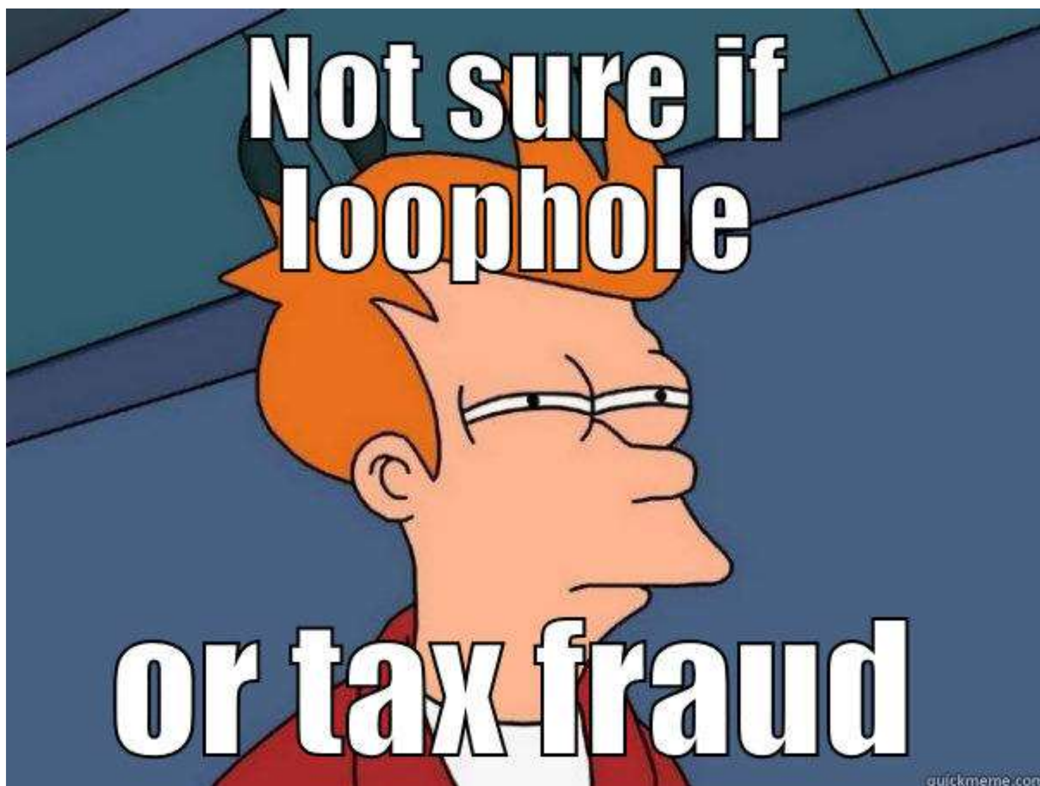
GAAR CASES



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Jonathan L. Richler
Ian Pryor
Nancy Thandi

Introduction

- GAAR is now almost 32 years old
- We have about 60 decided GAAR cases (incl 4 SCC decisions)
- We have statistics on GAAR Committee cases and rulings
- We have studies of GAAR in action
- So, we have a track record
- What can we learn?

Outline

- GAAR Process
- "Tax Benefit" and "Avoidance Transaction" (N Thandi)
- Selected Cases on "Misuse and Abuse" (J Richler & I Pryor)
- GAAR Statistics
- Lessons
- Final Reflections (M Cadesky)

- Auditor in Tax Services Office identifies transaction
- Auditor refers to Aggressive Tax Planning Division of CRA (ATPD) – Taxpayer given opportunity to respond
- Sometimes ATPD identifies transactions on its own, in course of reviewing applications for clearance certificates, rollovers, foreign reporting
- ATPD is "gatekeeper" to ensure consistent application of GAAR
- If ATPD concludes that GAAR may apply it refers to GAAR Committee in Ottawa

GAAR Process (cont'd)

- GAAR Committee comprises members from CRA, Dept of Finance and Dept of Justice
- Meets bi-weekly
- GAAR Committee decides whether to apply GAAR and, if necessary, litigate

- Pre-*Canada Trustco* (SCC 2005) – much confusion on how to apply and interpret GAAR
- *Canada Trustco* clarified requirements for applying GAAR

Canada Trustco SCC 2005

- 3 requirements must be established:

(1) Must have "tax benefit"

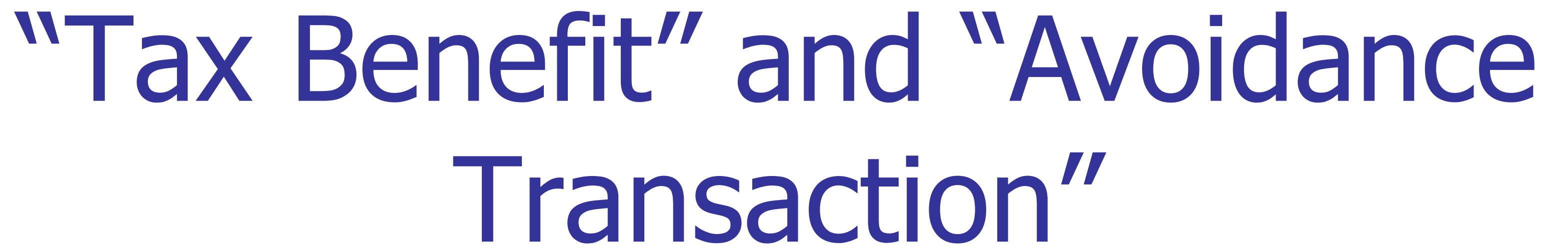
(2) Must have an "avoidance transaction"

(3) Transaction must be abusive ("misuse" or "abuse")

- Onus on Taxpayer to refute (1) and (2). Onus on Minister to establish (3)
- Benefit of doubt goes to Taxpayer
- Courts use "textual, contextual and purposive" analysis of provisions giving rise to tax benefit to determine why they were out in place and why benefit was conferred
- Having only a tax purpose is insufficient by itself to establish abusive tax avoidance
- Abusive tax avoidance may be found where relationships and transactions lack a proper basis

GAAR Cases in Practice

- “Tax benefit” almost always found (or conceded)
- Likewise, “avoidance transaction”
- Most GAAR cases turn on “misuse” and “abuse” per ITA 245(4) -75% according to CRA statistics



"Tax Benefit" and "Avoidance Transaction"

- First two conditions under GAAR before getting to "misuse or abuse"
- Onus is on Taxpayer – *Canada Trustco*
- Not as many cases focus on these 2 conditions but there are some

#
“Tax Benefit”

- Defined in ss. 245(1):
  - *“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 Benefit”

- Cases where Taxpayer won
  - *1245989 Alberta (Wild) v. Canada, 2018 FCA 114*
    - PUC grind in s. 84.1 circumvented – PUC and ACB stepped up tax-free
  - *The Bank of Montreal v. The Queen, 2018 TCC 187*
    - Complex case – ss. 39(2) applied to deem a FX loss on disposition of shares to be a capital loss from disposition of currency, not ss. 112(3.1)
  - *Univar Canada Ltd. v. The Queen, 2005 TCC 723*
    - Complex case - no alternative arrangement could be proven by the CRA to indicate that there had been a reduction in tax

“Tax Benefit”

- Cases where Taxpayer lost
  - *Deans Knight Income Corporation v. The Queen, 2019 TCC 76*
    - Tax attributes (non-cap losses, SRED, ITCs) used to shelter post-IPO income
  - *Gervais, G. v. The Queen, 2018 FCA 3*
    - Taxpayer sold/gifted shares to spouse, who sold to 3rd party for a capital gain and used LCGE
  - *Fiducie financiere Satoma v. Canada, 2018 FCA 74*
    - Family trust received dividends tax-free through ss. 112(1) and ss. 75(2)
  - *Canada v. 594710 British Columbia Ltd., 2018 FCA 166*
    - Redemption and stock dividend transactions - TCC concluded that there was no tax benefit, FCA overturned this decision

"Tax Benefit" – Key Lessons

- Comparison with an alternative arrangement – choosing an option which results in less tax proves the existence of a tax benefit
  - *Canada Trustco, Copthorne, McNichol, Univar Canada*
- A transaction cannot be portrayed as something which it is not, and cannot be recharacterized to make it an avoidance transaction
  - *Canada Trustco, Univar Canada, Canadian Pacific Ltd.*

"Tax Benefit" – Key Lessons (cont'd)

- Importance of **who** is getting the tax benefit
  - *Fiducie Financiere Satoma* – looking at Trust as the taxpayer, not the beneficiaries
- Tax benefit needs to be actually realized as a result of the transactions – cannot just be a future benefit (i.e. an increase in tax attributes)
  - *OSFC Holdings, 1245989 Alberta, Copthorne*

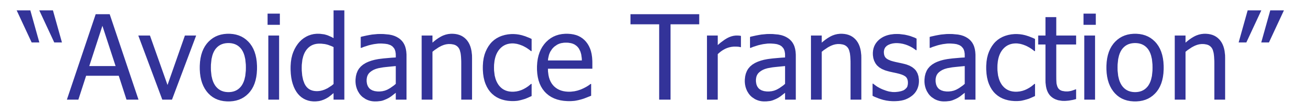
- Defined in ss. 245(3):

"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.”

“Avoidance Transaction”



- Cases where Taxpayer won
  - *Loblaw Financial Holdings Inc. v. The Queen 2018 TCC 182*
    - Avoiding FAPI was a factor, but there were other non-tax purposes which held more weight
  - *Spruce Credit Union v. R, 2014 FCA 143*
    - Purpose of dividends paid from a deposit insurance corporation to member credit unions was to fund certain required payments (not tax)
  - *Swirsky v. R, 2013 TCC 73*
    - Tax benefits were found to be incidental - primary purpose was creditor protection
  - *McClarty Family Trust v. R, 2012 TCC 80*
    - Creditor protection was the primary purpose

*Swirsky and Loblaw – GAAR analysis is obiter

“Avoidance Transaction”

- Cases where Taxpayer lost
  - *Gervais, G. v. The Queen, 2018 FCA 3*
    - Previously discussed
  - Canada v. Oxford Properties Group Inc., 2018 FCA 30
    - Jonathan to discuss in detail – main focus is on misuse or abuse
  - *Global Equity Fund Ltd. v. R., 2012 FCA 272*
    - Loss on disposition of shares denied – tax was primary purpose, not creditor protection
  - *1207192 Ontario Ltd. v. R, 2012 FCA 259*
    - There was a bona fide non-tax purpose for the series (creditor protection), but some individual transactions NOT done for this purpose
  - *Triad Gestco Ltd. v. R., 2012 FCA 258*
    - Purpose of entire series was to obtain a tax benefit, not to implement a reverse freeze

“Avoidance Transaction” – Key Lessons

- Not just testing a series – even if one transaction in a series has tax as a primary purpose, entire series is caught
  - *MacKay, Gervais, 1207192 Ontario, Oxford*
- If the entire series has tax as a primary purpose, the individual transactions must also have the same purpose
  - *Global Equity Fund*
- The taxpayer cannot avoid GAAR by just stating that they had a primary non-tax purpose – judge needs to weigh the evidence objectively
  - *Canada Trustco, Global Equity Fund*
- Quality of evidence – written and oral – is critical (consistency, plausibility, credibility, etc.)

"Avoidance Transaction" – Key Lessons (cont'd)

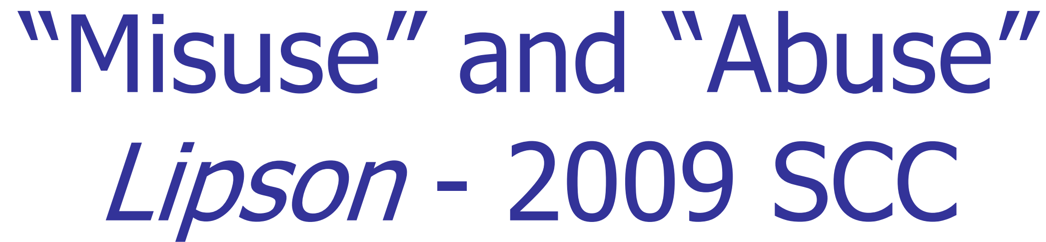
- Non-tax purpose does not just mean business purpose – can have others e.g. family or investment purposes
  - *Canada Trustco*
- Comparison with alternative arrangement does **not** = avoidance transaction (but can be **a** factor)
  - *Spruce Credit Union, Canada Trustco, Copthorne*
- If there are tax and non-tax purposes, need to determine if non-tax purpose was primary
  - *Canada Trustco*

"Misuse" and "Abuse" *MIL Investments* - 2007 FCA

- In 1996, a non-resident TP sold shares of a Canco (DFR) to another Canco (Inco)
- Gain was exempt from Cdn tax under Article XIII of *Canada-Luxembourg Treaty* (and Luxembourg does not tax capital gains)
- Although at time of sale MIL was resident of Luxembourg and owned < 10% of shares of DFR, it had started out as a Caymans Island corp and initially owned 29.4% of DFR
- MIL had continued into Luxembourg and reduced its shareholdings to below the 10% threshold through a sale of a portion of the DFR shares to Inco in exchange for shares of Inco on a tax-deferred basis

“Misuse” and “Abuse” *MIL Investments* - 2007 FCA

- CRA attempted to apply GAAR
- HELD (by TCC and FCA). GAAR does *not* apply. No misuse or abuse of Act or Treaty.
- Treaty clearly intends to exempt non-residents from Canadian CG tax on disposition of treaty exempt property (i.e. shares)
- TCC held it was not even an “avoidance transaction” but this is questionable since the continuation into Luxembourg was clearly a tax-motivated decision (and TP conceded in FCA that it was an “avoidance transaction”)
- CRA argued that Treaty should not be permitted to permit double non-taxation. Court gave short shrift to that argument.



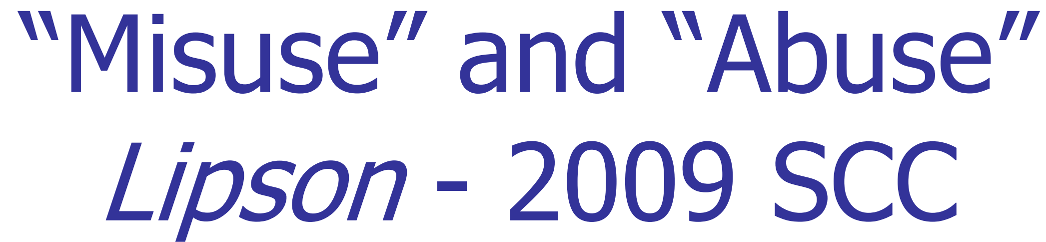
"Misuse" and "Abuse" *Lipson* - 2009 SCC

GOAL: To make mortgage interest deductible to H

PLAN:

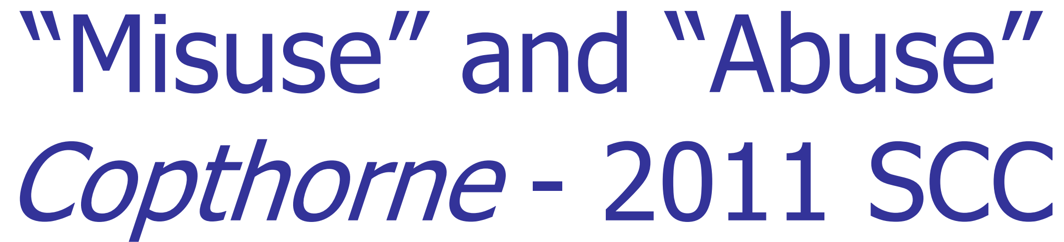
- W borrows $562K from Bank to purchase shares in family investment co. Share loan is repayable the next day
- H transfers shares to W on rollover basis
- 1 day later H & W purchase home and take out mortgage for $562K
- W's share purchase loan repaid with mortgage proceeds
- Over next 3 yrs H reports $54K of dividends on shares but deducts $105K of mortgage loan interest to create an overall loss – relying on attribution provisions

HELD (4-3) aff'g FCA and TCC: GAAR *applies*



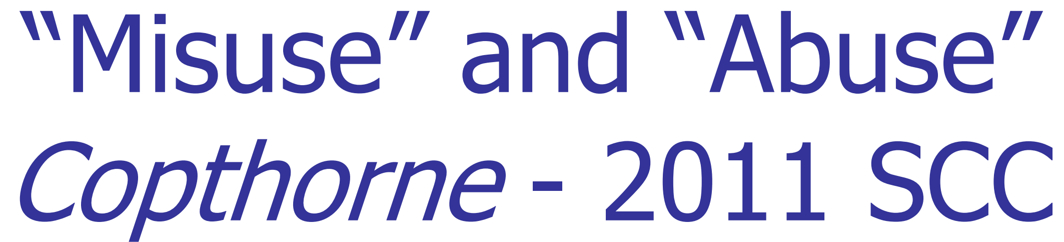
“Misuse” and “Abuse” *Lipson* - 2009 SCC

- Cycling home mortgage interest to make it deductible is ok, but H’s use of the spousal rollover and the spousal attribution provisions of ITA to attribute loss from W to H is a misuse that violates GAAR.
- 2 dissenting judgments



“Misuse” and “Abuse”
Copthorne - 2011 SCC

- Very complex facts – but basically involved an artificial increase to the paid-up capital of a Canco by $67M through a series of amalgamations and the return of PUC to a non-resident shareholder (by a redemption of shares for an amount that did not exceed PUC) without Cdn withholding tax
- Instead of amalgamating 2 Cdn cos in a vertical amalgamation, shares of Canco were transferred to a non-resident corp and then the 2 Cancos amalgamated. This allowed PUC of Canco sub to be retained.



"Misuse" and "Abuse" *Copthorne* - 2011 SCC

- The increase to PUC did not offend any technical provision of ITA
- SCC held (unanimously) that the amalgamations and redemption were all part of the same series. GAAR *applied.*
- To allow the same cross-border PUC to be used twice frustrated the purpose of the rules that would have cancelled PUC of one of Cancos in a vertical amalgamation

"Misuse" and "Abuse" *Global Equity Fund* - 2012 FCA

- TP, Global, was a trader in securities.
- Global is sole SH of Newco, held common shares that it subscribed for $5.6 million
- Newco declared high-low stock dividend (pref shares with a redemption value of $5.6 million and PUC of $56)
- Global sells common shares to a children's trust (children of principal of Global) and claimed a $5.6 million loss

"Misuse" and "Abuse" *Global Equity Fund* - 2012 FCA

- HELD: GAAR *applied*
- "Loss was a paper loss only"
- "Transactions were vacuous and artificial"
- "No air of business or economic reality was associated with the loss"
- Transactions which created the loss defeated the underlying rationale of the sections of the ITA that allow for use of business losses

GAAR Statistics (to 2012)

GAAR Statistics – up to October 30, 2012

Issue	GAAR Applied
Surplus strips	26
Losses creation via stock dividend	26
Kiddie Tax	12
Miscellaneous	7
Income Splitting	6
Losses, capital and non-capital	4
Tower structure	2
Offshore trusts	1
Charitable donations	1
Interest deductibility	3
Total	88

Statistics published by GAAR Committee - March 2012

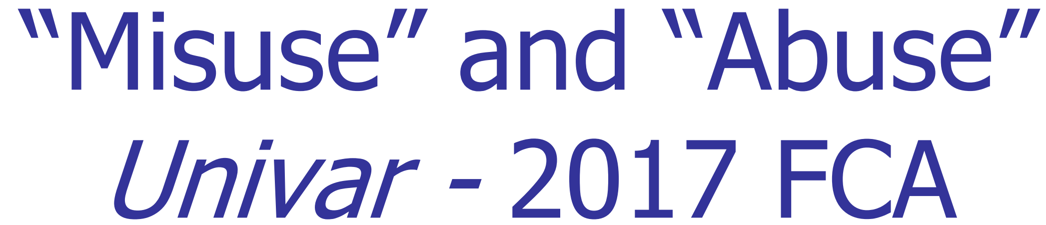
Issue	No. of GAAR cases referred to Committee	Committee held GAAR Applied	%
Surplus strips	180	148	82
Losses	162	138	85
Income splitting (w Kiddie Tax)	109	100	92
International	101	81	80

"Misuse" and "Abuse" *Gwartz* - 2013 TCC

- TPs (Brianne and Steven) were children of a dentist (Dr. Mark)
- Dr. Mark's dental mgmt co issues pref shares to a family trust as a stock dividend
- Trust sells shares to Dr. Mark
- Allocates CGs to beneficiaries who are minor children

"Misuse" and "Abuse" *Gwartz* - 2013 TCC

- Even though technical compliance with "kiddie tax" (before amendments), CRA alleged that GAAR applies
- HELD – GAAR does *not* apply
- No general policy in Act against surplus stripping or income splitting
- Act contains many specific anti-avoidance rules. If those rules successfully navigated – no "misuse" or "abuse"
- GAAR cannot be used to "fill gaps"

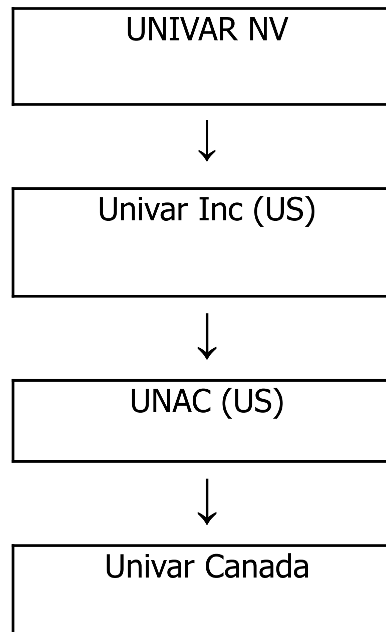


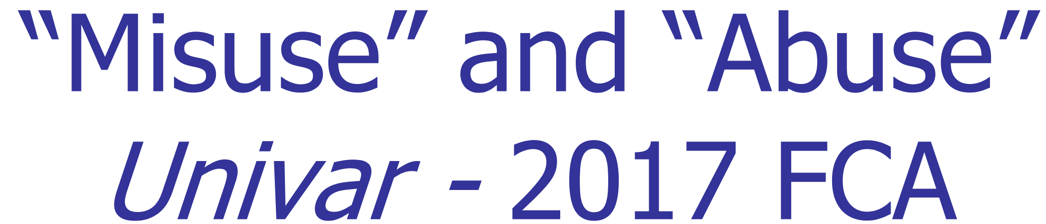
"Misuse" and "Abuse" *Univar* - 2017 FCA

<u>FACTS</u>

- Univar NV ("DutchCo") was a Dutch public company.
- Univar Canada Ltd. ("Univar Canada") was part of the Univar Group. Its shares were held by a Washington corp, Univar North American Corporation (UNAC US), all the shares of which were held by a Delaware corp , Univar Inc. ("Univar US"). All the shares of Univar US were held by DutchCo.
- Univar Canada shares had an ACB of $10,000, PUC of $911,729 and FMV of $889M.
- CVC Capital Properties, a UK private equity firm ("CVC") wished to acquire all the shares of Univar NV (and thereby acquire Univar Canada) and then to extract the corp surplus of the Cdn corp without Cdn tax.

"Misuse" and "Abuse"
Univar - 2017 FCA





- Prior to acquisition of Univar NV shares by CVC, Univar Holdco Canada ULC (“ULC”) was incorporated.
- Through a series of sales and amalgamations, including a sale by Univar US (which had amalgamated with UNAC US) of its shares in Univar Canada to ULC, Univar US ended up with a Note payable in ULC for $589,262,400 and with 100% of the shares of ULC having a PUC of $302,436,000 (Total: $891,698,400).
- Shareholdings were reorganized so that immediately prior to the sale by Univar US of its Univar Canada shares to ULC, ULC controlled Univar US.
- Univar US then stripped the surplus of Univar ULC.
- Univar US relied on Article XIII of Canada-US Treaty to exempt it from the resulting capital gain on the sale of shares of Univar Canada to ULC.
- It also relied on the exception in ss. 212.1(4) to avoid deemed dividend that would otherwise have arisen under ss. 212.1(1) on the sale.
- At time of hearing (although not at time of transactions), 2016 amendments to 212.1(4) were proposed which would have caught these transactions (and which now do).
- CRA assessed under GAAR. TCC held for the Minister. TP appealed.

CRA's position

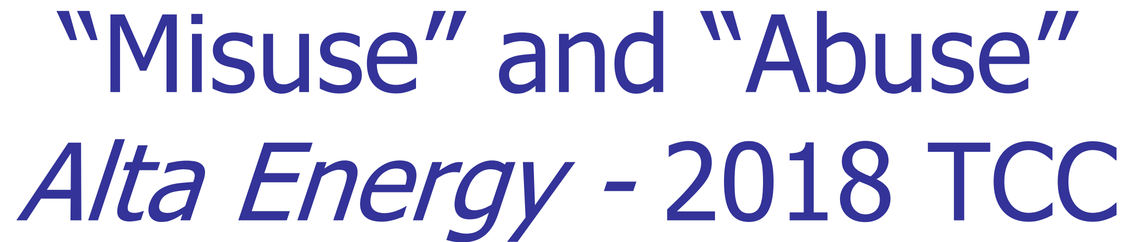
- Clearly, there is a "tax benefit". Also, the sale of Univar Canada shares is an "avoidance transaction".
- There is misuse of ss. 212.1(1) & (4).
- Policy of 212.1 is to prevent extraction of corporate surplus by non-residents (same as 84.1 for residents). TP has triggered a CG and then relied on Treaty.
- 2016 amendments (then proposed, now passed) show this.

TP's position

- Acknowledged there was a "tax benefit".
- Acknowledged that sale by Univar US of Univar Canada shares to ULC was an "avoidance transaction".
- However, this was not a misuse of ss. 212.1(1) of the Act, since ss. 212.1(4) (as it then read) provides an exception into which the TP fell.
- Could have achieved same result without GAAR by using a Cdn AcquisitionCo.

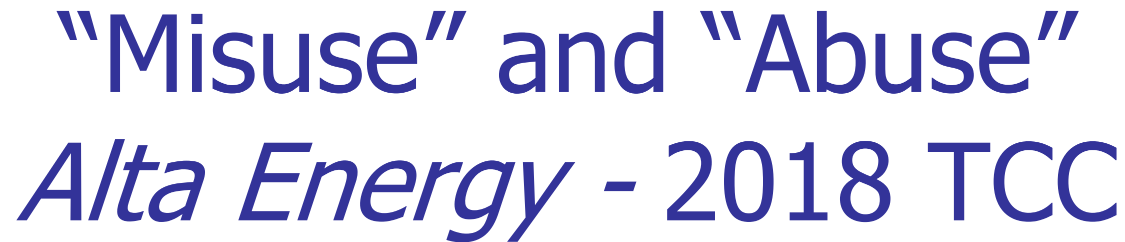
HELD: Appeal allowed. *GAAR does not apply*.

- In GAAR, onus is on Minister to show that "misuse" or "abuse" has occurred (per *Copthorne*). Minister has not discharged this onus.
- s. 212.1 does not cover all transactions. There is exception in 212.1(4). If TP falls into exception, can't say there is a "misuse" or "abuse".
- TCC erred in not taking into account that transactions could have been structured in a way that would have achieved same result and not triggered GAAR (through use of a Canadian AcquisitionCo).
- Proposed amendments to 212.1(4) do not necessarily support the argument that GAAR applies without them. On the contrary, they could demonstrate that GAAR does not apply, for otherwise, they would not have been necessary. Amendments that were proposed in 2016, 9 years after the transactions were completed, cannot be used to find that the transactions were abusive.
- Comparison of ss. 84.1 and 212.1 is misplaced. Both sections deal with sales of shares to NAL purchasers. In this case, the sale by Univar US of the Univar Canada shares was to an arm's length purchaser (ULC) (controlled by investors).



"Misuse" and "Abuse"
Alta Energy - 2018 TCC

- Alta LP was Canadian partnership that owned Alta Lux, a Luxembourg corporation. Alta Lux was Respondent.
- Alta Lux owned Alta Canada, a Canadian corporation, which had rights to explore and drill in Alberta, in addition to government licenses.
- Oil and gas is owned by Alberta government but they grant leases and licences. Alberta maintains ownership of land.
- Alta Lux sold the shares of Alta Canada.
- CRA assessed the shares as TCP and taxpayer conceded because more than 50% of FMV was derived, directly or indirectly, from Canadian resource property.
- Pursuant to Article 13(4) of Treaty Canada has right to tax gains from disposition of shares where they derive their value from real property in Canada, EXCEPT where the business of the corporation is carried on in the property ("Excluded Property")
- Article 13(5) says that if not caught under 13(1) to (4) then gain only taxable in resident country.
- Taxpayer argued that rights were Excluded Property and due to 13(5) shares were "treaty protected property" so not TCP.
- CRA argued no Excluded Property.
- TCC held property was treaty protected property and therefore Excluded Property.
- CRA argued GAAR should apply.



"Misuse" and "Abuse" *Alta Energy* - 2018 TCC

- Tax benefit and avoidance conceded.
- Question was whether there was misuse or abuse of Treaty.
- CRA asserted that Luxco shouldn't benefit from Treaty b/c no tax paid in Lux, that Luxco was conduit despite being beneficial owner, and treaty shopping.
- Treaty contained treaty shopping provision that didn't apply.
- TCC provided "[CRA] is seeking to apply the GAAR in order to deal with what Finance now believes is an unintended gap in the Treaty"
- Referred to *Garron* case and quoted:

  The problem that I have with this argument is that, if accepted, it would result in a selective application of the Treaty to residents of [a country] <u>depending on criteria other than residence</u>. It seems to me that this is contrary to the object and spirit of the Treaty,

- TCC concluded that this was inappropriate and held GAAR did not apply to Treaty.

“Misuse” and “Abuse”
Gervais – 2018 FCA

- TP’s appeal dismissed. GAAR applies.
- Case involved a planning technique known as the “half loaf”.
- TP (G) sold $1 million of shares to his spouse for FMV and elected out of 73(1).
- TP also gifted other half of his shares to his spouse which was subject to 73(1).
- Spouse owned shares worth $2M which she then sold to an arm’s length purchaser. Because of cost base averaging, her ACB was $1M.

"Misuse" and "Abuse" *Gervais* – 2018 FCA

- Spouse realizes a CG of $1M, 1/2 of which ($500K) was taxable. G reports 1/2 of this taxable gain (i.e. the gifted portion), or $250K, taking the position that this portion is attributed to him.
- The other half of the taxable gain was reported by the spouse, but was sheltered by her lifetime CG deduction.
- TCC held that GAAR applied. FCA affirmed. The entire gain should have been attributed to G. Court went through the analysis of the 3 GAAR conditions ("benefit", "avoidance transaction" and "misuse or abuse") and concluded that this series of transactions frustrated the purpose of 73(1) and 74.2(1) of the Act, which was to ensure that the gain or loss deferred by reason of a transfer between spouses be attributed back to the transferor.

“Misuse” and “Abuse” *Oxford Properties* - 2018 FCA

- Oxford is a publicly traded Canadian real estate firm
- Oxford rolled 3 real estate properties through a tiered partnership structure under 97(2)
- Increased ACB of partnership interests through 88(1)(d) bumps
- Then sold partnership interests to tax-exempt entities
- No tax paid on latent recapture or on accrued capital gains
- Minister alleged that GAAR applied (ITA 100(1) abused) and assessed on a recapture of $116M and a taxable capital gain of $32M (total $148M)
- Taxpayer won in Tax Court. Minister appealed
- HELD: *GAAR applied* (ITA 100(1) abused), but Minister’s reassessment under 245(5) was improper because reasonable GAAR consequences should apply only to recapture, not capital gain

“Misuse” and “Abuse”
Oxford Properties - 2018 FCA

- “Tax benefit“ and “avoidance transaction” conceded
- Only issue was ”misuse or abuse”
- GAAR requires an “object, spirit and purpose” analysis
- This can lead to different result than a traditional word-based textual, contextual and purposive interpretation of the meaning of enactment
- TP’s transactions may be in strict compliance with relevant provisions, but still frustrate object, spirit or purpose of relevant provisions. If so, GAAR applies
- Here, rollovers under 97(2) and bump under 88(1)(d) were strictly complied with, but 100(1), which is designed to ensure that tax is paid on a sale of a partnership interest, was frustrated because purchaser was tax-exempt. HELD: *GAAR applies, but TCG is $116M, not $148M*
- ITA was amended 100(1.1) to deal with sales of a partnership interest to an exempt entity

"Misuse" and "Abuse"
Fiducie Financiere Satoma - 2018 FCA

- Taxpayer was involved in distribution of pharmaceuticals, but wanted to expand into manufacturing as well.
- Wanted to use corporate funds to invest in manufacturing, but litigation risk was high.
- Entered into reorganization to assist with creditor proofing.
- Company 9134 was beneficiary of Trust
- 9134 made gift to Trust and Trust then used funds to subscribe for shares of 9163.
- 75(2) applied because shares of 9136 were substituted property contributed by beneficiary.
- Dividends were paid by 9163 to Trust. Trust allocated/paid dividends to 9134 which deducted under 112.
- 9134 then contributed funds directly to 9163 as contributed surplus. Another round of dividends were paid to Trust.
- Dividend income was then attributed to 9134. Due to 112 no tax payable in 9134.
- Funds remained in Trust and were not taxable to Trust. $6.25 million received by Trust. $4.575 million used to finance manufacturing business.

"Misuse" and "Abuse"
Fiducie Financiere Satoma - 2018 FCA

- Trust made no distributions to individual beneficiaries.
- CRA reassessed to include taxable dividends in income of Trust pursuant to 12(1)(j).
- TCC upheld reassessment.
- Taxpayer argued that no tax benefit had been realized to date because funds had not been distributed to beneficiaries (consistent with *OSFC Holdings*). As a result no abuse…yet.
- TCC disagreed. FCA found no palpable error because tax benefit was realized because no amount included in Trust income(?). Does this mean all trusts enjoy a tax benefit when a deduction is made under 104(6)?
- Seems like reasoning/understanding may be flawed – would benefit not be that amounts were added to capital without tax being paid (or exception being relied on)?
- Concluded abuse because taxable dividends had been transformed into "tax-paid dividends" by operation of 112.

"Misuse" and "Abuse"
1245989 Alberta (Wild) - 2018 FCA

Surplus Strip – Abuse or misuse

- Taxpayer implemented reorg to creditor proof assets of Opco. As part of series, PUC of shares was increased from $110 to $595,264 through various steps:
  - Taxpayer owned 100% of Opco common shares w FMV=$2,337,500; ACB/PUC=$110
  - Taxpayer also owned 100% of Holdco 1
  - Spouse owned 100% of Holdco 2
  - Taxpayer rolled (s.85) 15% of common shares of Opco to Holdco 2 w FMV=$348,500 and ACB/PUC=$16.40 for Freeze Shares and elected at $129,000
  - Taxpayer claimed CGE to shelter gain – ACB =$129,000 and PUC=$16.40 (due to 84.1)
  - Opco then rolled (s.85) equipment to Holdco 2 w FMV=$348,500 and UCC of ~$256,000. Elected at UCC. ACB/PUC of Freeze Shares=$256,000
  - Same class of Freeze Shares issued to Taxpayer and Opco the PUC was averaged and Taxpayer had PUC of ~$128,000 on his Freeze Shares
  - Holdco 2 and Opco both redeemed intercorporate shares w equal FMV. Issued P-Notes. Notes then offset.
  - Taxpayer rolled (s.85) remaining Opco common shares to Holdco 1 for Freeze Shares. Elected at $621,000 and claimed CGE.
  - Opco rolled (s.85) land and depreciable property to Holdco 1. Elected at UCC/ACB of ~$1,509,000. ACB/PUC of Freeze Shares reduced to ~$896,000 via 85(2.1).
  - Same class of Freeze Shares issued to Taxpayer and Opco, PUC averaging increased Taxpayer's PUC in Holdco 1 Freeze Shares to ~$467,000
  - Holdco 1 and Opco both redeemed intercorporate shares w equal FMV. Issued P-Notes. Notes then offset.
  - Taxpayer rolled (s.85) remaining shares of Holdco 2 to Holdco 1 with PUC of $129,000. Share were redeemed and P-Note issued in satisfaction.
  - Taxpayer held shares of Holdco 1 with PUC of $595,264

"Misuse" and "Abuse"
1245989 Alberta (Wild) - 2018 FCA

- TCC held that "no capital contribution was made"; "lifetime capital gains exemption was used" and "existing assets were merely shuffled from one entity to another" with no tax payable.
- TCC held that utilization of s.85 and 84.1 to average the PUC were avoidance transactions that defeated object of 84.1 and 89. Constituted abuse.
- FCA found that TCC erred and that 84.1 was not abused:
  - 84.1 is intended to prevent a tax-free distribution of R/E
  - No evidence of any distribution of R/E
  - Therefore no misuse or abuse of 84.1
- Court did not preclude Minister from reassessing if/when surplus eventual extracted.
- Same court found that NO abuse can be realized until distribution in *Satoma*. How do we reconcile these?

"Misuse" and "Abuse" *Pomerleau* - 2018 FCA

Surplus Strip

- Taxpayer is president of construction company (Opco) and wanted to build chalet w corporate funds.
- Holdco owned Opco and taxpayers family owned Holdco.
- Taxpayer and certain family members crystallized CGE as part of freeze several years prior (1989).
- Family rolled (s.85) Freeze Shares to new holdco (Newco) for 2 classes of shares of Newco (common and pref.) and elected at ACB. ACB was attributed to only 1 class (pref.)
- Family gifted their high ACB shares to Taxpayer and no tax resulted.
- High ACB was attributable to CGE claimed.
- Pref. shares redeemed and deemed dividend resulted for Taxpayer. Capital loss also resulted, but was added to the ACB of common shares (40(3.6) and 53(1)).
- Taxpayer then rolled common shares to personal holdco (Finco) in exchange for 2 classes of shares (common and pref.). ACB and PUC was allocated to pref.
- Pref. then redeemed for PUC of $1,993,812

"Misuse" and "Abuse" *Pomerleau* - 2018 FCA

- TCC found that $994,628 of $1,993,812 could be attributed to CGE of non-arm's length people.
- Benefit and avoidance transactions conceded.
- Object of 84.1 "…is to prevent amounts that have not been taxed from being used to remove corporate surplus on a tax-free basis."
- Cannot be held that link between CGE and surplus was broken by addition to ACB via loss.
- Judge did acknowledge that 84.1 can be punitive in the context of intergenerational transfers of family businesses…

“Misuse” and “Abuse” *Gladwin* – 2019 TCC

- Taxpayer corporation operated commercial real estate business.
- Taxpayer was owned by Holdco parent.
- Taxpayer intended to sell real estate property and plan was devised to pay funds out to shareholders tax-free via CDA.
- Plan involved transferring property to LP on tax-deferred basis and then selling property in LP. Half of gain was added to CDA.
- Second gain was realized via negative ACB created in LP interest and half of gain was also added to CDA. CDA = full gain on sale of property.
- Taxpayer elected to realize capital loss via 40(3.12) to offset against gain amount.
- This would no longer work as 89(1) was amended in 2013 to disallow additions to CDA for gains triggered by 40(3.1) and (3.12).

“Misuse” and “Abuse” *Gladwin* – 2019 TCC

- Transactions were designed to achieve result that was inconsistent with underlying rationale of 40(3.1) and (3.12). They were not intended to allow for the tax benefit achieved.
- Therefore there is abuse/misuse.
- GAAR applies.
- Under appeal to FCA

- Through a complicated series of transactions, a newly-launched public oil & gas co., Birchcliff, which was acquiring oil & gas properties, amalgamated with Veracel, an unrelated medical diagnostics co., that had accumulated $35M in tax losses (including $16M of business losses, R&D carryovers & ITCs).
- Rather than financing the oil & gas properties directly, private placement investors were told that they could subscribe for subscription receipts of Veracel instead.
- The subscription receipts would shortly thereafter be converted into Veracel Class B common shares as a transitory step under a Plan of Arrangement in which Veracel was then amalgamated with Birchcliff. No risk to investors since they would either convert into shares of Amalco or get their money back.

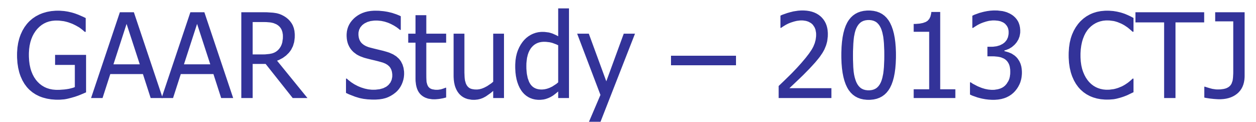
- As the investors received a majority voting equity interest in Amalco, the loss streaming rules otherwise engaged by ss. 256(7)(b)(iii)(B) and 111(5)(a) were avoided
- The original Veracel shareholders got a modest preferred share interest in Amalco, which was redeemed for cash.
- TCC found that this was a “manipulation of the shareholdings” of Veracel to avoid 256(7) and applied GAAR. FCA dismissed TP’s appeal.

Recent GAAR Statistics

- As of Sep, 2018 - 1,472 files referred to GAAR Committee (No stats after Sep 2018)
- Approx 80-100 new cases a year
- Committee has recommended that GAAR be applied in 79% of the cases (in 21% GAAR not applied)
- About 60 cases have been litigated. Overall, CRA and Taxpayer have each won about ½ the time, but CRA has won more cases recently
- 75% of cases turn on “misuse or abuse”

Where does GAAR usually apply?

- GAAR Committee has considered GAAR in following types of cases:
  - Surplus strips (GAAR usually applied)
  - Kiddie tax (GAAR usually applied)
  - Loss creation via stock dividend (GAAR almost always applied)
  - Income splitting (GAAR usually applied)
  - Cross-border lease (GAAR usually applied)
  - Part XIII tax (GAAR rarely applied)
  - Kiwi loan (GAAR usually applied)
  - Treaty exemption claim (GAAR usually applied)
  - Tower structure (GAAR usually applied)
  - Foreign tax credit (GAAR usually applied)
  - Offshore trusts (GAAR usually applied)



GAAR Study – 2013 CTJ

- Study on “GAAR in Action” by Jinyan Li and Thaddeus Hwong in 2013 Canadian Tax Journal
- Studied all TCC cases from 1997 to 2009
- Also studied personal & societal attributes of judges
- Consulted with Bowman CJTC
- Interested in process of judicial decision-making in GAAR cases and effects on tax practice

Lessons from GAAR Study

- GAAR has been a "game-changer", but a modest one re: court's approach to tax avoidance cases
- Although uncertainty remains, some patterns emerging
  1. GAAR consistently applied to loss utilization cases, but not others
  2. "tax benefit" conceded by most TPs
  3. "avoidance transaction" conceded since *Canada Trustco*
  4. "series of transaction" not controversial

Red Flags for GAAR

- Loss transfers (*Mathew*, *MacKay*)
- Synthetic losses (*Triad Gestco*, *1207192 Ont*)
- Naked surplus strip (*McNichol*, *Desmarais*)
- Some interprovincial tax arbitrage (*OGT Holdings*)
- Duplication of paid-up capital (*Copthorne*)
- Spousal rollover and mortgage (*Lipson*)
- Use of spousal attribution rules and LCGE to reduce capital gain (*Gervais*)

Red Flags for GAAR (cont'd)

- Using share redemption and 84.1 to avoid deemed dividend (*Pomerleau*)
- Using 75(2) and 112(1) to convert taxable dividends into non-taxable dividends (*Fiducie Fjnanciere Satoma*)
- Using a partnership and interposing a corporation between two companies to avoid s. 160 (*594710 British Columbia*)
- "Artificial" CDA increases (*Gladwin*)

GAAR held *<u>not</u>* to apply:

- Sale-leaseback (*Canada Trustco*)
- Surplus strip plus income splitting (*Evans*)
- Treaty shopping (*MIL Investments*)
- Tiered financing *(Univar, Bank of Montreal*)
- Interest coupon stripping (*Lehigh Cement*)
- Capital gain strip or hybrid assets and share sales (*Geransky*, *Donohue*, *McMullen*)

Lessons from the Cases

GAAR held <u>*not*</u> to apply (cont'd):

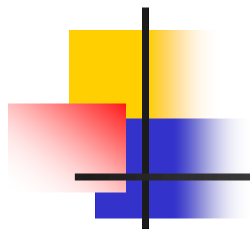
- Recognition of terminal loss (*Landrus*)
- Increase in PUC (*1235989 Alberta*)
- Reliance on Treaty provision allowing source state to tax gains on sale of shares where value derived principally from real estate (*Alta Energy*)
- Where specific FAPI rule is avoided (*Loblaw Financial*)

Lessons from the Cases

- Judicial decisions vary widely in GAAR cases, more than in other types of cases
- Hard to reconcile reasoning even from same court (FCA in *Satoma* and *Wild*)
- Factors that influence judicial decision-making in GAAR cases
  - gender
  - pre-appointment experience
  - regional ties
- Judicial "smell test" seems to be at play in some GAAR decisions

“*The 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 .. I think there continues to be a certain visceral element – people inelegantly call it the smell test, the olfactory factor, the gut reaction*”.

- Donald Bowman (former CJTC)



THANK YOU !!