Tapping into a quarter-century's judicial experience with the Canadian General Anti-avoidance Rule (GAAR): some insights for South Africa

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Abstract

Increased tax avoidance globally has led the Organisation for Economic Cooperation and Development (OECD), with the sanction of the G20 countries, to launch an action plan on Base Erosion and Profit Shifting (BEPS), to assist and support governments across the world in an endeavour to counter tax avoidance. Anti-avoidance measures include legislative, judicial and administrative techniques. This article reviews the use of the judicial approach adopted in Canada, as this country has a long-established General Anti-avoidance Rule (GAAR) and is considered to be at the forefront in combating abusive tax avoidance. Although the previous South African GAAR had led to numerous judicial decisions, the current GAAR provisions have not yet been considered by South African courts. Through an evaluation of the Canadian judiciary's quarter of a century experience with its GAAR, the article seeks to draw insights from the Canadian courts regarding the application of their GAAR. Notwithstanding the uncertainty surrounding the Canadian GAAR as a legal norm, it is submitted that the Supreme Court of Canada's seven-step guide to the application of the GAAR can assist South African courts to distinguish objectively between legitimate tax planning and abusive tax avoidance.

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INTRODUCTION

The Organisation for Economic Cooperation and Development (OECD) aims to improve international tax cooperation between governments. This is partly an attempt to counter international tax avoidance and evasion by identifying trends in international tax planning, and to assist governments to respond more quickly and effectively to emerging risks.[1] In furtherance of these goals, the OECD launched an action plan on Base Erosion and Profit Shifting (BEPS) in 2013. The BEPS initiative was endorsed by the governments of the G20 countries[2] and, therefore, it also applies to certain OECD non-member countries.

BEPS refers to tax planning strategies that 'exploit gaps in the architecture of the international tax system to artificially shift profits to places where there is little or no economic activity or taxation'.[3] In South Africa, the importance of combating BEPS is highlighted by the fact that the Davis Tax Committee has appointed a sub-committee specifically to address issues relating to BEPS.[4] Moreover, as the OECD's recommendations have become a globally accepted standard, and South Africa is a member of the G20 community, an argument could be advanced that South Africa is bound, in a way, to follow BEPS (thereby escalating its importance).

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[1] OECD *OECD's work on tax planning* (2015) at: http://www.oecd.org/ctp/aggressive/ (last accessed 20 July 2015).

[2] The G20 membership comprises a mix of finance ministers and central bank governors from twenty of the world's largest advanced and emerging economies. These countries are: Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Republic of Korea, Mexico, Russia, Saudi Arabia, South Africa, Turkey, the UK, the USA and the EU. Information available at ERLINK"https://g20.org/about-g20/g20-members/"*https://g20.org/about-g20/g20-members/* (last accessed 19 July 2015).

[3] Per OECD n 1 above. In terms of the BEPS Action Plan, there are four items to be addressed by the OECD Working Party 11 (Aggressive Tax Planning), *viz* Action 2: Neutralising the effects of hybrid mismatch arrangements; Action 3: Strengthening CFC rules; Action 4: Limiting base erosion via interest deductions and other financial payments; and Action 12: Requiring taxpayers to disclose their aggressive tax planning arrangements.

[4] The committee submitted its interim report to the Minister of Finance on 30 June 2014. See Davis Tax Committee *Addressing base erosion and profit shifting in South Africa – Davis Tax Committee interim report* (2014) at: https://www.google.co.za/url?sa=t&rct=j&q=&esrc=s&source=web&cd=3&cad=rja&uact=8&ved=0CCgQjBAwAmoVChMI0tinqb7pxgIVDBjbCh31nwC5&url=http%3A%2F%2Fwww.taxcom.org.za%2Fdocs%2FNew_Folder%2F1%2520DTC%2520BEPS%2520Interim%2520Report%2520-%2520The%2520Introductory%2520Report.pdf&ei=kMusVdLQL4yw7Ab1v4LICw&usg=AFQjCNFeAULU4xLNXjv931dXMO_zSqtZCg&sig2=45l7EaXh2oeUTfMFZVjpDQ&bvm=bv.98197061,d.ZGU (last accessed 21 July 2015).

Clearly, anti-avoidance measures are viewed in a serious light across the globe. These measures may be classified as three distinct approaches: legislative, judicial, and administrative.[5] In this article we review the use of the second technique – the judicial approach – in Canada where the courts are called upon to settle disputes between taxpayers and the tax administration concerning the interpretation of the law and its application to an aggressive tax planning scheme.

Courts all over the world have been hard pressed to achieve an optimal balance between regulating abusive practices and preserving certainty in tax planning. In Canada, this struggle is reflected in the courts.[6] Moreover, Canada is considered to be at the forefront of combating abusive tax avoidance[7] and has one of the largest tax treaty networks among developed countries.[8] This, coupled with the fact that Canada has a long-established General Anti-avoidance Rule (GAAR), makes it an ideal choice for a comparative study.

Our primary goal with this article is to highlight the potential application of the South African GAAR by drawing attention to some of the insights gleaned from the Canadian literature. To that end, we bring together judicial comments and provide a synthesis of scholarly opinion on the interpretation of the Canadian GAAR. The article opens with a brief overview of the history of the South African GAAR, followed by the development of its Canadian counterpart. We then attempt to identify the Supreme Court of Canada's (SCC) approach to the statutory interpretation of the GAAR before concluding with some practical insights from the Canadian Revenue Agency (CRA) regarding the application of the GAAR.

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5 As categorised by, among others, Finance Québec *Aggressive tax planning* (2009) at: www.finances.gouv.qc.ca/documents/.../AUTEN_DocCons_PFA.pdf (last accessed 14 December 2011) and the UK Tax Law Review Committee *Tax avoidance* (1997) at: http://www.ifs.org.uk/publications/1908 (last accessed 21 July 2015).

6 Samtani & Kutyan 'GAAR revisited: from instinctive reaction to intellectual rigour' (2014) 62/2 *Canadian Tax Journal* 401 403.

7 See OECD (2011) *Peer review report of Canada* 7, which also acknowledges that Canada has an extensive history of exchanging information for tax purposes, during which time it has established a strong framework to ensure the elements for effective availability and access to relevant information are in place.

8 Duff *Responses to tax treaty shopping: a comparative evaluation* (2010) at: *http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1688689* (last accessed 3 April 2012) at 7.

THE SOUTH AFRICAN GAAR

South Africa's first GAAR provision was introduced by section 90 of the Income Tax Act[9] and was subject to a number of amendments. When the current Income Tax Act[10] was introduced to replace the 1941 Act, section 90 was replaced by section 103(1) of the current Act. The latter essentially retained the provisions of section 90 (as amended). In 1995, the Katz Commission attempted an holistic evaluation of the tax system and addressed a variety of matters.[11] Both the 1987 Margo Commission,[12] and the 1995 Katz Commission noted that section 103 had certain shortcomings. Consequently, section 103(1) of the Act was amended in 1996 to address these deficiencies.[13]

Subsequently, the South African Revenue Service (SARS) conducted a review of the GAAR provision in section 103(1). It was found that it had not kept pace with the times, and that improvements were possible based on both domestic and international experience. Accordingly, the SARS released a discussion paper on tax avoidance and section 103(1) in November 2005.[14] As a result of these proposals, and borrowing extensively from the Canadian GAAR legislation, section 103(1) was repealed and replaced by sections

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9 31 of 1941.

10 58 of 1962 (the Act).

11 Katz Commission *Third interim report of the Commission of Inquiry into certain aspects of the tax structure of South Africa* (1995). Of relevance here is Chapter 11 of the report, which dealt with tax avoidance.

12 Margo Commission *Report of the Commission of Inquiry into the tax structure of the Republic of South Africa* (1987). According to the Katz Commission Report n 11 above at par 11.2.2, s 103 suffered from two particular deficiencies: the test of abnormality presents difficulties for Revenue in that if a particular form of transaction is widely used for tax avoidance purposes, it may gain a commercial acceptability to the extent that its utilisation becomes normal; and there was no disadvantage from the taxpayer's point of view in embarking even upon tax avoidance schemes with little probability of success against a challenge by the Commissioner in terms of the provisions of s 103.

13 The recommendations were: where the transaction occurs in the context of trade, a business purpose test should be substituted for the normality test; where the transaction occurs in a non-business context, the existing normality test should continue to apply; and the provisions of s 103(1) must not apply where it may reasonably be considered that the transaction would not result directly or indirectly in a misuse of the provisions of the Act or an abuse having regard to the provisions of the Act, read as a whole.

14 Admittedly, the release of the discussion paper prompted a 'healthy and constructive' debate, with a wide variety of views on the issues raised by the discussion paper. See SARS *Discussion Paper on Tax Avoidance* (2005) at: http://www.sars.gov.za/AllDocs/LegalDoclib/DiscPapers/LAPD-LPrep-DP-2005-01%20-%20Discussion%20Paper%20Tax%20Avoidance%20Section%20103%20of%20Income%20Tax%20Act%201962.pdf (last accessed 11 December 2013) at 60.

80A to 80L which apply to impermissible avoidance arrangements entered into on or after 2 November 2006.[15]

In essence, an arrangement will be considered an impermissible avoidance arrangement when it meets the following four requirements:

- an *arrangement* is entered into or carried out;
- the arrangement must be an *avoidance arrangement*, *ie* it results in a tax benefit;
- any one of the following 'tainted elements' is present: abnormality regarding means, manner, rights or obligations; a lack of commercial substance in whole or in part; and misuse or abuse of the provisions of the Act; and
- the sole or main purpose is to obtain a tax benefit.

Although the previous GAAR – contained in section 103(1) of the Act – had resulted in numerous judicial decisions, the 'new' GAAR provisions, contained in sections 80A to 80L, have not yet been considered by South African courts.[16] Furthermore, the SARS has not yet issued any updated

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[15] The new GAAR was inserted by s 34(1)(*a*) of the *Revenue Laws Amendment Act* 20 of 2006. Clegg & Stretch 'Chapter 26: Tax avoidance and reportable arrangements' (2015) *Income Tax in South Africa* par 26.3.1 comment that this new GAAR represents a complete restructuring and it introduces a number of new components, while retaining certain conceptual elements of s 103(1).

[16] A caveat must be noted regarding this article. Despite the lack of indigenous court cases, academic literature concerning the South African GAAR is relatively extensive and well developed. For leading textbooks which incorporate tax avoidance matters, see, for example, Clegg & Stretch n 14 above; De Koker & Williams 'Chapter 19: Tax avoidance' (2015) *Silke on South African Income Tax*; Cilliers 'Chapter 46: Anti-avoidance' (2010) in De Koker & Brinckler (eds) *Silke on International Tax*; and Olivier & Honiball 'Chapter 19: Tax avoidance' *International tax – a South African perspective* (2011). For recently published articles from a South African perspective, see, amongst others: Kujinga 'Factors that limit the efficacy of general anti-avoidance rules in income tax legislation: lessons from South Africa, Australia, and Canada' (2014) 47/3 *CILSA* 429–459; Cassidy 'Tainted elements or nugatory directive? The role of the General Anti-avoidance provisions ("GAAR") in fiscal interpretation' (2012) 23/2 *Stellenbosch Law Review* 319–351; Kujinga 'Analysis of misuse and abuse in terms of the South African general anti-avoidance rule: lessons from Canada' (2012) 45/1 *CILSA* 42–60; Van Schalkwyk & Geldenhuys 'The nature of the purpose requirement of an impermissible tax avoidance arrangement' (2010) 35/1 *Journal for Juridical Science* 71–92; Cassidy 'The Holy Grail: the search for the optimal GAAR' (2009) 126/4 *SALJ* 740–779; Van Schalkwyk & Geldenhuys 'Section 80A(c)(ii) of the Income Tax Act and the interpretation of tax statutes in South Africa' (2009) 17/2 *Meditari Accountancy Research* 167–185; and Mazansky 'South Africa's new General Anti-avoidance Rule – the final GAAR' (2007) 61/4 *Bulletin for International Taxation* 159–167. However, until such time as the courts or SARS provide further clarification, this literature is largely theoretical and laden with moot arguments. It is therefore considered both necessary and appropriate to place the spotlight of this article on the Canadian GAAR

guidance or an Interpretation Note as to the application of the impermissible avoidance arrangement provisions.[17] The dividing line between permissible and impermissible tax avoidance will therefore remain somewhat blurred until the South African courts have had an opportunity to provide guidance on the interpretation of key aspects of the new GAAR.[18]

THE CANADIAN GAAR

Background

The difficulty in defining and distinguishing certain of the terms used in anti-avoidance literature (including, legitimate tax planning, tax evasion, tax avoidance, and aggressive tax planning) is not limited to South Africa. In Canada, in contrast to the well-recognised distinction between tax evasion and tax avoidance, the distinction between unacceptable (or abusive) tax avoidance, and acceptable tax minimisation (or tax planning) is considerably less clear and often questioned.[19]

For example, in the United Kingdom case of *MacNiven v Westmoreland Investments Ltd,*[20] Lord Hoffman declared that unless the statutory provisions at issue 'contain words like "avoidance" or "mitigation", I do not think that it helps to introduce them'. In a similar vein, Freedman has dismissed the attempt to divide acceptable avoidance, tax planning or mitigation, on the one hand, and unacceptable avoidance, on the other, in any general sense, as 'unhelpful'.[21] Although affirming the distinction, Evans observes that it is 'generally recognised as not being as clear as the distinction between avoidance and evasion'.[22]

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and case law. As such, a detailed analysis of the South African GAAR is considered beyond the scope of this work.

[17] When the GAAR provisions of s 103(1) were repealed and replaced by ss 80A to 80L during 2006, SARS subsequently issued a *Draft Comprehensive Guide to the General Anti-Avoidance Rule* (Draft GAAR Guide) on 13 December 2010 after which public comments were invited. Unfortunately, the Draft GAAR Guide has not been issued in its final format and no response documents have been released by SARS to date. Also, the Draft GAAR Guide is no longer available on the SARS website and has seemingly been withdrawn.

[18] This lack of interpretational certainty is multifaceted, as the operative provisions of the GAAR are complex and difficult to apply in practice.

[19] Duff 'Tax avoidance in the 21st Century' (2009) in Evans & Krever (eds) *Australian Business Tax Reform in Retrospect and Prospect* 479.

[20] [2001] UKHL 6, 2001 STC 237 at 257.

[21] Freedman 'Defining taxpayer responsibility: in support of a general anti-avoidance principle' (2011) 4 *British Tax Review* 332 335.

[22] Evans 'Containing tax avoidance: anti-avoidance strategies' (2008) 40 *UNSW Law Research Paper Series* 4–5.

In many Commonwealth jurisdictions the challenge of distinguishing between unacceptable tax avoidance and acceptable tax planning or mitigation is directly traceable to the traditional doctrine of interpretation that tax statutes must be construed strictly and in accordance with the *Duke of Westminster* judicial principle[23] that '[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'.[24]

In addition to the numerous anti-avoidance provisions in the Canadian Income Tax Act (CITA)[25] which assist in delineating tax evasion and avoidance arrangements, the CRA also uses numerous judicial principles developed under the cases decided by the Canadian tax courts. These principles are:[26] incomplete transactions;[27] agency;[28] sham transactions;[29] substance versus form;[30] artificiality;[31] step transactions;[32] the business purpose test;[33] and the abuse of law principle.[34]

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23 Per Alarie & Duff 'The legacy of UK tax concepts in Canadian tax law' (2008) 3 *British Tax Review* 228 238.

24 *IRC v Duke of Westminster* [1936] AC 1 at 19.

25 RSC 1985 c 1 (5th Supp) (CITA).

26 Shafer & Solursh 'Canada/Kanada in tax avoidance/tax evasion' (1983) *Cahiers de droit fiscal international* 295 299–301.

27 *Id* at 299: if a taxpayer failed to document a transaction fully and properly, and did not take all appropriate legal steps to implement it, the courts will disregard the transaction for purposes of the Canadian Income Tax Act.

28 *Ibid*. If a company *(eg* a tax haven subsidiary) is found to have acted as the agent of another taxpayer (*eg* a Canadian resident parent company), the parent company can be held taxable as principal on the subsidiary's income.

29 *Id* at 300. A sham refers to acts performed or documents executed by parties which are intended by them to give appearances to third parties (or to the courts) of creating legal rights and obligations which differ from the actual legal rights and obligations which the parties intended to create.

30 *Ibid*. It is not general practice for the Canadian courts to look to the substance of a tax transaction; instead, they usually look at the legal form. The courts have, however, been prepared to look to the substance of a particular transaction when appropriate. This is due, in part, to an extension of the sham doctrine.

31 *Ibid*. Although practically a statutory method of attacking tax avoidance, this doctrine refers to deductions that artificially or unduly reduce income.

32 *Ibid*. The Canadian courts have not adopted a doctrine of 'step transactions' as in, for example, the USA. However, an entire series of transactions can be reviewed if each one of a series of transactions is preordained and depends upon another.

33 *Id* at 301. This test will be addressed as part of the analysis of the GAAR's evolution. Under this test, the legal rights and obligations created by taxpayers will be ignored if the sole purpose thereof is to minimise taxation.

34 *Ibid*. This principle (also referred to as the 'abuses of rights') does not form part of Canadian legislation or common law. As such, it has had no impact on the interpretation of Canadian income tax statutes.

The particular importance of the GAAR in the context of the Canadian tax system can be attributed to the fact that Canadian courts have rarely used judicial anti-avoidance doctrines (such as substance over form and sham) to prevent tax avoidance.[35] At the time of its introduction, the Canadian GAAR was touted as a solution to tax avoidance, and the federal government had high hopes that it would be 'effective in combating the most egregious and aggressive tax avoidance schemes without resort to patchwork and stopgap specific anti-avoidance rules'.[36]

In the following section we explore the legislative history and development of the Canadian GAAR in light of the fact that courts often refer to the legislative history of a statutory provision.

The legislative history and development of the Canadian GAAR

Tax avoidance in Canada was formerly based on two central aspects of the income tax system: the strict interpretation of fiscal legislation; and attention to the legal substance of transactions. Both influences were inherited from the UK and contributed significantly to tax avoidance.[37] As part of the *White Paper on Income Tax Reform*, the Canadian Department of Finance expressed its concern over tax avoidance, and noted that the law in Canada (regarding tax avoidance) did not allow the tax administration to attack schemes on the basis of the absence of business purpose.[38] In addition, the department did not deem the then applicable legislation adequate in allowing the tax administration to deal effectively with certain tax avoidance measures. Consequently, the Department of Finance resolved that a change was necessary.

The GAAR was adopted in response to the SCC's rejection of the business purpose test in *Stubart Investments Ltd v Canada*.[39] *Stubart* was a tax avoidance case in which the taxpayer and its affiliates had entered into transactions for the purpose of applying tax losses of one member of the corporate group, to shelter the income of a sister corporation. It was argued,

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35 Arnold 'Policy forum: confusion worse confounded – the Supreme Court's GAAR decisions' (2006) 54/1 *Canadian Tax Journal* 167 168.

36 Alarie 'Trebilcock on tax avoidance' (2010) 60/2 *University of Toronto Law Journal* 623–630.

37 *Id* at 626.

38 Department of Finance Canada *The white paper: tax reform* (1987) at: http://www.parl.gc.ca/Parlinfo/Compilations/FederalGovernment/PaperDetail.aspx?Paper=c6a4db8e-e464-430b-bbfe-ca77532e9ccb&Document=3d22083a-917c-4ff8-88ef-f32cc8141f23&Language=E (last accessed 20 March 2012) at 129–130.

39 [1984] SCR 1.

on behalf of the minister, that the transactions were ineffective on the ground that they lacked a valid business purpose.

In *Stubart*, the SCC officially rejected a textual approach to interpretation in favour of the more modern approach proposed by Driedger.[40] Therefore, the words of a statute, such as the GAAR, should be read in their entire context. Consequently, post-*Stubart* decisions gave greater consideration to the object and spirit of the taxing provisions when interpreting the CITA.[41] This encouraged taxpayers and their advisers to become increasingly aggressive.[42]

In response to the ensuing criticism levelled against the tax authorities, the CRA – the successor to Revenue Canada – adopted a permissive interpretation of the CITA. Despite the SCC's endorsement of a purposive approach to statutory interpretation, the CRA maintained an 'excessively literal' approach.[43]

The CRA announced that it would issue advance rulings in respect of transactions lacking any business purpose. Concomitantly, the CRA issued a *Declaration of Taxpayer Rights* in 1985, informing taxpayers that '[you] have a right to arrange your affairs in order to pay the minimum tax required by law'.[44] The Declaration introduced no new rights,[45] but sought to consolidate the various rights available to taxpayers under the Canadian

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[40] Elmer Driedger was a Canadian lawyer who eventually became the Deputy Minister of the Canadian Department of Justice. He later became a professor of law at the University of Ottawa. Driedger was considered a leading authority on statutory interpretation. He incorporated the three 'master rules' of interpretation, *viz* the literal meaning rule, the mischief rule and the golden rule, into a single formula which he called the 'modern principle'. According to Driedger *Construction of Statutes* (2ed 1983) at 87 – Today there is only one principle or approach, namely, the words of the 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. Sullivan 'Statutory interpretation in Canada – the legacy of Elmer Driedger' (2007) in Gotsis (ed) *Statutory interpretation: principles and pragmatism for a new age – Judicial Commission of New South Wales* 106 remarks that, since its initial appearance in 1974, Driedger's rule has been continually cited and relied on by Canadian courts. The SCC formally adopted the rule as its preferred approach in *Rizzo v Rizzo Shoes Ltd* [1998] 1 SCR 27.

[41] Innes, Boyle & Nitikman *The essential GAAR manual: policies, principles and procedures* (2006) 27.

[42] Arnold 'The Canadian anti-avoidance rule' (1997) in Cooper (ed) *Tax avoidance and the rule of law* 224.

[43] Arnold 'The Canadian anti-avoidance rule' (1995) 6 *British Tax Review* 541 543.

[44] *Ibid*.

[45] Croome *Taxpayer's rights in South Africa* (1ed 2010) 274.

Charter of Rights and Freedoms (the Charter).[46] In 2007, the Canadian government adopted the Taxpayer Bill of Rights and the Commitment to Small Business. This bill describes and defines sixteen rights and is intended to build upon the CRA's corporate values of professionalism, respect, integrity, and cooperation.[47] The first right embodied in the Taxpayer Bill of Rights echoes the right mentioned in the Declaration above:

> 1 **You have the right to receive entitlements and to pay no more and no less than what is required by law**. You can expect to receive the benefits, credits and refunds to which you are entitled under the law and to pay no more and no less than the correct amount required under the law. (original emphasis.)[48]

Arnold and Wilson observe that:[49]

> There followed a significant change in Revenue Canada's attitude concerning the interpretation and application of the tax law. Revenue Canada began to seek refuge from taxpayers' complaints by adopting a strict, literal interpretation of the Income Tax Act. Tax officials ceased to refuse to give rulings on transactions that lacked a business purpose or that were designed for improper tax avoidance; in fact, they considered whether or not they had legal authority to refuse to give rulings at all.

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46 The Canadian Bill of Rights is a federal statute which was enacted in 1960 and provides Canadians with certain quasi-constitutional rights in relation to other federal statutes. Although the Bill remains in effect (with regards to federal statutes), most of its provisions have been replicated and enshrined in the Charter, which was adopted in 1982.The Charter, being entrenched in Canada's Constitution, is the supreme law of Canada. According to the Privy Council Office (Government of Canada) *Law-making framework* (2003) at: http://www.pco-bcp.gc.ca/index.asp?lang=eng&page=information&sub=publications&doc=legislation/chap1.2-eng.htm (last accessed 10 February 2014), because the Charter is part of the Constitution, other acts and regulations are ineffective to the extent that they are inconsistent with the Charter. Moreover, McConnell *Canadian Bill of Rights* (2007) at: http://www.thecanadianencyclopedia.com/en/article/canadian-bill-of-rights/ (last accessed 19 February 2014) notes that the Charter is a much broader source of human rights law and also has greater power, because it applies to provincial as well as federal laws and actions.

47 CRA *Taxpayer bill of rights* (2001) at: http://www.cra-arc.gc.ca/E/pub/tg/rc4418/rc4418-13e.html (last accessed 11 April 2014).

48 *Ibid.*

49 Arnold & Wilson 'The general anti-avoidance rule – part 1' (1988) 36 *Canadian Tax Journal* 829 838.

A 'serious shortfall' in corporate revenue followed and ultimately led to the enactment of a new GAAR.[50] On 18 February 1987, the Minister of Finance heralded a new anti-avoidance dispensation in his budget speech:[51]

> I am concerned that abusive tax-avoidance transactions are a significant factor in eroding corporate tax revenues. They also undermine respect for the integrity of our tax system. Such schemes permit some corporations – often large and profitable – to avoid paying income tax. The government has acted repeatedly to curb these and other such abuses with a series of specific rules. Where required, the government will continue this practice. In addition, to ensure a fairer and more stable income tax system, I intend to propose improved general anti–avoidance rules as part of tax reform.

The White Paper delivered on this promise and included a proposal to introduce a GAAR to prevent artificial tax avoidance arrangements.[52] In summary, the draft provided that a transaction that resulted in the reduction, avoidance, or deferral of tax was to be ignored unless the transaction was carried out primarily for *bona fide* business purposes. If a transaction was part of a series of transactions that resulted in tax avoidance, the rule would apply unless the transaction was carried out primarily for *bona fide* business purposes.[53]

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50 Per SARS n 14 above at 30. Arnold n 43 above at 544 maintains that a statutory GAAR was necessary in Canada for the following reasons: Taxpayers and their advisors were becoming increasingly aggressive; the CRA was adopting a very lenient attitude towards tax avoidance transactions; and the SCC had rejected any broad general judicial approach to combating tax avoidance.

51 Wilson *The budget speech* (1987) at: http://www.budget.gc.ca/pdfarch/1987-sd-eng.pdf (last accessed 20 February 2013) at 11.

52 Canada Department of Finance n 38 above at 129. The White Paper recognised that a GAAR had to strike a balance between the taxpayer's need for predictability and the responsibility of the government to protect its tax base. The document also conceded that the introduction of the GAAR would inevitably bring about a level of uncertainty that had to be resolved by the courts.

53 If the GAAR was applicable, s 245(4) determined the tax consequences as follows:
Adjustments
'(4) Where subsection (1) applies, in determining the income, taxable income, tax payable or other amount payable of or refundable to any person under this Act as is reasonable in the circumstances, without restricting the generality of the foregoing,
(a) any deduction in computing income, taxable income, or tax payable or any part thereof may be disallowed in whole or in part;
(b) any such deduction, any income, loss or other amount or part thereof may be allocated to any other person; and
(c) the nature of any payment or other amount may be recharacterized.
Section 245(6) stipulated that any other taxpayer was entitled to request the Minister of Revenue to establish an assessment or proceed to determine an amount concerning the same transaction. It also contained a purpose clause to spell out that "the purpose of this section is to counter artificial tax avoidance"'.

Needless to say, the proposed GAAR created considerable controversy in the tax community.[54] Regardless of the generally negative public opinion, the government continued to engage the tax community and released a revised tax reform package on 16 December 1987. This version took note of concerns about the uncertainty that would arise from a business purpose test, and the courts' findings in favour of an approach based on the object and spirit of the law.[55]

Whereas the first GAAR proposal only contained a reference to an 'avoidance transaction',[56] the second GAAR proposal introduced definitions for terms such as 'tax benefit', 'tax consequences' and 'transaction', and amended certain aspects of the first GAAR proposal. Chief amongst these was the deletion of the 'notwithstanding' clause in section 245(1).[57]

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54 Innes *et al* n 41 above at 31 relate some of the criticisms directed at the draft proposal: It was perceived as the most significant change to Canadian tax law since the introduction of the Income War Tax Act (the CITA's predecessor); the proposed GAAR was unnecessary as the existing legislative and judicial tools were sufficient to preclude this type of abusive tax avoidance; the rule was unconstitutional, or at best, a tool the courts would be reluctant to use; the CRA would have increased power and administrative discretion; the ambiguity caused by such a rule would seriously impede legitimate commercial transactions; there were claims that the GAAR would legislate a business purpose test and step transactions doctrine; and the Senate Standing Committee also rejected this proposal and suggested that the GAAR be completely abandoned.

55 Lacroix 'GAAR: observations on the concept of abuse' (2013) 61 (supp) *Canadian Tax Journal* 181 184.

56 See n 53 above.

57 The second GAAR proposal defined the term so as to mean:
'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.'
The purpose clause contained in the first GAAR proposal was deleted. The second GAAR proposal now allowed for an exception that the GAAR would not apply to a transaction where it may reasonably be considered that the transaction would not, but for this section, result directly or indirectly in a misuse of the provisions of this Act or an abuse having regard to the provisions of this Act read as a whole.
The adjustment provisions of s 245(6) were also revised in the second GAAR proposal, which now provided that the courts could make reference to the explanatory notes accompanying the legislation when interpreting the section. As regards the explanatory notes, the second GAAR proposed that recourse may be had to any explanatory notes thereto provided by the Minister of Finance who shall cause such notes to be published in the *Canada Gazette* forthwith on the coming into force of this section.

To summarise the second GAAR proposal: the White Paper's proposed business purpose test was replaced with a non-tax purpose test; new definitions were added; the purpose clause was deleted; a general exemption was introduced for transactions that did not involve an abuse or misuse of the provisions of the CITA; the adjustment provisions were revised; and courts were empowered to refer to explanatory notes.

Following yet more public criticism, government released a third GAAR proposal on 13 April 1988, which effected minor technical changes to the previous proposals. When the proposed GAAR was given its first reading in the House of Commons on 30 June 1988, it was again revised. The principal change was the deletion of the specific authorisation of the courts to refer to the explanatory notes when interpreting the rule.[58]

Finally, the GAAR was enacted by Parliament as part of Bill C–139 and became effective on 13 September 1988.[59] The CITA at no time up to the enactment of the GAAR, contained any rule of general application requiring that transactions be entered into for business purposes or other non-tax purposes.[60] Although the accompanying explanatory notes provided some examples as to the application of the GAAR, further guidance was issued by the CRA in its Information Circular 88–2 on 21 October 1988.[61] The

[58] Innes *et al* n 41 above at 35.

[59] The coming-into-force provisions provided that transactions that began before 13 September 1988 and that were concluded before 1989, would not be subject to the GAAR; nor would transactions entered into before 13 April 1988 where a taxpayer had received confirmation from the Department of National Revenue.

[60] Bowman 'Interpretation of tax legislation: the evolution of purposive analysis' (1995) 43/5 *Canadian Tax Journal* 1167 1176.

[61] CRA *Information Circular 88–2: General anti-avoidance rule section 245 of the Income Tax Act* (1988) at: http://www.cra-arc.gc.ca/E/pub/tp/ic88-2/ic88-2-e.txt (last accessed 02 February 2014). The salient aspects of the guidelines are as follows:
Par 2: The CRA will issue advance rulings with respect to the application of the GAAR to proposed transactions and will publish summaries of the facts and rulings in those cases that will provide further guidance where the rulings themselves are not published.
Par 2: In order to ensure that the rule is applied in a consistent manner, proposed assessments involving the rule will be reviewed by the CRA.
The CRA's position in respect of 'an avoidance transaction' is explained:
Par 3: Each step in a series of transactions should satisfy the test of being carried out primarily for a non-tax purpose.
Par 4: Where a transaction that is primarily tax-motivated forms part of a series of transactions that is carried out primarily for non-tax purposes, the single transaction will, nevertheless, be considered an avoidance transaction.
Par 4: Although a series of transactions could have *bona fide* purposes, it would not preclude a tax-motivated transaction within the series from being an avoidance transaction.
Par 4: A transaction undertaken primarily for a *bona fide* business, investment, or family

Information Circular also provides 22 examples, and states whether the CRA would apply section 245 to each example.

The GAAR remained unchanged from its enactment on 12 September 1988, until it was amended in several respects by the Budget Implementation Act[62] (the BIA) in 2005. The BIA received royal assent on 13 May 2005. Basically, the amendments clarify that the GAAR applies to the abuse of tax treaties as well as statutes related to the CITA. The wording of section 245(4) – the misuse and abuse test – was also revised.[63] These amendments

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purpose, would not be an avoidance transaction.

Par 4: If a transaction had a business, investment, or family effect, the primary purpose of which was to obtain a tax benefit, the transaction would be considered an avoidance transaction.

Par 5: An avoidance transaction would not be subject to the GAAR if the transaction would not result in the misuse of the provisions of the CITA or an abuse of the CITA read as a whole.

Par 5: Transactions that rely on specific provisions (whether incentive provisions or otherwise) for their tax consequences, or on general rules of the CITA, can be negated if these consequences are so inconsistent with the general scheme of the CITA that they cannot have been within the contemplation of Parliament.

Par 5: A transaction that is consistent with the object and spirit of the provisions of the CITA is not to be affected.

62 Budget Implementation Act 2004 No. 2 SC 2005 c19 s 52. Available at: http://laws.justice.gc.ca/eng/AnnualStatutes/2005_19/FullText.html (last accessed 10 May 2014).

63 The definition of 'tax benefit' in s 245(1) of the CITA was replaced by the following definition: '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. The marginal note as to the application of section 245(4) was replaced by the following:

'(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.

Portions of s 245(5) of the CITA were amended, relating to the marginal note which deals with the 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,

were applied retroactively as section 52(5) of the BIA provides that the amended language of section 245(4) applies 'with respect to transactions entered into after September 12, 1988'.

The 2005 amendments were extensively and vigorously debated in Parliament, especially the issue of the retroactive application of legislation.[64] Consequently, the GAAR in its current form contains the following definitions in section 245(1):

> '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 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' includes an arrangement or event.

The GAAR provision is contained in section 245(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.

An avoidance transaction is described in section 245(3) as meaning 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

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.'

[64] The debates of the Senate are available on the Parliament of Canada website at: http://www.parl.gc.ca/Search/Results.aspx?Language=E&search_term=%22general%20anti-avoidance%20rule%22%20debate (last accessed 17 May 2014).

(*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.

The amended misuse and abuse provisions are contained in section 245(4), which determines that the GAAR 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.

The tax consequences are determined by the amended section 245(5) as follows:

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.

A person may request an adjustment in terms of section 245(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.

The exception rule in section 245(7) reads as follows:

> 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.

Section 245(8) places a number of duties upon the Minister:

> 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).

Essentially, the GAAR targets transactions with the following core elements:[65]

[65] It is not the purpose of this article to offer an in-depth analysis of the core elements of the Canadian GAAR, *viz* a 'tax benefit', an 'avoidance transaction' and the 'misuse and abuse' test, as extant literature on this topic abounds. For informative discourses on these elements, see, *eg* – Li & Hwong 'GAAR in action: an empirical exploration of Tax Court of Canada cases (1997–2009) and judicial decision making' (2016) 61/2 *Canadian Tax Journal* 321–366; Arnold 'Policy forum: some thoughts on the Supreme Court's approach to the determination of abuse under the General Anti-avoidance Rule (2014) 62/1 *Canadian Tax Journal* 113–127; Pound 'GAAR at 25: a trip down memory lane and charting an uncertain future' (2013) 61(supp) *Canadian Tax Journal* 355–364; Lacroix

- there must be an avoidance transaction;
- a tax benefit must result from the avoidance transaction; and
- there must have been a direct or indirect misuse or abuse of the provisions of the CITA.

Having considered the legislative development of the GAAR from its enactment in 1988 to its current form, in the following section we examine the Canadian court cases that have contributed to its interpretation.

The SCC's approach to interpreting the Canadian GAAR

In *Canada Trustco Mortgage Company v Canada,* the circumstances leading to the introduction of the GAAR were summarised as follows:[66]

> The GAAR was enacted in 1988, principally in response to *Stubart Investments Ltd.* v. *The Queen*, [1984] 1 S.C.R. 536, which rejected a literal approach to interpreting the Act. At the same time, the Court rejected the business purpose test, which would have restricted tax reduction to transactions with a real business purpose. Instead of the business purpose test, the Court proposed guidelines to limit unacceptable tax avoidance arrangements. Parliament deemed the decision in *Stubart* an inadequate response to the problem and enacted the GAAR.

The first case involving the GAAR, *McNichol v The Queen*,[67] was heard by the Tax Court of Canada in 1997, almost ten years after the rule had been enacted. Since then, there has been a steady stream of GAAR cases in the lower courts. Despite a number of GAAR-related decisions of the Tax Court and the Federal Court of Appeal, before *Canada Trustco,* the SCC had declined to grant leave to appeal on any of these decisions.[68] The SCC has

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n 55 above; Finance Québec n 5 above; Arnold 'A comparison of statutory general anti-avoidance rules and judicial general anti-avoidance doctrines as a means of controlling tax avoidance: which is better? (What would John Tiley think?)' (2008) in Jones, Harris & Oliver (eds) *Comparative perspectives on revenue law: essays in honour of John Tiley* 1–10; Edgar 'Building a better GAAR' (2007–2008) 27 *Va Tax Rev*; Li '"Economic substance": drawing the line between legitimate tax minimization and abusive tax avoidance' (2006) 54/1 *Canadian Tax Journal* 23–56; Sandler 'The Minister's burden under GAAR' (2006) 54/1 *Canadian Tax Journal* 3–22 and Arnold 'Reflections on the relationship between statutory interpretation and tax avoidance' (2001) 49/1 *Canadian Tax Journal* 1–39.

[66] [2005] SCC 54 at par 14.

[67] 97 DTC 729 (TCC).

[68] Per PWC 'Reflections on Supreme Court ruling on GAAR – Copthorne Holdings Ltd' *Tax memo – Canadian tax updates* (2011) at: http://www.pwc.com/en_CA/ca/tax-memo/publications/2011-12-copthorne-supreme-court-gaar-ruling-analysis-en.pdf (last accessed 20 August 2013) at 1.

only considered the application of the GAAR in four cases, despite the fact that the GAAR has been in force for twenty-five years.

An excerpt from *Canada Trustco* encapsulates the difficulty in interpreting the GAAR:[69]

> The GAAR draws a line between legitimate tax minimization and abusive tax avoidance. The line is far from bright. The GAAR's purpose is to deny the tax benefits of certain arrangements that comply with a literal interpretation of the provisions of the Act, but amount to an abuse of the provisions of the Act. But precisely what constitutes abusive tax avoidance remains the subject of debate. Hence these appeals.

In October 2005, the SCC decided its first cases dealing with the application of the GAAR. The *Canada Trustco* case was decided in favour of the taxpayer, and the *Mathew v Canada*[70] case in favour of the Crown. Both were unanimous decisions.

SCC case 1: Canada Trustco Mortgage Co v Canada
Canada Trustco entailed a tax deferral arrangement involving the claiming of a substantial capital cost allowance (CapCA) following a sale-and-leaseback transaction. The taxpayer had claimed CapCA in respect of property acquired in the context of a series of transactions in which the taxpayer bore no financial risk. With reference to the language of the applicable provisions, the property clearly qualified for the CapCA deduction. The issue was whether the taxpayer qualified for a legally defined cost, since it had not incurred an economic cost (no financial risk was taken on).

The minister reassessed the taxpayer and disallowed the claim on the basis that the arrangement to sell and lease-back the trailers was subject to the GAAR. The argument was that the taxpayer's CapCA claims were abusive and should be denied on the basis that the taxpayer had minimised its economic risk with respect to the trailers. In other words, the minister took the position that the CapCA provisions should only apply where sums of money are at economic risk. The taxpayer appealed and was successful in both the lower courts and the SCC.

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[69] Note 66 above at par 16.
[70] [2005] SCC 55.

A literal reading of the CapCA provisions indicates that entitlement to a CapCA claim is based on a taxpayer's tax cost of an asset. However, the minister argued that the purpose of the CapCA provisions was to allow CapCA deductions only where taxpayers assume the economic risk associated with the asset. The SCC rejected the minister's argument that the CapCA provisions had been abused by *Canada Trustco* in these circumstances. Furthermore, the SCC held that the transaction in question was not so dissimilar from ordinary sale-leaseback transactions as to place it outside the object, spirit, and purpose of the relevant CapCA provisions. Of note is that the court concluded that there is no general economic substance test that can be used to determine whether transactions are subject to the GAAR.

SCC case 2: Mathew v Canada

The *Mathew* decision is a 'loss-trading' case, involving the transfer of business income losses to a number of taxpayers through the use of a partnership. The various transactions comprised the transfer of mortgages with accrued losses, to a partnership, the acquisition of interests in the partnership by arm's-length investors, and the deduction of those losses by the investors when realised by the partnership.

The CRA attacked tax loss deductions claimed by investors in a partnership that had been established to utilise the tax losses of an arm's-length entity. The losses originated from certain underperforming mortgages that the partnership acquired from a vendor. At the time, the recognition of a loss in the context of a non-arm's-length disposal, was disallowed. Since the vendor and the partnership were not at arm's-length when the mortgages were acquired, the court regarded this as analogous to a superficial loss.[71] The key point at issue in the appeal to the SCC was whether the transactions resulted in a misuse or abuse under section 245(4) of the CITA. Specifically, the court asked whether allowing taxpayers to deduct the partnership losses would frustrate the object, spirit, or purpose of the specific CITA provisions that gave rise to the tax benefit.[72]

Consistent with the two-part inquiry that it affirmed in *Canada Trustco*, the court first interpreted the provisions to determine their object, spirit, and purpose. Thereafter, the court considered the transactions themselves to

71 *Mathew* n 70 above at par 58.
72 *Mathew* n 70 above at par 59.

determine whether they frustrated these purposes. The SCC held that the transactions resulted in abusive tax avoidance.[73]

SCC case 3: Lipson v Canada

Lipson v Canada[74] entailed an arrangement whereby the taxpayer restructured his financial affairs to obtain an interest deduction in respect of borrowed funds used indirectly to purchase a personal residence.[75] The spouses structured a loan so that the interest would be deductible. As a result of the attribution rules, the cost of interest was deducted by the spouse with the higher income.[76] The court focused on the abuse of the attribution rules under the GAAR. The abuse arose not from the financing arrangements, but rather from the non-arm's-length relationship between the husband and wife.

The taxpayer admitted that there had been both a 'tax benefit' and an 'avoidance transaction'.[77] However, he argued that the GAAR could not apply as the 'misuse and abuse' requirement of section 245(4) had not been fulfilled.[78] A majority of the SCC (four of the seven judges) held that to allow the attribution rules to operate to reduce Lipson's income by allowing him the benefit of the interest deduction, was an abuse of those rules and that the GAAR should therefore apply.[79] When Lipson chose not to elect out of the rollover rule for spousal transfers, the income and loss from the shares sold to Mrs Lipson were attributed back to Lipson, so enabling him to apply his wife's interest deduction to his own income.[80]

The majority ruling appears to have agreed that motivation, purpose, and economic substance are relevant in the misuse or abuse analysis, but only to

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73 The Court stated at n 70 above at par 58: 'We are of the view that to allow the appellants to claim the losses in the present appeal would defeat the purposes of s 18(13) and the partnership provisions, and that the Minister properly denied the appellants the losses under the GAAR.'

74 [2009] SCC 1.

75 *Lipson* is similar to the *Singleton v Canada* [2001] SCR 2 case, but with the distinction that it involved an attribution rule.

76 Section 74.1(1) of the CITA attributes income or losses on transferred property from a transferee spouse to a transferor spouse. Section 73(1) of the CITA provides for an automatic rollover when one spouse transfers property to another spouse, unless the transferor spouse elects out of the rollover. This rollover applies even when the transferor spouse receives cash consideration on the transfer.

77 *Lipson* n 74 above at par 86.

78 *Ibid*.

79 *Lipson* n 74 above at para 40 and 41.

80 The court concluded at n 74 above at par 42 that '[t]he only way the Lipsons could have produced the result in this case was by taking advantage of their non-arm's-length relationship. [H]is motivation or purpose is irrelevant.'

the extent that they establish whether the transaction frustrates the purpose of the relevant provisions.[81] The SCC confirmed that the *overall results* of the taxpayer's transactions are relevant, not the *overall purpose.*[82]

Of great significance are the dissenting judgments. The majority diverged from the previously established guidelines in their approach to the onus imposed on the minister to establish that the planning was clearly abusive.[83] In *Canada Trustco*, it was determined that if the existence of abusive tax avoidance is unclear, the benefit of the doubt goes to the taxpayer. In *Lipson*, the majority concluded – without a clear demonstration of whether the Crown had met that onus – that the attribution rules had been misused or abused because their object, spirit, and purpose had been frustrated.[84]

It should be pointed out that the majority ruling on the applicability of the GAAR is quite narrowly focused on the particular facts of the case and on the taxpayer's reliance on the attribution rules of the CITA. The SCC's decision did not significantly change the basic framework (from that in the *Canada Trustco* and *Mathew* cases) for the analysis of when the GAAR applies. It is clear, however, that *Lipson* brought substantial uncertainty to the application of the GAAR.[85] Undoubtedly, the split in the court decision

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[81] *Lipson* n 74 above at par 23.

[82] However, it should be noted that the court also determined that the legal analysis could not stop with the overall result, but should also consider the individual benefits. The court stated at n 74 above at par 22: 'The appellants sought an overall result, that is, the deduction of the interest payments on the mortgage from their income. Nevertheless, the legal analysis required by the GAAR cannot stop at this level. Its focus must be on the individual benefits – which may in combination have led to the overall result – in the context of the series of transactions.'

[83] Also see analysis by PWC 'New Supreme Court ruling on GAAR – reflections on the Lipson case' *Tax memo – Canadian tax updates* (2009) at: http://www.pwc.com/en_CA/ca/tax-memo/publications/tm-nscr-0109-en.pdf (last accessed 13 February 2014) at 4 and Porter 'Supreme Court of Canada releases its decision in Lipson' *Deloitte tax breaks special edition* (2009) at: http://www.deloitte.com/view/en_CA/ca/services/tax/11f05a1264001210VgnVCM100000ba42f00aRCRD.htm (last accessed 17 February 2014).

[84] In his dissenting judgment in *Lipson* n 74 above at par 55, Binnie J concluded that 'the attribution rules expressly foresee the possibility that losses be attributed; the application of these rules was in conformity with their object and spirit; and the Crown did not demonstrate the clearly abusive character of the transaction'.

[85] In the *Lipson* case, a lack of consistency existed in identifying the proper threshold for the application of the misuse and abuse test. Prior to *Canada Trustco*, the misuse and abuse test required the Minister to identify a clear and unambiguous policy that had been offended. In *Canada Trustco*, the Minister was required to identify a clear policy that had been offended. In *Lipson*, the Minister had to prove on a balance of probabilities that the avoidance transaction resulted in abuse or misuse.

reflects the high degree of difficulty associated with cases involving the GAAR.

SCC case 4: Copthorne Holdings Ltd v Canada

The corporate taxpayer in *Copthorne Holdings Ltd v Canada*[86] undertook a series of transactions to consolidate its losses. An investment gave rise to the recognition of paid-up capital (PUC) at two levels: the parent corporation benefited from the original investment; and the subsidiary benefited from the parent's investment of proceeds from the original investment.[87]

As a vertical amalgamation would have eliminated the PUC of the subsidiary, the taxpayer ensured that the two corporations became sister corporations before the merger. The PUC of the amalgamated corporation was thus equal to the sum of the PUC of the two amalgamated corporations. A subsequent redemption of shares gave rise to a deemed dividend reduced by the preserved PUC.[88]

The Tax Court upheld the GAAR assessment, finding both a tax benefit in the redemption, and an avoidance transaction in the share sale. Interestingly, the Tax Court did not find misuse or abuse on the basis of the specific provisions in the CITA, but nonetheless held that the taxpayer had abused the CITA insofar as its preservation of PUC amounted to a double counting. The Federal Court of Appeal dismissed the taxpayer's appeal, effectively agreeing with the Tax Court that the rationale for eliminating PUC on vertical amalgamations had been circumvented in this case.[89]

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86 [2011] SCC 63.

87 According to PWC n 68 above at 1, PUC can be a valuable tax attribute because Canadian tax rules allow a corporation to return PUC to a non-resident shareholder without withholding tax.

88 The definition of PUC can be found in s 89(1) of the CITA, which basically provides that the PUC of a class of shares is the corporate stated capital of that class, adjusted to take into account certain 'grinds' contained in specific provisions of the CITA listed therein. Section 84(3) is a deemed dividend rule which provides that a deemed dividend arises on the redemption of a share to the extent that the redemption amount exceeds the PUC of the redeemed shares. Also, s 87(3)(*a*) specifically excludes from the computation of the PUC of the amalgamated corporation, the PUC of a share held by any other predecessor corporation.

89 Studniberg 'Minding the gap in tax interpretation: does specificity oust the General Anti-avoidance Rule post-Copthorne?' (2012) 38 *Queen's LJ* 209 229 comments that the Federal Court of Appeal did not explain what was abusive about such a preservation of capital. He also points out the fact that the Federal Court of Appeal did not refer to the *Lipson* case at all in its decision.

The specific issues before the SCC were:

- whether the redemption was part of the series of transactions that included the first series (ie the prior share sale and first amalgamation), by virtue of the extended definition of 'series of transactions' in section 248(10); and
- if so, whether the transactions constituted a misuse or abuse of the CITA.

Justice Rothstein delivered the SCC's unanimous decision, dismissing the taxpayer's appeal and commenting on the abuse analysis as follows:[90]

> The most difficult issue in this case is whether the avoidance transaction was an abuse or misuse of the Act. The terms "abuse" or "misuse" might be viewed as implying moral opprobrium regarding the actions of a taxpayer to minimize tax liability utilizing the provisions of the Income Tax Act in a creative way. That would be inappropriate. Taxpayers are entitled to select courses of action or enter into transactions that will minimize their tax liability.

The SCC confirmed the principles enunciated in *Canada Trustco* and affirmed that the GAAR only applied where 'the abusive nature of the transaction is clear' and that the Act had to be read with an eye to 'consistency, predictability and fairness'.[91] However, it would have been helpful had the SCC elaborated on the proper method for determining tax abuse.

The SCC's guidance for applying the GAAR

The term 'abusive tax avoidance' was mentioned 38 times in *Canada Trustco* and twelve times in *Mathew*. However, this phrase does not appear in the GAAR or anywhere else in the CITA.[92] It is merely a label that the SCC uses to describe the conduct that the GAAR was designed to prohibit.

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[90] Note 86 above at par 65. The judge accepted the Tax Court's finding that the transactions in the case resulted in double counting of the PUC, but like the Federal Court of Appeal, failed to explain why this was abusive. The transfer of shares that made the horizontal amalgamation possible was found to be an abusive transaction, since it was contrary to the purpose of s 87(3). Studniberg n 89 above at 231 draws attention to the court's distinction between statutory interpretation of a 'traditional sort' and statutory interpretation under the misuse and abuse analysis; he explains as follows: 'Under the former, the court applies a textual, contextual and purposive approach to determine what the specific language of a statute means; under the latter, it seeks to ascertain the object, spirit or purpose of a provision of the Act. The court applied the latter type of analysis to subsection 87(3), which reduces the PUC of the shares of an amalgamated corporation if it exceeds the PUC of the shares of the predecessor companies in certain circumstances.

[91] Note 86 above at par 67.

[92] Per Innes *et al* n 41 above at 64.

Attempting to elaborate on the parameters of abusive tax avoidance, the SCC relied heavily on two guiding principles:

- A court should require a unified textual, contextual, and purposive approach to the interpretation of tax statutes.[93]
- Tax law should be certain, predictable, and fair, so that taxpayers can intelligently order their affairs.[94]

The SCC provided guidance on the application of the GAAR through the enunciation of seven principles in the *Canada Trustco* case:[95]

1. Three requirements must be established to permit application of the GAAR:
   - a tax benefit resulting from a transaction or part of a series of transactions (section 245(1) and (2));
   - that the transaction is an avoidance transaction in the sense that it cannot be said to have been reasonably undertaken or arranged primarily for a *bona fide* purpose other than to obtain a tax benefit; and
   - that there was abusive tax avoidance in the sense that it cannot be reasonably concluded that a tax benefit would be consistent with the object, spirit, or purpose of the provisions relied upon by the taxpayer.

2. The burden is on the taxpayer to refute the first and second requirements above, and on the minister to establish the third requirement.

3. If the existence of abusive tax avoidance is unclear, the benefit of the doubt goes to the taxpayer.

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93 The SCC in *Mathew* n 70 above at par 42 asserted that '[t]here is an abiding principle of interpretation: to determine the intention of the legislator by considering the text, context and purpose of the provisions at issue. This applies to the Income Tax Act and the GAAR as much as to any other legislation'.

94 The SCC affirmed this stance in *Canada Trustco* n 66 above at par 42 by stating that: '[a]lthough Parliament's general purpose in enacting the GAAR was to preserve legitimate tax minimization schemes while prohibiting abusive tax avoidance, Parliament must also be taken to seek consistency, predictability and fairness in tax law'.

95 This synopsis is based on the *Canada Trustco* case n 66 above at par 66 and is also partly derived from Gwynne 'Supreme guidance on GAAR' *CGA Magazine* (2006) at: http://www.cga-canada.org/en-ca/AboutCGACanada/CGAMagazine/2006/Mar-Apr/Pages/ca_2006_03-04_ft1.aspx (last accessed 01 July 2013).

4. The courts proceed by conducting a unified textual, contextual, and purposive analysis of the provisions giving rise to the tax benefit in order to determine why they were put in place, and why the benefit was conferred. The goal is to arrive at a purposive interpretation that is harmonious with the provisions of the CITA that confer the tax benefit, read in the context of the CITA as a whole.

5. Whether the transactions were based on any economic, commercial, family, or other non-tax purpose may form part of the factual context that the courts may consider in the analysis of abusive tax avoidance allegations under section 245(4). However, any finding in this respect would form only one part of the underlying facts of a case, and would be insufficient in itself to establish abusive tax avoidance. The central issue is the proper interpretation of the relevant provisions in the light of their context and purpose.

6. Abusive tax avoidance may be found where the relationships and transactions, as expressed in the relevant documentation, lack a proper basis relative to the object, spirit, or purpose of the provisions that are purported to confer the tax benefit, or where they are wholly dissimilar to the relationships or transactions contemplated by the provisions.

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

Having considered the judicial development of the Canadian GAAR, it is apposite to highlight some practical considerations from the CRA.

The CRA's approach

Following the adoption of the GAAR, the CRA issued Information Circular 88–2 confirming that it would apply the rule only to abusive tax avoidance.[96] A special GAAR Committee has been established, comprising senior officials from the CRA, the Department of Finance, and the Justice Department.[97]

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96 CRA *Information circular* n 61 above.

97 CRA *Tax avoidance* (2013) at: http://www.cra-arc.gc.ca/gncy/lrt/vvw-eng.html#q3 (last accessed 02 August 2013). According to EY *GAAR rising: mapping tax enforcement's evolution* (2013) at:

The most recently available GAAR-related statistics (as at 12 September 2013) reveal the extent of the CRA's workings:[98]

- Since the inception of the GAAR in 1988, 1 163 files have been referred to the GAAR Committee. Of those files, the GAAR Committee has recommended that the GAAR be applied in 897 cases.
- A total of 54 files have been litigated in the courts. The Minister of National Revenue has been successful in 28 of these cases (that is, the GAAR applied to the plans and the tax benefits claimed were denied).

The CRA notes that many of the issues originally dealt with by the GAAR Committee have been clarified and resolved by way of subsequent legislative amendments.[99] Figure 1 below illustrates the process adopted by the CRA when considering the application of the GAAR.

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http://www.ey.com/Publication/vwLUAssets/GAA rising/$FILE/GAAR rising 1%20Feb2013.pdf (last accessed 11 January 2014) at 40, the GAAR Committee is not a statutory committee. It advises on whether it is appropriate to apply GAAR in particular fact situations and whether the application is consistent with how GAAR has been applied in other cases. Referrals to the GAAR Committee usually originate from ordinary audits or from the CRA's Income Tax Rulings Directorate.

[98] Auditor General of Canada *Report: chapter 3 – aggressive tax planning* (2014) at: http://www.oag-bvg.gc.ca/internet/English/parl oag 201405 03 e 39334.html (last accessed 10 July 2015) at 8.

[99] CRA *Annual report to Parliament 2013–2014* (2014) at: http://www.cra-arc.gc.ca/gncy/nnnl/2013-2014/p4-cmplnc-eng.html (last accessed 10 July 2015) at 7.

Figure 1: The CRA's application of the GAAR[100]

Identification	• An auditor in the local Tax Services Office identifies transaction (or series of transactions) to which the GAAR may apply. • The ATPD may identify potential transactions in the course of a review of application for clearance certificates, rollover transactions or foreign reporting information; they may also identify other similarly-situated taxpayers who may have undertaken similar transactions.
Fact finding	• The auditor collects relevant facts and drafts a proposal letter with a detailed analysis of the potential application of the GAAR. • The auditor will invite the taxpayer to provide a response to the proposal letter.
Referral	• After receiving the taxpayer's representations, the auditor will make a referral the the ATPD. • Documents included: auditor's proposal letter, taxpayers's representations, auditor's response (if any) and other possibly relevant information. • If the GAAR is the primary basis for the assessment: referral is made before the proposal letter is issued to taxpayer. • If the GAAR is the secondary basis of the assessment: referral is made before issuing the assessment.
Analysis	• ATPD performs own analysis in consultation with other CRA divisions, the Department of Finance and the Department of Justice. • If ATPD's view is that the GAAR may apply: file is referred to GAAR Committee. • If ATPD's view is the the GAAR does not apply: the auditor is provided with that view without referral to the GAAR Committee.
GAAR Committee	• 'New issue': ATPD drafts a referral, including the auditor's views, the taxpayer's representations and the ATPD's views. • No 'new issues': ATPD provides a recommendation. • GAAR Committee meets periodically to consider referrals. It comprises members from the CRA, Department of Finance and Department of Justice. • Committee members consider the file beforehand and discuss and develop a view during meetings. • Committee recommends the application of the GAAR in a particular case.

[100] Derived from a presentation made by the CRA's Income Tax Rulings Directorate and the Aggressive Tax Planning Division (ATPD). Also see Moreno & Saydeh *Application of the GAAR – slide presentation* (2013) at: http://www.canadiantaxlitigation.com/wp-content/uploads/2013/06/Application-of-the-GAAR.pdf. (last accessed 21 August 2013).

CONCLUSION

A GAAR is a provision in tax legislation that works to curb impermissible tax avoidance, which, broadly, consists in the avoidance of tax that is inconsistent with the spirit of the tax laws. The starting point for the development of Canada's judicial approach to tax avoidance is the landmark *Stubart* case. Before 1984, the approach adopted by the Canadian courts in tax avoidance cases was not entirely clear. A number of decisions left some uncertainty as they typically involved a combination of the sham, business purpose, substance over form, and step transaction arguments.

The SCC in *Stubart* rejected the business purpose test and accepted a modern approach to interpretation based on the object and the spirit of fiscal legislation. In 1987, the Canadian government announced its intention to enact a GAAR. After numerous rounds of consultation and redrafting, section 245 of the CITA was enacted one year later. The business purpose rule is now incorporated in the statutory scheme of the GAAR, specifically in the definition of 'avoidance transaction' in section 245(3) of the CITA.

Twenty-five years and four SCC judgments later, it is arguable whether the GAAR criteria have been consistently applied. The first two judgments (*ie Canada Trustco* and *Mathew*) offered a structured analytical framework. However, the third judgment (*Lipson*) reveals a profound division within the court. The fourth decision (*Copthorne*) relies on the first two judgments, but seemingly creates more questions than answers.

It is encouraging to note that the Davis Tax Committee finds that South Africa has made 'good progress in devising provisions to deal with BEPS' and that South Africa's tax legislation is 'comparable to many developed countries'.[101] In addition, the committee counsels that South Africa can address BEPS by applying its GAAR.[102]

Therefore, notwithstanding the uncertainty surrounding the Canadian GAAR as a legal norm, it is submitted that the SCC's seven-step guide to the application of the GAAR can assist South African courts to distinguish objectively between legitimate tax planning and abusive tax avoidance. At the very least, it is incumbent upon South African tax practitioners to consider insights from Canada's quarter-century of experience to help clarify the potential application of the South African GAAR.

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101 See n 4 above at 36.

102 *Id* at 37.