited as a capital gain exempt from Canadian tax withholding. The Minister assessed Equilese Corporation and RMM for failure to withhold or pay tax on deemed dividends, relying on Sections 84(2) (deemed dividend) and 245 (GAAR) of the Act. The parties appealed to the Tax Court.

Bowman T.C.C. J. found against the appellants on both Sections 84(2) and 245 of the Act. He carried out the GAAR analysis as an alternative justification to his Section 84(2) finding. In doing so he attempted to provide some clarity with respect to the terms misuse and abuse, providing an example of an instance of abuse in a past case without putting forward a clear definition or test. Notably, in the decision, Bowman T.C.C. J rejects substance over form as a general concept, stating:

> What of the fact that there was a sale of shares? Of course there was a sale. It was not a sham. "Sale of shares" is a precise description of the legal relationship. Nor do I suggest that the doctrine of "substance over form" should dictate that I ignore the sale in favour of some other legal relationship. That is not what it is all about. Rather it is that the essential nature of a transaction cannot be altered for income tax purposes by calling it by a different name. It is the true legal relationship, not the nomenclature that governs.[59]

While simultaneously adopting substance over form when applying GAAR, the judge found that:

> The *Income Tax Act*, read as a whole, envisages that a distribution of corporate surplus to shareholders is to be taxed as a payment of dividends. A form of transaction that is otherwise devoid of any commercial objective, and that has as its real purpose the extraction of corporate surplus and the avoidance of the ordinary consequences of such distribution, is an abuse of the Act as a whole.[60]

These contrasting statements appear to affirm the common law of form over substance except where otherwise stated in statute, as is the case with GAAR.

At the time of writing, there have been approximately seventy GAAR rulings with many more pending cases yet to be decided. Since its enactment, the Supreme Court of Canada has weighed in on the provision on four occasions and in doing so attempted to provide increased clarity as to how the section is to be interpreted and applied. The first two GAAR Supreme Court cases were *Canada Trustco Mortgage Co v. Canada*[61] and *Mathew v. Canada* in 2005.[62]

5.2 *Canada Trustco & Mathew*

The case of *Canada Trustco* involved Canada Trustco Mortgage Company ("CMTC"), a mortgage lender with revenues from leased assets, that purchased trailers from a vendor and then leased them back to the same vendor in order to offset revenues from its leased assets by claiming a capital cost allowance ("CCA") on the trailers in the 1997 tax year. This resulted in a deferment of taxes until recapture calculated at the time of disposition. The Minister assessed CTMC and disallowed the claim for CCA. The Tax Court of Canada set aside the Minister's decision on appeal, finding that the transaction was consistent with the purpose and spirit of the CCA provisions and that, consequently, GAAR did not apply because there was no misuse or abuse. The Federal Count of Appeal affirmed the decision and, upon further appeal, the Supreme Court dismissed the case, providing important commentary on the interpretation and application of GAAR. Specifically, the Chief Justice and Major J. found for the Supreme Court that:

> The application of GAAR involves three steps. It must be determined: (1) whether there is a tax benefit arising from a transaction or series of transactions within the meaning of s. 245(1) and (2) of the Income Tax Act; (2) whether the transaction is an avoidance transaction under s. 245(3), in the sense of not being "arranged primarily for *bona fide* purposes other than to obtain the tax benefit"; and (3) whether there was abusive tax avoidance under s. 245(4), 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. The burden is on the taxpayer to refute points (1) and (2), and on the Minister to establish point (3).[63]

With respect to interpretation of GAAR Section 245(4) misuse and abuse test, the court further states that there is a unified test for both that consists of two parts:

> The first part of the inquiry under s. 245(4) requires the court to look beyond the mere text of the provisions and undertake a contextual and purposive approach to interpretation in order to find meaning that harmonizes the wording, object, spirit and purpose of the provisions of the Income Tax Act.[64] […]The second step is to examine the factual context of a case in order to determine whether the avoidance transaction defeated or frustrated the object, spirit or purpose of the provisions in issue.[65] […] [A]busive 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.[66] […]If the existence of abusive tax avoidance is unclear, the benefit of the doubt goes to the taxpayer.[67]

Canada Trustco is significant in that it is the first Supreme Court ruling on GAAR and it provides a methodology for GAAR analysis with increased clarity on the process for determining what constitutes misuse and abuse. In the same year, the Supreme Court further contemplated these ideas in *Mathew v. Canada*.[68]

In *Mathew*, the Supreme Court applies the interpretation and process put forward in *Canada Trustco*. The facts of the case are as follows: Standard Trust Company ("STC") was in

the business of lending money secured by real property mortgages. The company became insolvent and a liquidator was appointed. At the time of liquidation, the company had seventeen bad loans, nine of which had underlying real estate worth approximately $33,000,000 CAD. The cost of these loans had been approximately $85,000,000 CAD. The approximately $52,000,000 CAD in unrealized losses from the bad loans was unrealizable due to the liquidation. In order to address this issue, the liquidator carried out a series of transactions to maximize returns on the disposal of the debt portfolio. The transactions involved transferring 99% of the debt portfolio to a first partnership (relying on Section 18(13) of the Act to do so at the valuation of $85,000,000 CAD), and then to a second arms length partnership (so that the non-arms length restriction did not apply). The appellant taxpayers then joined the second partnership and claimed their proportionate share of the losses against the sale and write down of the bad debt (in accordance with Section 96 of the Act), deducting over $10,000,000 CAD of STC's losses. The Minister assessed the taxpayers and disallowed the deductions relying on GAAR. The Tax Court, Federal Court of Appeal, and Supreme Court all upheld the Minister's decision.

The Chief Justice and Major J. for the court upheld the test for applying GAAR and reaffirmed the unified test for misuse and abuse as stated in *Canada Trustco*. The court, in applying the test and process found that the series of transactions was not consistent with the intent of the applicable provisions of the Act (Sections 18(13) and 96). This determination was made because the transactions were found to constitute an abuse due to a lack of shared business activity amongst the partners of the second partnership and because the result of the transactions

frustrated Parliaments purpose of confining the transfer of losses between non-arms length partnerships.[69]

Notably in the case, the court also appears to expand upon the application of purposive statutory interpretation with respect to tax avoidance, suggesting that it applies not only to GAAR analysis due to the wording of Section 245(4), but also more broadly:

> The basic rules of statutory interpretation require that the larger legislative context be considered in determining the meaning of statutory provisions. This is confirmed by s. 245(4), which requires that the question of abusive tax avoidance be determined having regard to the provisions of the Act, read as a whole.[70]

Mathews not only affirms *Canada Trustco*, it also broadens the applicability of purposive statutory interpretation in the context of tax avoidance.

5.3 *Lipson v. Canada*

In the 2009 Supreme Court case of *Lipson v. Canada*,[71] the taxpayer and his wife entered into a purchase and sale agreement to buy a home. The wife borrowed $562, 500 CAD from the bank to purchase shares in a family corporation from her husband. The taxpayer and his wife then obtained a mortgage from the bank for $562, 500 CAD and that day used the funds to repay the initial loan used to purchase the shares. The taxpayer then deducted the interest on the loan in tax years 1994, 1995 and 1996 and reported the taxable dividends as income. The Minister disallowed the deductions and reassessed the taxpayer accordingly. The Tax Court dismissed the

taxpayers' appeal, stating that the transactions were an abuse of Sections 20(1)(c), 20(3), 73(1) and 74.1 of the *Income Tax Act*. The Court of Appeal and Supreme Court upheld this decision.

The case follows the GAAR analysis as well as the single two-part inquiry for misuse and abuse put forward in *Canada Trustco*. The court additionally notes that the wording of GAAR dictates that:

> [T]he misuse and abuse must be related to the specific transactions forming part of the series. However, the entire series of transactions should be considered in order to determine whether the individual transactions within the series abuse one or more of the provisions of the Act. Individual transactions must be viewed in the context of the series.[72]

The court finds that it is the "overall result" of the transaction at issue and not the "overall purpose" because the overall purpose of the transaction is not determinative in the Section 245(4) analysis.[73] The Supreme Court further elaborated on the appropriate interpretation and application of GAAR with respect to step transactions in the 2001 case of *Copthorne Holdings Ltd. v. Canada*.[74]

5.4 *Copthorne Holdings Ltd. v. Canada*

In *Copthorne Holdings* "Copthorne I" and VHHC Holdings Ltd., two corporations making up part of the same group, changed from parent and subsidiary to "sister" corporations – two corporations owned directly by the same shareholder – in this case the non-resident corporation Big City Project Corporation B.V. Copthorne I and VHHC Holdings Ltd. were then

amalgamated and the paid up capital of their respective shares was aggregated to form the paid up capital of the amalgamated corporation. This process retained the paid up capital because if Copthorne I and VHHC Holdings Ltd. had remained as parent and subsidiary, then the paid-up capital would have been cancelled for tax purposes upon amalgamation. The amalgamated corporation then redeemed a significant percentage of its shares and paid out the paid up capital attributed to them to its non-resident shareholder. This payment was consequently treated as a non-taxable return of capital. The Minister took the position that this transaction circumvented provisions of the Act in an abusive manner contrary to Section 245 (GAAR). The Minister reassessed as if the transaction had not occurred, taxing the payment as a deemed dividend. The Tax Court, Appeal Court, and Supreme Court all upheld the Minister's decision.

The case is significant because it elaborates on how a series of transactions is to be assessed during GAAR analysis. Specifically, the case finds that:

> Where, as here, the Minister assumes that the tax benefit resulted from a series of transactions rather than a single transaction, it is necessary to determine if there was a series, which transactions make up the series, and whether the tax benefit resulted from the series. If there is a series that results, directly or indirectly, in a tax benefit, it will be caught by s. 245(3) unless each transaction within the series could "reasonably be considered to have been undertaken or arranged primarily for *bona fide* purposes other than to obtain [a] tax benefit." If any transaction within the series is not undertaken primarily for a *bona fide* non-tax purpose that transaction will be an avoidance transaction.[75]

The test for this process has two parts: "[t]he first consideration is whether there was a series that resulted in a tax benefit[…]. The second consideration is whether any of the transactions within the purported series is an avoidance transaction."[76] *Copthorne Holdings Ltd. v. Canada* both reaffirmed *Canada Trustco* and provided additional clarity on the process for GAAR analysis for a series of transactions.

5.5 *Husky Energy Inc. v. Alberta*

The 2012 Alberta Court of Appeal case of *Husky Energy Inc. v. Alberta*[77] involves the application of materially identical provincially enacted GAAR provisions. The matter at issue was whether GAAR could be invoked when a corporation reorganizes in order to take advantage of a different Province's more favourable tax regime. Husky reorganized to take advantage of preferable Ontario tax law from 2003 to 2005 and consequently did not pay some Alberta tax that it had previously paid and claimed additional deductions against its Alberta income. The Tax Court disallowed the Minister's assessment and the Court of Appeal upheld the Tax Court's position, dismissing the appeal. In dismissing the case the court first cited the finding of the Tax Court, stating that:

> It cannot be abusive for corporations to reorganize and refinance. To find that Subsidiaries and Operations cannot change the way they finance their operations when the motivation is tax avoidance would mean that they are chained to Alberta. Attaching a chain to any corporation who engages in tax avoidance is nowhere within the object, spirit and purpose of s. 20(1)(c). It cannot be the case when a fundamental principle of tax law is that taxpayers may arrange their affairs to minimize tax. Moreover, with the exception of one sentence in

> Novapharm, the cases do not say that. To the extent that Novapharm says the contrary, it cannot stand in the face of *Canada Trustco* and *Lipson*. Finally, to argue that this is only a paper transaction is equivalent to saying this is only a shuffle of cheques. In the words of Major, J. the paper transactions define the legal relations between these entities. I must give effect to those legal relations. There is nothing abusive in deducting the interest paid by Subsidiaries and by Operations.[78]

The case then elaborates on its decision in the context of Canadian federalism, noting that:

> The constitutional reality of Canada is that each level of government has taxation authority. Provinces are free to fully adopt the federal system, and some have done so. Alberta and Ontario have not. Each case of alleged abuse must be carefully assessed in the context of Supreme Court law.[79]

Husky Energy Inc. v. Alberta is notable because of its finding that organizing between jurisdictions to minimize tax exposure does not constitute a misuse or abuse of tax legislation.

6. Reconciling Legal Certainty with Laudable Public Policy Objectives

A review of the history of GAAR, the provision, its administration, related controversy and judicial interpretation demonstrates an ongoing tension, at its root, between the classical liberal primacy of individual rights and the socialist emphasis on the collective. In this context this debate has manifested itself as a struggle over literal versus purposive tax avoidance statutory interpretation and specific versus general anti-avoidance provisions in the Act. That GAAR

remains vague after four Supreme Court rulings and the adoption of purposive interpretation for tax avoidance transactions indicates that the socialist viewpoint is winning out over classical liberal ideals. This shift puts individual and property rights at risk from increased state power. An analysis of how GAAR continues to be vague and why this is contrary to public policy provides insight into how GAAR can best be interpreted and applied in order to balance competing individual and collective public policy interests.

6.1 GAAR Remains Vague

The text of GAAR is vague because of the text's failure to offer a fixed standard. It does not permit the taxpayer to calculate his or her tax liability in advance because the liability is dependent on what is "reasonable in the circumstances" as per Section 245(2). Because two (or indeed many) different amounts may be reasonable, there is lack of clarity and the provision is vague.[80] What does or does not constitute a *bona fide* business purpose in Section 245(3) also involves a significant degree of subjective interpretation, as does characterizing misuse and abuse in Section 245(4).

GAAR judicial treatment has attempted to provide additional clarity, but clarifications regarding interpretation and process for analysis cannot provide an exacting standard where none exists in the text of the provision. For example, when *Canada Trustco* provides clarity on the application of Section 245(4) misuse and abuse, the Court arguably creates yet another level of ambiguity by finding that purposive statutory interpretation looking to the "object, spirit and purpose," of the relevant provision should be applied. Because the Act is silent on each section's "object, spirit and purpose" the adjudicator is left to rely on his or her own interpretations and

beliefs about the appropriate role of the tax system in society and how the provision at issue fits into it. While Parliamentary Hansard, if available, can provide some insight into considerations of legislative intent, the often competing views expressed can be more effective for retroactively justifying a position than determining that intent with certainty beforehand. Because judicial clarification simply provides an equally vague test that will vary in its application from adjudicator to adjudicator, judicial treatment of GAAR has arguably failed at providing meaningful certainty to taxpayers. Such a broad and vague provision cannot be made exact without fundamentally changing its wording, nature and effect. And indeed, its vagueness and uncertainty might be an ineliminable feature of the broad approach it takes and is meant to take.

6.2 Vague Law is Contrary to Public Policy

Vague law is contrary to public policy because it is a violation of the doctrine of legal certainty – a fundamental element of the rule of law. Legal certainty means that those subject to a body of law must have the ability to conduct themselves in a lawful way. This is important because such clarity in law safeguards against the arbitrary exercise of state authority. When vague law exists, the state has the capacity to selectively enforce, apply and penalize persons irrespective of their efforts to act lawfully. Collier J in *British Railway Co. v. The Queen,* adopted Adam Smith's articulation of this doctrine:

> The tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person. Where it is otherwise, every person subject to the tax is put more or less in the power of the tax-gatherer, who can either

> aggravate the tax upon any obnoxious contributor, or extort, by the terror of such aggravation, some present or perquisite to himself. The uncertainty of taxation encourages the insolence and favours the corruption of an order of men who are naturally unpopular, even where they are neither insolent nor corrupt.[81]

Legal certainty is a doctrine that should not be taken lightly because it is an important protection of individual rights to liberty and property against government impropriety and overreach. Competing with the need for legal certainty, however, is the need for government to protect its tax base while ensuring that tax burdens are not unfairly borne and that public trust in the tax system is maintained. GAAR was implemented in response to government's concerns regarding the ineffectiveness of the pre-GAAR anti avoidance measures. The appropriate balance must be found between legal certainty and the public policy objective of protecting the integrity of the tax system.

6.3 Presumption of Parliamentary Ability & Foresight Balances Competing Interests

Pragmatically, GAAR is here to stay and the Supreme Court has ruled decisively on the interpretation and process to be used in its application. What remains an open issue is how, within the framework put forward in *Canada Trustco* and otherwise, adjudicators interpret the facts to determine whether or not they fall afoul of GAAR, including the business purpose test and the misuse and abuse analysis. In recognition of the inherently vague nature of GAAR and the importance of the doctrine of legal certainty, adjudicators of GAAR cases should carry out their analysis of the relevant facts and provisions of the Act in a manner that minimizes uncertainty for the taxpayer.

In *RMM Canadian Enterprises*, the court rejected a narrow interpretation of misuse finding against the use of literal statutory interpretation for GAAR analysis. This ruling is consistent with the text of GAAR and finding otherwise would have gutted the then newly enacted provision. In *Mathews*, the court found that the use of partnerships to disburse debt portfolio losses to individual partners was a misuse and abuse of Sections 18(13) and 96 of the Act. In doing so, the court made determinations about the intended purpose of the Act and relevant sections to find that the transaction constituted misuse and abuse and was therefore in breach of GAAR. Throughout the decision, the court emphasized the importance of legislative intent.[82] It found that the presumed inability of Parliament to anticipate the use of the sections as they were used in this case, contributed to its characterization of misuse and abuse. In contrast to *Mathews*, *Husky Energy* asserted that taking advantage of different Canadian tax regimes does not constitute misuse and abuse, upholding the right of the taxpayer to structure his or her affairs in a manner that minimizes tax liability. A notable difference between *Mathew* and *Husky Energy* is that because Provinces like Ontario and Alberta chose to enact tax legislation different from the Federal regime, it was foreseeable that taxpayers would structure their enterprises to take advantage of differing tax benefits. This in and of itself, however, does not preclude a finding of misuse and abuse when transactions are carried out taking advantage of legislation in differing jurisdictions for the primary purpose of obtaining a tax benefit. Rather, *Mathews* appears to be an instance where the Court diminished Parliament's presumed ability and foresight (stating it did not intend the provision to be used as it was), while *Husky Energy* presumed a high degree of Parliamentary ability and foresight (that the Parliament did or should have anticipated that companies will reorganize in different jurisdictions for tax purposes). Notably, this presumption (or lack thereof) differs from that given to the taxpayer if the existence of abusive tax avoidance

is unclear as per *Canada Trustco*. It is a presumption that can be and is used in the process of applying the facts when the court does not rely upon a lack of clarity regarding the existence of tax avoidance.

The GAAR provision in the Act and the interpretation and application put forward in *Canada Trustco* grant broad latitude to government to protect the tax base at the expense of legal certainty for the taxpayer. In recognition of this significant concession by the individual to the state, adjudicators should presume a high degree of capacity and foresight by Parliament when applying the facts of a case to the GAAR process. An example of appropriately making such a presumption and consequently balancing legal certainty and individual rights with GAAR's laudable public policy purpose is the finding in *Husky Energy*. In this case, unlike in *Mathews*, the state is presumed to act with knowledge and foresight and the right of the taxpayer to organize its affairs as it so chooses is given primacy of consideration.

7. Conclusion

The implementation of GAAR in 1988 was a direct result of government concern over the erosion of the tax base from tax avoidance and the rejection of the business purpose doctrine in *Stubart*. The provision's broad reach and vague provisions resulted in legitimate concern amongst the taxpaying public regarding what would and would not constitute a breach of GAAR. The lack of a penalty provisions and the characterization of the section as a tool of last resort mediated some of these concerns. But even after four Supreme Court of Canada cases clarifying the appropriate interpretation and application of the section, a significant amount of Ministerial and Judicial discretion remains as to when GAAR will be applied and when breach will be

found. This uncertainty is contrary to the doctrine of legal certainty. It also is contrary to the historical recognition of taxation as an area requiring special citizen protections in recognition that taxation is an inherent infringement on individual property rights that is only justified as being necessary to achieve greater societal goods. The debate surrounding the implementation of GAAR is, at its root, a philosophical one between those who subscribe to the classical liberal conception of individual rights and property where each person has a right to be free from undue government overreach and interference and a socialist conception of individual rights and property, where the interests of the collective take primacy over the interests of the individual. The trend towards purposive interpretation of tax avoidance and vague and broadly applicable provisions is not just a government response to a perceived failure of pre-GAAR anti avoidance mechanisms. It is indicative of a shift away from classical liberal values towards socialist collectivism. To protect individual liberties and property rights, we must be aware of such encroachments in all areas of public policy. While GAAR may be a necessary evil to prevent a serious erosion of the tax base in our current system, in order to protect citizen's rights, the courts should presume a high degree of Parliamentary ability and foresight when applying GAAR including the test for misuse and abuse. This will ensure that the balance continues to be tipped, if ever so slightly, towards individual and property rights and away from unrestrained government action. This does not mean rejecting the test put forward in *Canada Trustco*, rather it involves an overarching recognition in its application that with matters where property rights are put at risk, special consideration is warranted.

END NOTES

[1] *Income Tax Act*, RSC 1985, c 1

[2] *Commissioners of Inland Revenue v. Duke of Westminster*; HL 1935 [hereafter *Duke of Westminster*].

[3] *Stubart Investments Ltd. v. R* [1984] 1 S.C.R. [hereafter *Stubart*].

[4] *Income Tax Act*. *Supra*. Section 245(4)

[5] Joel Nitikman, "Is GAAR Void for Vagueness?" (1989) 37:6 Canadian Tax Journal 1409-47.

[6] David Crerar, "Interpretations of GAAR: Before and Beyond McNichol and RMM," (1997) 23 Queens Law Journal 231-257. Page 256.

[7] Alan M. Schwartz, Q.C., "GAAR Interpreted: The General Anti-Avoidance Rule" (Toronto: Thompson Carswell 2006).

[8] *Income War Tax Act*, 1917, S.C. 1917, c. 28, s. 11.

[9] Schwartz. *Supra*.

[10] Brian J. Arnold "Reflections on the Relationship Between Statutory Interpretation and Tax Avoidance" in Tax Avoidance in Canada: The General Anti-Avoidance Rule (Toronto: Irwin Law 2002). Cited in Schwartz. *Supra*. Page 1-2.

[11] *Income War Tax Act*. *Supra*. Cited in Schwartz. *Supra*. Page 1-5.

[12] *Income Tax Act*, RSC 1985

[13] Schwartz. *Supra*. Page 1-5.

[14] *Ibid*. Page 1-4.

[15] Peter W. Hogg, Joanne E. Magee, Jinyan Li, "Principles of Canadian Income Tax Law 8th Edition" (Toronto: Carswell 2013). Page 652.

[16] *Ibid*. Page 654.

[17] Defined in *Snook v. London & West Riding Investments Ltd*. [1967] 1 All E.R. 518 (C.A.) and adopted in Canada by the Supreme Court in *M.N.R. v. Leon* [1976] C.T.C. 532, 76 D.T.C. 6299 (F.C.A.).

[18] Schwartz. *Supra*. Page 1-6.

[19] *Ibid*.

[20] *Ibid*. Pages 1-7, 1-8.

[21] *Queen v*. *Daly* [1981] C.T.C. 270, 81 D.T.C. 5197 (F.C.A)

[22] *Ibid*. 5204. As cited in Schwartz. *Supra*. Page 1-8.

[23] Schwartz. *Supra*. Page 1-9.

[24] H. Kellough & P. McQuillan, Taxation of Private Corporations and Their Shareholders (Toronto: Canadian Tax Foundation, 1983) at 21. As cited in Schwartz. *Supra*. Page 1-9.

[25] Schwartz. *Supra*. Page 1-10.

[26] *Ibid.* Page 1-12.

[27] *Furniss (Inspector of Taxes) v. Dawson D.E.R.* [1984] A.C. 474. Page 517. As cited in Schwartz. *Supra*. Page 1-11.

[28] Schwartz *Supra*. Page 1-11.

[29] *Ibid*.

[30] *Commissioners of Inland Revenue v*. *Duke of Westminster*. *Supra*.

[31] *Ibid*. Page 19.

[32] *Ibid*. Pages 24-25.

[33] Arnold. "Reflections on the Relationship Between Statutory Interpretation and Tax Avoidance." *Supra*. Page 6.

[34] *Ibid*. Page 537. Para A. [Emphasis added].

[35] Crerar. *Supra*. Page 234 Para 4.

[36] *Ibid*. Page 538 Para J.

[37] *Ibid*. Page 578 Para D.

[38] Arnold. "Reflections on the Relationship Between Statutory Interpretation and Tax Avoidance" *Supra*. Page 6.

[39] *Income Tax Act*, RSC 1985, c 1 (5th Supp)

[40] *Excise Tax Act*, RSC 1985, c E-15

[41] *Alberta Personal Income Tax Act*, RSA 2000, c A-30. Part 4.1.

[42] *Income Tax Act*, RSO 1990, c I.2. Section 5.

[43] Schwartz. *Supra*. Section 2.

[44] Hogg. *Supra*. Page 658.

[45] Hogg. *Supra*. Page 658.

[46] Schwartz. *Supra*. Section 2.

[47] Nitikman. *Supra*.

[48] Arnold, B.J. "The Long Slow, Steady Demise of the General Anti-Avoidance Rule" (2004), 52 Canadian Tax Journal 488-511.

[49] *Canada Trustco Mortgage Co v. Canada*. *Supra*. Note 4 at Paras 77 and 91 (TCC). As cited in Arnold. "The Long Slow, Steady Demise of the General Anti-Avoidance Rule" *Supra*.

[50] *Fredette v. The Queen*, [2001] 3 CTC 2468. Note 4 at Para 76. Cited in Arnold, B.J. "The Long Slow, Steady Demise of the General Anti-Avoidance Rule" *Supra*.

[51] *OSFC Holdings Ltd. v. The Queen,* [2001] 4 CTC 82. Note 4 at Para 69, quoted with approval in Water's Edge, supra note 4, at paragraph 52. As cited in Arnold, B.J. "The Long Slow, Steady Demise of the General Anti-Avoidance Rule." *Supra*.

[52] *McNichol v. The Queen*, [1997] 2 CTC 2088 (TCC), note 3, at paragraph 23. As cited in Arnold, B.J. "The Long Slow, Steady Demise of the General Anti-Avoidance Rule" *Supra*. Page 4-5.

[53] Jinyan Li and Thaddeus Hwong. "GAAR in Action: An Empirical Exploration of Tax Court of Canada Cases," (2013), vol. 61, no. 2 Canadian Tax Journal, 321-366. Page 7.

[54] The Honourable Donald G.H. Bowman with Al Meghji and J. Scott Wilkie, "A Fireside Chat with the Chief Justice of the Tax Court of Canada" (2010) 58, special supp. Canadian Tax Journal 29-40, at 35. 2013 CTJ 2 321 Footnote -18 GAAR in Action: An Empirical Exploration of Tax Court Cases (Li, J. and T. Hwong). Special Supplement to mark the retirement of Donald Bowman as chief justice of the Tax Court of Canada as cited Li and Hwong. *Supra*. Page 7.

[55] Arnold. "The Long Slow, Steady Demise of the General Anti-Avoidance Rule" *Supra*. Pages 5-6.

[56] *RMM Canadian Enterprises Inc. v. R.*, 97 D.T.C. 302 (T.C.C)

[57] *McNichol et al. v. R.*, [1997] 2 C.T.C. 2088, 97 D.T.C. 111 (T.C.C.)

[58] *Ibid*. Page 21.

[59] *RMM Canadian Enterprises Inc. Supra*. Page 12.

[60] *Ibid*. Page 26.

[61] *Canada Trustco Mortgage Co v. Canada*, [2005] 2 SCR 601

[62] *Mathew v. Canada*, 2005 SCC 55

[63] *Canada Trustco. Supra*. Page 612-13. Para. 17.

[64] *Ibid*. Page 622. Section 47.

[65] *Ibid*. Page 625. Section 55.

[66] *Ibid*. Page 27. Para. 60

[67] *Ibid*. Page 630 Para 66.

[68] *Mathew v. Canada. Supra*.

[69] *Ibid*. Page 667. Para. 62.

[70] *Ibid. Supra*. Page 661. Para. 47.

[71] *Lipson v. Canada*, 2009 SCC 1

[72] *Ibid*. Page 22. Para 34.

[73] *Ibid*. Page 22. Para 34.

[74] *Copthorne Holdings Ltd. v. Canada*, 2011 SCC 63

[75] *Ibid*. Page 738 Para. 40.

[76] *Ibid*. Page 738 Para. 41.

[77] *Husky Energy Inc. v. Alberta*, 2012 ABCA 231

[78] *Ibid*. Page 6 Para. 13.

[79] *Ibid*. Page 14. Para. 59.

[80] Nitikman. *Supra*. Page 37.

[81] *British Columbia Railway Co. v. The Queen* 79 DTC 5020, at 5025 (FCTD), quoting Adam Smith, The Wealth of Nations (1776), book V, chapter II, part II (New York: Methuen, 1961), 350-51. Cited in Nitikman. *Supra*. Page 37.

[82] *Husky Energy Inc. v. Alberta. Supra.* Page 659. Para. 5.3.1.

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APPENDIX A
INCOME TAX ACT SECTION 245

Definitions
245. (1) In this section,

"tax benefit" « avantage fiscal »
"tax benefit" means a reduction, avoidance or deferral of tax or other amount payable under this Act or an increase in a refund of tax or other amount under this Act, and includes a reduction, avoidance or deferral of tax or other amount that would be payable under this Act but for a tax treaty or an increase in a refund of tax or other amount under this Act as a result of a tax treaty;

"tax consequences" « attribut fiscal »
"tax consequences" to a person means the amount of income, taxable income, or taxable income earned in Canada of, tax or other amount payable by or refundable to the person under this Act, or any other amount that is relevant for the purposes of computing that amount;

"transaction" « opération »
"transaction" includes an arrangement or event.

General anti-avoidance provision
(2) Where a transaction is an avoidance transaction, the tax consequences to a person shall be determined as is reasonable in the circumstances in order to deny a tax benefit that, but for this section, would result, directly or indirectly, from that transaction or from a series of transactions that includes that transaction.

Avoidance transaction
(3) An avoidance transaction means any transaction

(a) that, but for this section, would result, directly or indirectly, in a tax benefit, unless the transaction may reasonably be considered to have been undertaken or arranged primarily for *bona fide* purposes other than to obtain the tax benefit; or

(b) that is part of a series of transactions, which series, but for this section, would result, directly or indirectly, in a tax benefit, unless the transaction may reasonably be considered to have been undertaken or arranged primarily for *bona fide* purposes other than to obtain the tax benefit.

Application of subsection (2)
(4) Subsection (2) applies to a transaction only if it may reasonably be considered that the transaction

(a) would, if this Act were read without reference to this section, result directly or indirectly in a misuse of the provisions of any one or more of

(i) this Act,
(ii) the Income Tax Regulations,
(iii) the Income Tax Application Rules,
(iv) a tax treaty, or
(v) any other enactment that is relevant in computing tax or any other amount payable by or refundable to a person under this Act or in determining any amount that is relevant for the purposes of that computation; or

(b) would result directly or indirectly in an abuse having regard to those provisions, other than this section, read as a whole.

Determination of tax consequences
(5) Without restricting the generality of subsection (2), and notwithstanding any other enactment,

(a) any deduction, exemption or exclusion in computing income, taxable income, taxable income earned in Canada or tax payable or any part thereof may be allowed or disallowed in whole or in part,

(b) any such deduction, exemption or exclusion, any income, loss or other amount or part thereof may be allocated to any person,

(c) the nature of any payment or other amount may be recharacterized, and

(d) the tax effects that would otherwise result from the application of other provisions of this Act may be ignored, in determining the tax consequences to a person as is reasonable in the circumstances in order to deny a tax benefit that would, but for this section, result, directly or indirectly, from an avoidance transaction.

Request for adjustments
(6) Where with respect to a transaction

(a) a notice of assessment, reassessment or additional assessment involving the application of subsection 245(2) with respect to the transaction has been sent to a person, or

(b) a notice of determination pursuant to subsection 152(1.11) has been sent to a person with respect to the transaction, any person (other than a person referred to in paragraph (a) or (b)) shall be entitled, within 180 days after the day of sending of the notice, to request in writing that the Minister make an assessment, reassessment or additional assessment applying subsection (2) or make a determination applying subsection 152(1.11) with respect to that transaction.

Exception
(7) Notwithstanding any other provision of this Act, the tax consequences to any person, following the application of this section, shall only be determined through a notice of assessment, reassessment, additional assessment or determination pursuant to subsection 152(1.11) involving the application of this section.

Duties of Minister
(8) On receipt of a request by a person under subsection 245(6), the Minister shall, with all due dispatch, consider the request and, notwithstanding subsection 152(4), assess, reassess or make an additional assessment or determination pursuant to subsection 152(1.11) with respect to that person, except that an assessment, reassessment, additional assessment or determination may be made under this subsection only to the extent that it may reasonably be regarded as relating to the transaction referred to in subsection 245(6).

NOTE: Application provisions are not included in the consolidated text; see relevant amending Acts. R.S., 1985, c. 1 (5th Supp.), s. 245; 2005, c. 19, s. 52; 2010, c. 25, s. 68.