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Some Thoughts on *Deans Knight*, the GAAR,
and the Proposed Amendments

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OUTLINE OF PRESENTATION

1. Major outstanding issues with respect to the interpretation and application of the GAAR
2. Discussion of SCC decision in *Deans Knight*
3. Proposed amendments to the GAAR in the 2023 budget

THE GAAR: OUTSTANDING ISSUES

- Treatment of increase in tax attributes as a tax benefit – fixed in 2022, but new issue with respect to the new penalty
- Primary purpose or one of the main purposes test
- The troublesome concept of a series of transactions

THE GAAR: OUTSTANDING ISSUES

- Relationship between the Duke of Westminster principle and the GAAR
- Relationship between taxpayers' need for or right to certainty, predictability and fairness and the GAAR
- Relationship between SPAARs and the GAAR
- The distinction between an ordinary textual, contextual and purposive (TCP) exercise in statutory interpretation and the interpretive approach under the first step of the abuse analysis under s. 245(4)
- The role of economic substance

DEANS KNIGHT, 2023 SCC 16

- DK has \$90 million of ITCs, losses, etc.
- All assets and business sold to Newco; Matco pays \$3-4 million for debenture convertible into 35% of voting shares and 79% of equity; only losses retained
- Matco converts debenture into shares
- Matco arranges for DK to acquire a new bond trading business and attracts new shareholders through IPO who benefit from use of losses against income from new business
- Complex agreements to make sure DK could not do anything except what Matco wanted

SUBSECTION 111(5)

Where, at any time, control of a corporation has been acquired by a person or group of persons, no amount in respect of its non-capital loss or farm loss for a taxation year ending before that time is deductible by the corporation for a taxation year ending after that time and no amount in respect of its non-capital loss or farm loss for a taxation year ending after that time is deductible by the corporation for a taxation year ending before that time except that . . .

- Case law says control means de jure control

DEANS KNIGHT, 2023 SCC 16

- TCC holds GAAR does not apply
- FCA reverses: GAAR supplements de jure control test in s. 111(5)
- Only issue on appeal: abuse
- SCC holds that transactions defeated or abused the object, spirit and purpose of s. 111(5) in 7:1 decision (Justice Côté dissenting; Brown did not participate)

MAJORITY'S DECISION

- Starts with a description of the background to the GAAR
- Discussion of the GAAR, the Duke, and the certainty, predictability and fairness mantra
 - The Duke is “attenuated” by GAAR
 - Better to recognize that the Duke is irrelevant
 - Some uncertainty, but only for a small subset of transactions; in contrast, Côté says GAAR will be relevant in each and every case

MAJORITY'S DECISION

“the principles of certainty, predictability and fairness do not play an independent role, rather they are reflected in the carefully calibrated test that Parliament crafted in s. 245”

- should relegate the mantra to a minor role rather than the dominant role given to it by the SCC in *Alta Energy*
- Still relevant in non-GAAR cases

MAJORITY'S DECISION

- Maintains error from *Copthorne* that GAAR involves “the unusual duty of going behind the words of the legislation” – what’s unusual about it?
- Confirms the 2-step abuse analysis from *Canada Trustco*
- First step is to identify the underlying rationale of the provision by reference to the text, scheme of the Act and extrinsic aids; Rowe calls it “a concise description of the rationale underlying the provision”

MAJORITY'S DECISION

- Distinguishes between the rationale of a provision and the means Parliament chose to reflect it
- The means is relevant but doesn't provide full answer to what the rationale is (just means that it is usually necessary to consider extrinsic aids because the text does not usually fully reveal the rationale)
- GAAR can apply to both foreseen and unforeseen abuses

MAJORITY'S DECISION

- Rowe endorses the distinction between ordinary interpretation and the interpretive exercise for abuse under s. 245(4)
- Interpretive exercise for abuse “ensures that the intrinsic and extrinsic evidence used to discern a provision’s rationale remains tied to the provision itself” and requires consideration of TCP, including legislative history and extrinsic aids
- But these are also true of an ordinary TCP interpretive exercise

DISTINCTION EXPLAINED IN *COPTHORNE*

“While the [unified TCP] approach is the same as in all statutory interpretation, the analysis seeks to determine a different aspect of the statute than in other cases. In a traditional statutory interpretation approach the court applies the textual, contextual and purposive analysis to determine what the words of the statute mean. In a GAAR analysis the textual, contextual and purposive analysis is employed to determine the object, spirit or purpose of a provision.”

MAJORITY'S DECISION

- As stated in prior cases, abuse may be found where:
 - Provisions seek to prevent the result
 - Transaction defeats the underlying rationale, or
 - Transaction circumvents the provision
- Disagrees with Côté that GAAR cannot apply where provisions are drafted with precision

MAJORITY'S DECISION

- Rowe concludes that the object, spirit and purpose of s. 111(5) (also referred to as the underlying rationale and the mischief) is “to prevent corporations from being acquired by unrelated parties in order to deduct their unused losses for the benefit of new shareholders”
- Refers to de jure control as “a rough proxy” (this is not helpful – proxy for what?)
- Wording of s. 111(5) has changed significantly but rationale has remained the same

MAJORITY'S DECISION

- Rowe rejects the references to “effective control” in *Duha Printers* and “actual control” in the FCA as inappropriate descriptions of the rationale of s. 111(5)
- He views the transactions realistically and concludes that they abused s. 111(5)

MAJORITY'S DECISION

- He terms the result of the transactions as the “functional equivalent” of de jure control
 - Exacerbates the confusion generated by references to actual and effective control
 - I don't attach any significance to the use of the term
- Transactions achieved a result that Parliament intended to prevent through s. 111(5) because they severed the business and shareholder “continuity that is at the heart of the object, spirit and purpose of s. 111(5)”

JUSTICE CÔTÉ'S DISSENT

- First sentence: case is “of profound concern to Canadian taxpayers” – Why?
- Focus is on restricting the GAAR
- Criticizes majority for adopting an “ad hoc approach” that “invites the exercise of unbounded judicial discretion” and makes GAAR applicable “in each and every case” (para.155) – hyperbole
- GAAR cannot override Parliament’s specific intent, as shown in particular provisions
- GAAR can’t be used to rewrite provisions of the Act
- Cites the Duke, although she admits it is not absolute

JUSTICE CÔTÉ'S DISSENT

- Abuse analysis is just a “specialized form of statutory interpretation”
- Although GAAR may supplement SPAARs, it cannot do so where a SPAAR is drafted in a technical, careful manner (para. 150) – derived from principle that GAAR cannot be used to rewrite provisions
- This is a weak argument used to frame the issue in a biased way: no one argues that GAAR applies to rewrite other provisions

JUSTICE CÔTÉ'S DISSENT

- Injection of the exception to TCP interpretive approach (where words are precise and unequivocal, text plays dominant role) into the determination of abuse under the GAAR – text completely captures the object, spirit and purpose
- Purpose of s. 111(5) completely captured by de jure control on basis of *Duha Printers*
- Her approach renders the GAAR meaningless with respect to most, if not all, SPAARs (and other provisions)

JUSTICE CÔTÉ'S DISSENT

- Justice Côté (and the SCC in other GAAR cases) ignores Parliament's intent in enacting the GAAR, but puts it front and centre when considering other provisions of the Act
- Purpose of the GAAR is apparent from its words and extrinsic aids
- Côté seems intent on undermining the GAAR

JUSTICE CÔTÉ'S DISSENT

- Argument that s. 111(5) is binary (i.e., only alternative to de jure control is de facto control, which Parliament clearly rejected in s. 111(5))
- Unconvincing – alternative is that GAAR supplements the de jure control test to prevent abuse; does not rewrite it as a de facto test
- Alternative is preferable because it provides a role for the GAAR in accordance with its purpose and it makes sense: a basic de jure control test supplemented by an anti-abuse rule

JUSTICE CÔTÉ'S DISSENT

- She repeats the mistake in *Alta Energy* that the GAAR is intended to deal with unforeseen tax strategies
- No evidence to support this view, and evidence to the contrary (repeal of ss. 55(1), old 245(1) and s. 247(1) (surplus stripping) when GAAR was enacted)
- Majority explicitly disagrees with this point
- See also the proposed preamble to the GAAR

CONCLUSION

- These types of loss utilization transactions have been prohibited specifically by s. 256.1 since 2013
- Does *Deans Knight* represent a significant shift in the SCC's attitude to the GAAR from *Alta Energy*?
 - 2 judges in the majority in *Alta Energy* have retired and been replaced by judges who sided with the majority in *Deans Knight*
 - Although Brown and Côté will continue to oppose the application of the GAAR, there may be a new 5-to-7 majority who see the GAAR as playing a meaningful role in controlling tax avoidance

Proposed Amendments to the GAAR

- 2023 budget proposed several amendments to the GAAR; detailed Notice of Ways and Means Motion in statutory language
- No effective date
- Finance did not wait for SCC's decision in *Deans Knight*
- Will proposed amendments be revised in light of public consultation or *Deans Knight*?

Proposed Amendments to the GAAR

- New preamble
- One of the main purposes test to replace primary purpose test and definition of avoidance transaction simplified
- New economic substance rules
- 25% penalty if no disclosure
- Extended reassessment period

New Preamble

- 3 aspects:
 1. Description of the GAAR with statement “allowing taxpayers to obtain tax benefits contemplated by the relevant provisions”
 - Adds little or nothing

New Preamble

2. Purpose of the GAAR: strikes a balance between taxpayers' need for certainty and government's responsibility to protect the tax base and tax fairness
 - attempt to rebut SCC's meaningless mantra "certainty, predictability and fairness"
 - effectiveness?

New Preamble

3. Assertion that the GAAR can apply to foreseen or unforeseen tax strategies
 - Attempt to rebut SCC's statement in *Alta Energy* that the applies only to unforeseen tax strategies
 - Necessary in light of DK?

Economic Substance Rules

- Where avoidance transaction is “significantly lacking in economic substance, that tends to indicate” it is abusive
- Factors that “tend . . . to establish that a transaction or series is significantly lacking in economic substance include”:
 1. No change in profit potential and risk of loss because of circular flows, offsetting financial positions, timing between steps

Economic Substance Rules

2. expected value of tax benefit exceeds economic return (excluding tax benefit and tax benefits from other jurisdictions)

3. entire or almost entire purpose was to obtain the tax benefit

GAAR Penalty

- Penalty of 25% of the tax benefit that would have resulted in the absence of the GAAR
- Penalty does not apply where taxpayer discloses the transaction (and series?)
- No penalty if tax benefit relates to a tax attribute (i.e. potential tax benefits)
 - This exception is difficult to justify