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## The Interpretive Exercise under the General Anti-Avoidance Rule

David G. Duff\*

### *Introduction*

According to subsection 245(4) of the Income Tax Act (the Act)<sup>1</sup> the general anti-avoidance rule (“GAAR”) applies to an avoidance transaction only if it is reasonable to consider that the transaction would, but for the GAAR, result directly or indirectly in a misuse of one or more provisions of the Act or other relevant enactments, including tax treaties, or an abuse having regard to those provisions other than the GAAR read as a whole.<sup>2</sup> Subsection 245(4) was added to the GAAR to ensure that it does not apply to “tax-motivated transactions that are otherwise in accordance with the object and spirit of the provisions of the Act,”<sup>3</sup> and “draws a line between legitimate tax minimization and abusive tax avoidance” by asking whether the avoidance transaction at issue is consistent with, or frustrates or defeats, the object, spirit, and purpose of the relevant provisions.<sup>4</sup> For this reason, application of the GAAR ultimately depends on an interpretive exercise to determine the object, spirit, and purpose of these provisions.

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<sup>1</sup> RSC 1985 c. 1 (as amended).

<sup>2</sup> Although the French version of the ITA uses the same word, “abus,” instead of separate words misuse and abuse, it distinguishes between an abuse in the application of one or more of the provisions of the ITA and other relevant enactments, including tax treaties (“dans l’application des dispositions d’un ou de plusieurs des textes suivant”), and an abuse in the application of those provisions read as a whole (dans l’application de ces dispositions ... lues dans leur ensemble”).

<sup>3</sup> David Dodge, “A New and More Coherent Approach to Tax Avoidance” (1988), 36:1 *Canadian Tax Journal* 1, at 20.

<sup>4</sup> *Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54, at paragraphs 16 and 57 (*Canada Trustco*).

Since the object, spirit, and purpose of a provision is also taken into account under the “textual, contextual and purposive” (TCP) approach to the interpretation of statutes endorsed by the Supreme Court of Canada,<sup>5</sup> an obvious issue in the application of the misuse or abuse test is the relationship between “ordinary interpretation” under the TCP approach and the interpretive exercise under the GAAR. Another important issue in the application of this provision is the method by which the object, spirit, and purpose of provisions is construed in order to determine whether an avoidance transaction results in a misuse of specific provisions or an abuse having regard to provisions read as a whole.

This chapter examines the interpretive exercise under the GAAR, contrasting this interpretive exercise with ordinary interpretation under the TCP approach, and considering the way in which the object, spirit, and purpose of the relevant provisions is determined in order to decide whether an avoidance transaction is subject to the GAAR. The first part distinguishes the interpretive exercise under the GAAR from the TCP approach, explaining that ordinary interpretation under the TCP approach is rightly constrained by the text of the applicable provisions in a way that the interpretive exercise under the GAAR is not. The second part addresses the way in which the object, spirit, and purpose of the relevant provisions is interpreted, criticizing the “unified textual, contextual and purposive” approach adopted by the Supreme Court in *Canada Trustco Mortgage Co. v. Canada*,<sup>6</sup> and arguing that separate inquiries into a misuse of specific provisions and an abuse having regard to provisions read as a whole is not only consistent with the Court’s admonition in *Canada Trustco* against judicial reliance on overarching or overriding policies that are not anchored in the interpretation of the relevant provisions, but mandated by the text of subsection 245(4).

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<sup>5</sup> Ibid., at paragraph 10.

<sup>6</sup> Ibid., at paragraphs 38 to 43.

## *I. The TCP Approach and the Interpretive Exercise Under the GAAR*

Although the object, spirit, or purpose of a provision is central to the interpretive exercise under the GAAR it also plays a role in the TCP approach. For this reason, it might be argued that this method of interpretation renders the GAAR irrelevant—since the application of the GAAR is not necessary to deny tax benefits where the relevant provisions are already interpreted in accordance with their object, spirit, and purpose to deny abusive transactions, and those provisions do not apply to transactions that are consistent with the object, spirit, and purpose of the relevant provisions.<sup>7</sup> Alternatively, it could be argued that the interpretive exercise under the GAAR presumes a literal approach to the ordinary interpretation of tax statutes and treaties, which is contrary to the TCP approach.<sup>8</sup>

Both of these arguments find support in the Supreme Court’s decision in *Canada Trustco*, which repeatedly conflates the interpretive exercise under the GAAR with the TCP approach,<sup>9</sup> and further states that the role of the GAAR is “to negate arrangements that would be permissible under a *literal interpretation* of other provisions” of the ITA.<sup>10</sup> In contrast, in *Cophorne Holdings Ltd. v. Canada*,<sup>11</sup> the court clearly distinguishes the

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<sup>7</sup> See, for example, Brian J. Arnold and James R. Wilson, “The General Anti-Avoidance Rule – Part 2” (1988), 46:5 *Canadian Tax Journal* 1123 at 1172.

<sup>8</sup> See, for example, Brian J. 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 at 125-26.

<sup>9</sup> *Canada Trustco*, supra note 4, at paragraph 40, stating that there is “but one principle of interpretation”; at paragraph 47, stating that “subsection 245(4) requires the court to look beyond the mere text of the provisions and undertake a contextual and purposive approach to interpretation in order to find a meaning that harmonizes the wording, object, spirit and purpose of the provisions”; at paragraph 51, stating that the provisions giving rise to a tax benefit “must be interpreted in their legislative context, together with other related and relevant provisions, in light of the purposes that are promoted by those provisions and their statutory schemes”; and at paragraph 58, stating that the “central issue” in the analysis of abusive tax avoidance is “the proper interpretation of the relevant provisions in light of their context and purpose.” I return to this point below; see the text accompanying notes 71 to 75.

<sup>10</sup> *Ibid.*, at paragraph 13 [emphasis added].

<sup>11</sup> 2011 SCC 63 (*Cophorne*).

interpretative exercise under the GAAR from ordinary interpretation under the TCP approach, explaining that ordinary interpretation applies a “textual, contextual and purposive analysis to determine what the words of the statute mean,” whereas a GAAR analysis employs this approach to determine the object, spirit, or purpose of the relevant provisions or “rationale that underlies the words” in order to apply the misuse or abuse test in subsection 245(4).<sup>12</sup>

The following sections examine the ordinary method of interpretation under the TCP approach and the interpretive exercise under the GAAR, explaining how (and why) they differ. As the first section explains, although the TCP approach departs from literal interpretation by considering the broader context and purpose of a provision as well as its text, the text continues to play a dominant role in the interpretive process by limiting the influence of contextual and purposive considerations to plausible meanings of the relevant text and outweighing these other interpretive considerations where they conflict with the text. In contrast, as the second section explains, the function of the interpretive exercise under the GAAR is not to determine the meaning of the text, but to override this meaning in order to deny a tax benefit that would otherwise result from an avoidance transaction that results in a misuse of the relevant provisions or an abuse having regard to the provisions as ordinarily interpreted. While in ordinary interpretation an emphasis on the text reflects rule of law principles of legal certainty and legislative supremacy, in the context of the GAAR, an emphasis on the object, spirit, and purpose of the relevant provisions is justified to distinguish legitimate tax minimization from abusive tax avoidance.

### ***1. Textual, Contextual, and Purposive Interpretation***

According to E.A Driedger’s “modern rule” of statutory interpretation, “the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of

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<sup>12</sup> Ibid., at paragraph 70.

Parliament.”<sup>13</sup> First endorsed by the Supreme Court in *Stuart Investments Ltd. v. Canada*,<sup>14</sup> this method of interpretation was reaffirmed and renamed the TCP approach in *Canada Trustco*,<sup>15</sup> and reaffirmed in subsequent Supreme Court decisions as the approved method for interpreting tax legislation.<sup>16</sup> The Vienna Convention on the Law of Treaties establishes a similar approach for interpreting treaties, including tax treaties, and provides that treaties “shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose.”<sup>17</sup>

Since a TCP approach provides that the words or terms of a provision are to be read “harmoniously with” or “in light of” their objects and purposes and the schemes of which they are a part, this method of interpretation differs from literal approaches such as strict construction or the plain meaning rule. Under strict construction, which was the dominant method for interpreting tax statutes in Canada until the Supreme Court’s decision in *Stuart*,<sup>18</sup> tax provisions were interpreted literally, without any regard to their objects or

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<sup>13</sup> E.A. Driedger, *Construction of Statutes*, 2d ed. (Toronto: Butterworths, 1983), at 87.

<sup>14</sup> [1984] 1 SCR 536 at paragraph 61 (*Stuart*).

<sup>15</sup> *Supra* note 4, at paragraph 10, quoting Driedger’s modern rule and stating that “[t]he interpretation of a statutory provision must be made according to a textual, contextual and purposive analysis to find a meaning that is harmonious with the Act as a whole.”

<sup>16</sup> See, for example, *Lipson v. Canada*, 2009 SCC 1, at paragraph 26; *Copthorne*, *supra* note 11, at paragraph 70; *Craig v. Canada*, 2012 SCC 43, at paragraph 38; and *Canada (National Revenue) v. Thompson*, 2016 SCC 21, at paragraph 32.

<sup>17</sup> Vienna Convention on the Law of Treaties, Article 31(1), signed at Vienna on May 23, 1969, UN doc. A/Conf. 39/27, fourth annex, UNTS 1155/331 (Vienna Convention).

<sup>18</sup> *Supra* note 15, at paragraph 60, referring to “the demise of the strict interpretation rule for the construction of taxing statutes.” The Supreme Court reaffirmed its rejection of strict construction two years later in *Golden v. The Queen*, [1986] SCR 209, at paragraph 10, stating that strict construction “no longer finds a place in the canons of interpretation applicable to taxation statutes” and that the *Stuart* decision “recognized that in the construction of taxation statutes the law is not confined to a literal and virtually meaningless interpretation of the Act where the words will support on a broader construction a conclusion which is workable and in harmony with the evident purposes of the Act in question.”

purposes or the broader context of the schemes of which they are a part.<sup>19</sup> Under the plain meaning rule that the Supreme Court affirmed from the mid-1990s to the early 2000s, the broader context and purpose of a provision could be considered only to resolve ambiguities resulting from a literal interpretation of the provision.<sup>20</sup> In contrast to these methods of interpretation, the TCP approach allows contextual and purposive considerations to be taken into account in all circumstances, not only to resolve ambiguities but to reveal ambiguities where none might otherwise be apparent on a literal reading of the text.

Although the TCP approach provides that the text of a provision should be read harmoniously with the scheme of which the provision is a part as well as with its objects and purposes, it is important to recognize that these interpretive considerations are not given equal weight. On the contrary, since the function of contextual and purposive analysis under the TCP approach is to determine the meaning of the relevant text, the text necessarily plays a leading role in the interpretive process, limiting the influence of contextual and purposive considerations and outweighing these considerations where they conflict with any plausible meaning of the text. This emphasis on the text reflects two core principles associated with the rule of law: (1) the principle of legislative supremacy, which requires courts to be attentive to the text that the legislature has approved in the form of legislation or the ratification of a treaty; and (2) a principle of legal certainty according to which persons should generally be able to rely on the apparent meaning of a legal text in order to govern their affairs.<sup>21</sup>

As a result, under a TCP approach, while contextual and purposive considerations may displace the ordinary or literal meaning of a text, the alternative meaning that is

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<sup>19</sup> For a detailed explanation, see David G. Duff, “Interpreting the *Income Tax Act*—Part 1: Interpretive Doctrines” (1999), 47:3 *Canadian Tax Journal* 464, at 469-477.

<sup>20</sup> *Ibid.*, at 504-517.

<sup>21</sup> See, for example, William N. Eskridge Jr. and Philip P. Frickey, “Statutory Interpretation as Practical Reasoning” [1990] 42 *Stanford Law Review* 321 at 354.

selected must be a plausible meaning that the words are reasonably capable of bearing.<sup>22</sup> For example, in *D & D Livestock Ltd. v. Canada*,<sup>23</sup> where the minister argued that a tax benefit (the duplication of safe income) resulting from a complex series of transactions carried out by the taxpayer should be denied because it was contrary to the object and purpose of subsection 55(2) of the Act (as it then read), the Tax Court rightly dismissed this argument on the grounds that the minister was asking the court “to give effect to the purpose of the subsection in spite of its wording rather than interpreting its wording in a manner which gives effect to its purpose.”<sup>24</sup> Notably, however, the court emphasized that the minister can always challenge abusive transactions under the GAAR.<sup>25</sup>

Moreover, where interpretive considerations point in different directions, a TCP approach weighs textual considerations more heavily than contextual and purposive considerations, and contextual considerations more heavily than purposive considerations.<sup>26</sup> For example, in *Stapley v. Canada*,<sup>27</sup> where the taxpayer sought to deduct the full cost of gift certificates for food and beverages and tickets to concerts and sporting events that he gave to clients for promotional purposes, the Federal Court of Appeal relied on the text of subsection 67.1(1) and its context within the scheme of section 67.1 as a whole to conclude that the allowable deduction was limited to 50 percent of the amount claimed,<sup>28</sup> notwithstanding its view that the application of the provision on the facts of the

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<sup>22</sup> See, for example, Ruth Sullivan, “Statutory Interpretation in a New Nutshell” [2003] 82 *Canadian Bar Review* 51 at 60, referring to the “plausible meaning rule” according to which a meaning that “give[s] effect to the actual or presumed intentions of the legislature, ... must be one the words are capable of bearing.”

<sup>23</sup> 2013 TCC 318 (*D & D Livestock*).

<sup>24</sup> *Ibid.*, at paragraph 32, adding (at paragraph 33) that the TCP method of interpretation affirmed in *Canada Trustco* does not “give me the authority to simply re-write the subsection to give effect to its purpose.”

<sup>25</sup> *Ibid.*, at paragraph 34.

<sup>26</sup> See, for example, David G. Duff, “Interpreting the *Income Tax Act* – Part 2: Toward a Pragmatic Approach” (1999) 47 *Canadian Tax Journal* 741 at 795, arguing that a “pragmatic approach” to statutory interpretation accords “greater weight to apparently unambiguous words supported by their immediate context than to other elements of statutory meaning.”

<sup>27</sup> 2006 FCA 36.

<sup>28</sup> *Ibid.*, at paragraphs 12 to 21.

case would contradict the purpose of the provision to limit the deduction of expenses that include an element of personal consumption.<sup>29</sup> According to the Court, “the statute dictates the result in this case.”<sup>30</sup>

As a result, as the Supreme Court observed in *Canada Trustco*, although courts should always “seek to read the provisions of an Act as a harmonious whole,” the “relative effects of ordinary meaning, context and purpose on the interpretive process may vary.”<sup>31</sup> On the one hand, where the text of a provision is “precise and unequivocal,” the ordinary meaning of the text should play “a dominant role in the interpretive process.”<sup>32</sup> On the other hand, where the text “can support more than one reasonable meaning,” “the ordinary meaning of the words plays a lesser role.”<sup>33</sup> However, in each case, the text constrains the range of permissible interpretations, consistent with principles of legislative supremacy and legal certainty.

In addition, as the court also explained in *Canada Trustco*, because the Act is “dominated by explicit provisions dictating specific consequences,” the text of this statute itself invites “a largely textual interpretation”<sup>34</sup>—suggesting a greater emphasis on the text of most provisions of the Act than on their broader contexts or purposes. However, according to the court, this approach should not be confused with a literal or plain meaning approach, since contextual and purposive considerations may be relied on to “reveal or resolve latent ambiguities” even where the meaning of a particular provision “may not appear to be ambiguous at first glance.”<sup>35</sup>

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<sup>29</sup> *Ibid.*, at paragraphs 22-27.

<sup>30</sup> *Ibid.*, at paragraph 31.

<sup>31</sup> *Canada Trustco*, supra note 4, at paragraph 10.

<sup>32</sup> *Ibid.*

<sup>33</sup> *Ibid.*

<sup>34</sup> *Ibid.*, at paragraph 13.

<sup>35</sup> *Ibid.*, at paragraph 47.

## 2. *The Interpretive Exercise under the GAAR*

While the TCP approach regards the text of a provision as the primary consideration in its interpretation and takes the broader context and purpose of the provision into account in order to interpret the meaning of the text, the interpretive exercise under the GAAR reverses this order, relying on the object, spirit, or purpose of provisions to override their meaning as ordinarily interpreted in order to deny tax benefits that would otherwise result from avoidance transactions resulting in a misuse of specific provisions or an abuse having regard to these provisions read as a whole. As a result, as the Supreme Court stated in *Cophorne*,<sup>36</sup> the GAAR is “a legal mechanism whereby Parliament has conferred on the court the unusual duty of going behind the words of the legislation” to deny tax benefits that would otherwise result from avoidance transactions that contradict the object, spirit, or purpose of the relevant provisions.<sup>37</sup> Judith Freedman makes a similar point, observing that the interpretive exercise under general anti-avoidance rules and principles is “an unusual form of interpretation” that “goes beyond” what is normally understood as statutory interpretation.<sup>38</sup>

Since, unlike ordinary interpretation under the TCP approach, this “unusual form of interpretation” is not constrained by the text, it is often argued that GAARs contradict the rule of law principle that laws should ideally be reasonably certain and predictable.<sup>39</sup> However, this departure from the principle of legal certainty is arguably consistent with the rule of law, on the grounds that it is necessary to discourage and counteract tax-motivated transactions that undermine the integrity of the law by complying with the text

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<sup>36</sup> *Supra* note 11.

<sup>37</sup> *Ibid.*, at paragraph 66.

<sup>38</sup> Judith Freedman, “The Anatomy of Tax Avoidance Counteraction: Abuse of Law in a Tax Context at Member State and European Union Level,” in Rita de la Feria and Stefan Vogenauer, eds., *Prohibition of Abuse of Law: A New Principle of EU Law?* (Oxford: Hart Publishing, 2011), 365 at 375-76.

<sup>39</sup> See, for example, Rebecca Prebble and John Prebble, “Does the Use of General Anti-Avoidance Rules to Combat Tax Avoidance Breach Principles of the Rule of Law? A Comparative Study” (2010) 55 *Saint Louis University Law Journal* 21 at 28-30.

of the relevant provisions without also adhering to their object, spirit, or purpose.<sup>40</sup> As a result, while the principle of legal certainty generally prohibits courts from invoking the object, spirit, and purpose of a provision to override its meaning as ordinarily interpreted, this principle is legitimately superseded by an anti-abuse principle where an avoidance transaction is undertaken or arranged in order to obtain a tax benefit.<sup>41</sup>

In order to interpret the object, spirit, and purpose of a provision, courts necessarily consider the same interpretive sources to which they refer to determine the meaning of its text: the text itself, the broader context of related provisions that comprise a scheme of which the specific provision is a part, and extrinsic evidence of the provision's purpose including the history of the relevant enactment and authoritative statements regarding its purpose.<sup>42</sup> As a result, as the Supreme Court noted in *Copthorne*,<sup>43</sup> the same textual, contextual, and purposive method of analysis that is used to determine the meaning of a provision under the TCP approach may also be used to identify its object, spirit, or purpose in a GAAR analysis. Although the method of analysis may be the same, the aim and function of the interpretive exercises differ, since the TCP approach applies a textual, contextual, and purposive analysis to determine what the words of the relevant provisions mean, while a GAAR analysis employs a textual, contextual, and purposive analysis to determine their object, spirit, or purpose.<sup>44</sup>

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<sup>40</sup> David G. Duff, "General Anti-Avoidance Rules Revisited: Reflections on Tim Edgar's 'Building a Better GAAR'" (2020), 68:2 *Canadian Tax Journal* 579 at 589-591, arguing that, if properly designed, a GAAR is consistent with the rule of law.

<sup>41</sup> *Ibid.*, at 595-596.

<sup>42</sup> See, for example, Sullivan, *Driedger on the Construction of Statutes*, 6<sup>th</sup> ed. (Toronto: LexisNexis Butterworths, 2014), chapter 9, explaining that reasonable interpretations with respect to the purposes of legislative provisions are generally based on plausible inferences from the text of the provisions, the broader schemes of which they are a part, and the history of the relevant enactment, in addition to authoritative statements in extrinsic materials.

<sup>43</sup> *Supra* note 11, at paragraph 70.

<sup>44</sup> *Ibid.*

To say that the interpretive exercise under the GAAR may result in the GAAR overriding the meaning of the text as ordinarily interpreted does not mean that the process of ordinary interpretation should revert to a literal approach in GAAR cases—although the Supreme Court, in several passages in *Canada Trustco* and *Mathew v. Canada*,<sup>45</sup> appears to have assumed this relationship declaring that the purpose of the GAAR is to deny tax benefits that would otherwise result from a “literal application” of other provisions of the Act.<sup>46</sup> In contrast, in *Copthorne*,<sup>47</sup> the Supreme Court states that the GAAR applies to transactions that are “in strict compliance with the text of the relevant provisions relied upon,”<sup>48</sup> without suggesting that the meaning of these provisions is based on a literal interpretation. On the contrary, although the *Copthorne* decision also contrasts “the rationale that underlies the words” with “the bare meaning of the words themselves,”<sup>49</sup> the court is clear that the “traditional statutory interpretation approach” that is used to determine “what the words of the statute mean” is a TCP approach that combines “textual, contextual and purposive analysis.”<sup>50</sup> Indeed, since the GAAR is generally recognized as “a provision of last resort,”<sup>51</sup> it makes sense that it should apply only where an avoidance transaction results in a tax benefit under tax provisions as ordinarily interpreted under the TCP approach.

Since the TCP approach is ultimately constrained by the text of the relevant provisions in a way that the interpretive exercise under the GAAR is not, the TCP approach does not render the GAAR irrelevant. On the contrary, although these interpretive exercises both consider the broader context and purpose of the provisions at issue, the TCP approach takes contextual and purposive considerations into account in order to determine the meaning of the text, while the interpretive exercise under the GAAR takes these

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<sup>45</sup> 2005 SCC 55 (*Mathew*).

<sup>46</sup> *Canada Trustco*, supra note 4, at paragraphs 1, 13, and 49; and *Mathew*, supra note 45, at paragraph 46.

<sup>47</sup> Supra note 11.

<sup>48</sup> *Ibid.*, at paragraph 66.

<sup>49</sup> *Ibid.*, at paragraph 70.

<sup>50</sup> *Ibid.*

<sup>51</sup> *Canada Trustco*, supra note 4, at paragraph 21.

considerations into account in order to determine the object, spirit, and purpose of the relevant provisions, which is relied on to deny a tax benefit that would otherwise result from an avoidance transaction that misuses or abuses the relevant provisions as ordinarily interpreted.<sup>52</sup>

## ***II. Interpreting the Object, Spirit, and Purpose of the Relevant Provisions***

Since subsection 245(4) refers to a misuse of provisions and an abuse having regard to provisions read as a whole, one might expect that the interpretive exercise under subsection 245(4) would involve two inquiries: one regarding the object, spirit, and purpose of the specific provisions that may be misused in order to obtain a tax benefit, and the other regarding the object, spirit, and purpose of the broader scheme that may have been abused by the avoidance transaction at issue.<sup>53</sup> Indeed, this was the interpretive approach adopted by the Federal Court of Appeal in *OSFC Holdings Ltd. v. Canada*,<sup>54</sup> concluding that subsection 245(4) contemplates two tests, one addressing the specific provisions at issue and another considering the broader scheme of which they are a part.<sup>55</sup>

However, in *Canada Trustco*, the Supreme Court rejected this interpretation, concluding that subsection 245(4) “requires a single, unified approach to the textual, contextual and purposive interpretation of the specific provisions of the *Income Tax Act*

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<sup>52</sup> For a similar point, see Marc Darmo and Olivier Fournier, “Recent Developments Regarding the Application of Subsection 245(4)” in *Report of Proceedings of the Sixty-Third Tax Conference*, 2011 Conference Report (Toronto: Canadian Tax Foundation, 2012), 37:1-33 at 6-7, explaining that the focus under subsection 245(4) is “entirely different” from that under ordinary interpretation, since “the words of the relevant provision do not necessarily constrain the contextual and purposive analysis in the same way that they do under the traditional statutory interpretation approach.”

<sup>53</sup> See, for example, Vern Krishna, *Fundamentals of Canadian Income Tax*, 6<sup>th</sup> ed. (Scarborough: Carswell, 2000) at 51, stating that the misuse concept “depends upon the object and spirit of the particular provision under scrutiny” while the abuse concept is a “wider question” requiring “an examination of the inter-relationship of the relevant statutory provisions in context.”

<sup>54</sup> 2001 FCA 260 (*OSFC*).

<sup>55</sup> *Ibid.*, at paragraph 60.

that are relied upon by the taxpayer in order to determine whether there was abusive tax avoidance.”<sup>56</sup> Although the court did not question this “single unified approach” in its subsequent decision in *Copthorne*,<sup>57</sup> its emphasis on the statutory scheme at issue is a significant departure from its emphasis in *Canada Trustco* on the specific provisions relied on by the taxpayer.

The following sections consider the interpretation and application of the misuse or abuse test in subsection 245(4), examining the interpretive frameworks established by the Supreme Court in *Canada Trustco* and *Copthorne* and the application of these interpretive frameworks in various GAAR cases. As the first section explains, the “single, unified approach” adopted in *Canada Trustco* disregards the text of subsection 245(4), downplays the relevance of the schemes of which provisions are a part, and conflates the interpretive exercise under the GAAR with the ordinary interpretation of tax provisions under the TCP approach. As the second section explains, while the modified interpretive framework established in *Copthorne* is a welcome improvement on the interpretive framework established in *Canada Trustco*, continued adherence to a single unified approach impedes the coherent application of the GAAR.

### ***1. The Interpretive Framework in Canada Trustco and Copthorne***

As noted above, in *OSFC* the Federal Court of Appeal concluded that subsection 245(4) contemplates separate inquiries into the object, spirit, or purpose of the provisions relied on by a taxpayer to obtain a tax benefit, and into the object, spirit, and purpose of the broader scheme that may be implicated by the avoidance transaction at issue. Referring to these terms collectively as the “policy of the provisions in question or of the Act read as a whole,”<sup>58</sup> Justice Rothstein stated that a misuse analysis considers each specific provision at issue and the policy behind it, while an abuse analysis considers “a wider context, having regard to the provisions of the *Income Tax Act* read as a whole and the policy behind

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<sup>56</sup> *Supra* note 4, at paragraph 43.

<sup>57</sup> *Supra* note 11, at paragraph 73.

<sup>58</sup> *OSFC*, *supra* note 55, at paragraph 66.

them.”<sup>59</sup> Although noting that the French version of subsection 245(4) uses the single word “abus” rather than the two words “misuse” and “abuse,” Justice Rothstein considered this distinction a matter of “linguistic nuance rather than a shading of the legislative intent,”<sup>60</sup> concluding that the French version should be interpreted to include “both the tests in the English version.”<sup>61</sup>

In *Canada Trustco*, the Supreme Court rejected this interpretation, for four reasons. First, it observed, the French version of subsection 245(4) not only used the single word “abus,” but also defined the test non-disjunctively as “d’abus dans l’application de dispositions de la présente loi lue dans son ensemble” (abuse in the application of the provisions of the law read as a whole).<sup>62</sup> Second, the court added, “Parliament could not have intended this two-step approach, which on its face raises the impossible question of how one can abuse the Act as a whole without misusing any of its provisions.”<sup>63</sup> Third, it declared:

There is but one principle of interpretation: to determine the intent of the legislator having regard to the text, its context, and other indicators of legislative purpose. The policy analysis proposed as a second step by the Federal Court of Appeal in *OSFC* is properly incorporated into a unified, textual, contextual, and purposive approach to interpreting the specific provisions that give rise to the tax benefit.<sup>64</sup>

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<sup>59</sup> *Ibid.*, at paragraph 61. For a critical analysis of the Court’s use of the word “policy,” which anticipated the Supreme Court’s reaction to this term in *Canada Trustco*, see Brian J. Arnold, “The Long, Slow, Steady Demise of the General Anti-Avoidance Rule” (2004) 52:2 *Canadian Tax Journal* 488, at 498-499, arguing that the use of the word “policy” as opposed to “statutory scheme” is “prejudicial to the application of the GAAR” since “judges inevitably prefer statutory words over unexpressed notions of parliamentary policy.”

<sup>60</sup> *Ibid.*, at paragraph 60, citing *RMM Canadian Enterprises v. The Queen*, [1998] 1 CTC 2300 (TCC), at paragraph 49, per Justice Bowman.

<sup>61</sup> *Ibid.*, at paragraph 61.

<sup>62</sup> *Canada Trustco*, supra note 4, at paragraph 38.

<sup>63</sup> *Ibid.*, at paragraph 39.

<sup>64</sup> *Ibid.*, at paragraph 39.

Finally, it stated, “courts cannot search for an overriding policy of the Act that is not based on a unified, textual, contextual and purposive interpretation of the specific provisions at issue,” since such a search would be “incompatible with the roles of reviewing judges” and “would run counter to the overall policy of Parliament that tax law be certain, predictable and fair, so that taxpayers can intelligently order their affairs”—thereby contradicting rule of law principles of legislative supremacy and legal certainty.<sup>65</sup>

None of these reasons for rejecting the two-step approach adopted in *OSFC* withstands serious scrutiny.

Beginning with the French version of the Act, the Supreme Court’s decision not only ignores the language in the English version, which refers to an abuse having regard to provisions of the Act other than the GAAR read as a whole, but also reads down the French version as if it referred only to the abuse of “specific provisions that give rise to the tax benefit,” not to an abuse in the application of the provisions of the Act read as a whole (“dans son ensemble”). More important, the 2005 amendments to subsection 245(4) clarified that the English and French versions both contemplate two separate inquiries, since each inquiry is now contained in a separate paragraph and the French version now explicitly refers to “un abus dans l’application des dispositions” (an abuse in the application of the provisions) in paragraph 245(4)(a) and “un abus dans l’application de ces dispositions ... lues dans leur ensemble” (an abuse in the application of these provisions ... read as a whole) in paragraph 245(4)(b), and prefaces these paragraphs with the words “selon le cas” (depending on the case).<sup>66</sup> Although in *Canada Trustco* the Supreme Court stated that these amendments “would not warrant a different approach to the issues on appeal,”<sup>67</sup> this conclusion is plainly incorrect with respect to the two-step approach adopted in *OSFC*.

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<sup>65</sup> *Ibid.*, at paragraphs 41 and 42.

<sup>66</sup> Budget Implementation Act, 2004, No. 2, SC 2005, c. 19, section 52.

<sup>67</sup> *Canada Trustco*, supra note 4, at paragraph 7, also concluding that the amendments, which were enacted to apply retroactively after the case was argued but before the decision was released, “cannot apply at this stage of appellate review after the parties argued their cases and the Tax Court judge rendered his decision

The second argument—that Parliament could not have intended a two-step approach because it is inconceivable how one could abuse the Act as a whole without misusing any of its provisions—ignores the relevance of broader schemes that may be implicated by avoidance transactions. While the use of one or more provisions to achieve a result that is contrary to their object, spirit, and purpose clearly misuses these provisions, the circumvention of a provision may contradict the object, spirit, or purpose of a scheme of which the provision is a part without specifically misusing any specific provision.<sup>68</sup> As a result, while the analysis of a misuse of specific provisions and an abuse having regard to the provisions of the Act read as a whole may have been “inseparable” on the facts in *Canada Trustco*,<sup>69</sup> that is not always the case and separate inquiries may be required to ensure that the GAAR is coherently applied.

The third argument—that there is only “one principle of interpretation” such that “the policy analysis proposed as a second step by the Federal Court of Appeal in *OSFC* is properly incorporated into a unified, textual, contextual, and purposive approach to interpreting the specific provisions that give rise to the tax benefit” —not only misconstrues what *OSFC* understood as “policy” analysis, but also erroneously conflates the TCP approach and the interpretive exercise under the GAAR.<sup>70</sup> As explained earlier, the use of the term “policy” in *OSFC* referred to the object, spirit, and purpose of specific provisions and the Act read as a whole, not to the second step of the two-step approach that the court employed.<sup>71</sup> More important, as explained in the first part of this chapter, the interpretive exercise under the GAAR differs from ordinary interpretation under the TCP approach.<sup>72</sup>

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on the basis of the GAAR as it read prior to the amendment.” Whether this is correct as a matter of law is an interesting question, which the analysis does not address.

<sup>68</sup> See, for example, Darro and Fournier, *supra* note 53, at 37:14, stating that: “For the GAAR to apply when a transaction circumvents a specific rule, a legislative scheme that includes the rule will generally have to be frustrated.”

<sup>69</sup> *Supra* note 4, at paragraph 39, citing the Tax Court decision at paragraph 90.

<sup>70</sup> See also *supra* note 9 and accompanying text.

<sup>71</sup> See above in the text accompanying notes 59 and 60.

<sup>72</sup> See above in the text accompanying notes 36 to 53.

As a result, as the Supreme Court confirmed in *Copthorne*, although courts may use the same TCP approach to determine “what the words of the statute mean” and “the rationale that underlies the words,”<sup>73</sup> the interpretive exercise under the GAAR involves a very different principle of interpretation than that under the TCP approach – one that requires courts to perform “the unusual duty of going behind the words of the legislation” to determine whether an avoidance transaction results in a misuse of specific provisions or an abuse having regard to the provisions read as a whole.<sup>74</sup>

Finally, although the Supreme Court rightly held in *Canada Trustco* that principles of legislative supremacy and legal certainty would make it inappropriate to apply the GAAR based on an “overriding policy” of the Act that is not “anchored in” an analysis of the relevant provisions,<sup>75</sup> this is clearly not what Justice Rothstein meant in *OSFC* when he used the word “policy” to refer to the object, spirit, and purpose of specific provisions and the Act read as a whole.<sup>76</sup> On the contrary, as the decision in *OSFC* itself indicates, the “policy” analysis conducted by the court was based on an analysis of the relevant provisions and the broader statutory scheme that was implicated by the transactions at issue.<sup>77</sup> As a result, as the court explained in *Copthorne*, while it is not permissible for courts to base a finding of abuse on “some broad statement of policy ... which is not attached to the provisions at issue,” the GAAR may be applied where an avoidance transaction contradicts the object, spirit, and purpose of a statutory scheme that is identified by a contextual analysis of the provisions comprising the scheme.<sup>78</sup>

Notwithstanding these criticisms, the Supreme Court did not reject the “single unified approach” in *Copthorne*, but instead reaffirmed the conclusion in *Canada Trustco*

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<sup>73</sup> *Copthorne*, supra note 11, at paragraph 70.

<sup>74</sup> *Ibid.*, at paragraph 66.

<sup>75</sup> *Canada Trustco*, supra note 4, at paragraph 55.

<sup>76</sup> See above in the text accompanying notes 58 and 59.

<sup>77</sup> *OSFC*, supra note 55, at paragraphs 73 to 81 and 82 to 101, examining the “policy” behind subsection 18(13) and the “policy” with respect to loss-trading by corporations and partnerships.

<sup>78</sup> *Copthorne*, supra note 11, at paragraph 118.

that “there is no distinction between an ‘abuse’ and a ‘misuse.’”<sup>79</sup> However, by clearly distinguishing the interpretive exercise under the GAAR from the TCP approach and clarifying that the contextual analysis of a statutory scheme differs from reliance on an “overriding policy,” the court modified the interpretive framework established in *Canada Trustco*, lessening the influence of textual considerations in the GAAR analysis and increasing the influence of contextual considerations with respect to the schemes that may be implicated by the avoidance transactions at issue.<sup>80</sup> The following section examines the impact of this shifting interpretive framework on key GAAR decisions and interpretive deficiencies resulting from continuing adherence to the single unified approach.

## 2. *Application in GAAR Cases*

As explained in the previous section, the interpretive framework established in *Canada Trustco* not only combined the two-step approach in *OSFC* into a single unified approach, but also downplayed the relevance of broader schemes in a GAAR analysis and increased the importance of textual considerations in a GAAR analysis by conflating the TCP approach and the interpretive exercise under the GAAR. In contrast, the interpretive framework established in *Copthorne* emphasizes the importance of the broader schemes of which provisions are a part and lessens the influence of textual considerations, while nonetheless adhering to the single unified approach adopted in *Canada Trustco*. A review of key GAAR cases illustrates the impact of these interpretive frameworks on the application of the GAAR and the deficiencies of the single unified approach.

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<sup>79</sup> *Ibid.*, at paragraph 73, citing *Canada Trustco*, *supra* note 4, at paragraph 43.

<sup>80</sup> For a similar point, see Darmo and Fournier, *supra* note 53, at 37:9, explaining that the *Copthorne* decision “could be read as modifying the interpretive exercise proposed under *Canada Trustco* from a search for the underlying rationale of each individual provision in issue to the search for the underlying rationale of ‘the scheme under consideration,’ which may include all of the provisions that have been either used or circumvented by the impugned transaction.”

**(1) *Impact of Interpretive Frameworks in Canada Trustco and Cophorne***

In *Canada Trustco*, the taxpayer carried out a circular series of transactions that allowed it to deduct capital cost allowance (CCA) on assets that it acquired at little or no economic cost and immediately leased back to the vendor of the assets. The minister argued that the deductions should be disallowed on the basis that the object, spirit, or purpose of the CCA provisions is limited to the recognition of the “real economic cost” of assets that are used to earn income.<sup>81</sup> Because this argument was based on explanatory notes to the GAAR stating that provisions of the Act are “intended to apply to transactions with real economic substance,”<sup>82</sup> and not on a detailed analysis of the relevant provisions and the CCA regime more generally, it is perhaps not surprising that the Supreme Court rejected this argument.

Instead, the court concluded that, since the relevant provisions use the word “cost” in the legal sense of “the amount paid to acquire assets” irrespective of financing arrangements or amounts at risk,<sup>83</sup> other provisions of the Act explicitly limit the deduction of costs to amounts that are at risk,<sup>84</sup> and ordinary sale-leaseback transactions do not contradict the purpose of the capital cost allowance provisions,<sup>85</sup> it was impossible to conclude that the transactions were contrary to the object, spirit, and purpose of the relevant provisions without invoking a concept of “economic substance” that was not based on a textual, contextual, and purposive interpretation of the CCA provisions.<sup>86</sup> It is in this context that one should understand the court’s statement that the GAAR cannot be applied

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<sup>81</sup> *Canada Trustco*, supra note 4, at paragraphs 68 and 70.

<sup>82</sup> Canada, Department of Finance, *Explanatory Notes to Legislation Relating to Income Tax* (Ottawa: Department of Finance, 1988), clause 186, adding that that “tax incentives expressly provided for in the legislation” are not intended to be “neutralized.”

<sup>83</sup> *Canada Trustco*, supra note 4, at paragraph 74.

<sup>84</sup> *Ibid.*, at paragraphs 72 and 74, referring to the at-risk rules for limited partnerships in subsections 96(2.1) to (2.7) of the Act.

<sup>85</sup> *Ibid.*, at paragraphs 68 and 74.

<sup>86</sup> *Ibid.*, at paragraph 76.

on the basis of an “overriding policy” that is not based on a textual, contextual, and purposive interpretation of the provisions at issue.<sup>87</sup>

In contrast, several cases decided before *Canada Trustco* applied the GAAR based on a contextual analysis of the relevant statutory scheme, rather than on any “overriding policy.” For example, in *McNichol v. The Queen*,<sup>88</sup> where the Tax Court applied the GAAR to what it called “a classic example of surplus stripping,”<sup>89</sup> the decision turned not on any overriding policy against surplus stripping but on a contextual analysis of various provisions, concluding that “the scheme of the Act calls for the treatment of distributions of corporate property as income.”<sup>90</sup> This statement was reaffirmed in *RMM Enterprises Inc. v. The Queen*,<sup>91</sup> in which Justice Bowman added that “the *Income Tax Act*, read as a whole envisages that a distribution of corporate surplus to shareholders is to be taxed as a payment of dividends.”<sup>92</sup>

In *Water’s Edge Village Estates (Phase II) Ltd. v. Canada*,<sup>93</sup> where the taxpayers acquired interests in a US partnership and claimed a terminal loss on the disposition of an obsolete computer that had been depreciated for US but not Canadian tax purposes, the Federal Court of Appeal referred to “the scheme of the capital cost allowance provisions” to conclude that the transactions were contrary to the purpose of those provisions “to recognize over time costs incurred to acquire capital assets actually used to earn income”

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<sup>87</sup> *Ibid.*, at paragraph 42.

<sup>88</sup> 97 DTC 111 (TCC).

<sup>89</sup> *Ibid.*, at paragraph 24.

<sup>90</sup> *Ibid.*, referring to the taxation of dividends under paragraph 12(1)(j) of the Act, the taxation of shareholder benefits under section 15, and the rules for deemed dividends in section 84. A more thorough analysis might also have referred to sections 84.1 and 212.1 and mentioned exceptions to this scheme such as the exclusion of capital dividends in subsection 83(2).

<sup>91</sup> *Supra* note 61.

<sup>92</sup> *Ibid.*, at paragraph 53.

<sup>93</sup> 2002 FCA 291.

under the Act.<sup>94</sup> Similarly, in *OSFC*,<sup>95</sup> where the transactions relied on the stop-loss rule in subsection 18(13) (as it then read) to transfer accrued losses to a non-arm's-length partnership, the interests in which were then sold to arm's-length parties who deducted their share of the losses when realized by the partnership, the Federal Court of Appeal's conclusion that the transactions abused a statutory "policy" against the transfer of corporate losses among arm's-length persons was based on a contextual analysis of provisions of the Act, including, in particular, the loss-restriction rule in subsection 111(5).

However, after the Supreme Court decision in *Canada Trustco*, lower courts became much less willing to rely on the statutory scheme in applying the GAAR. For example, in *Evans v. The Queen*,<sup>96</sup> where the minister argued that a series of transactions was "nothing more than a surplus strip" to which the GAAR should apply,<sup>97</sup> the Tax Court allowed the taxpayer's appeal on the grounds that each provision operated "exactly the way it is supposed to do" and the only basis on which it could uphold the minister's application of the GAAR "would be to find that there is some overarching principle of Canadian tax law that requires that corporate distributions to shareholders must be taxed as dividends" which "is precisely what the Supreme Court of Canada has said we cannot do."<sup>98</sup> Although it is not clear that the transactions involved surplus stripping as much as income splitting,<sup>99</sup> the impact of *Canada Trustco* is clear.

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<sup>94</sup> *Ibid.*, at paragraphs 41 and 42.

<sup>95</sup> *Supra* note 55, at paragraphs 82 to 98, considering the "policy" with respect to loss-trading by corporations.

<sup>96</sup> 2005 TCC 684 (*Evans*).

<sup>97</sup> The specific transactions involved the payment of a stock dividend to the taxpayer, the sale of these shares to a limited partnership in which the taxpayer's three minor children each held a 33 percent interest in exchange for a promissory note, and the payment of dividends on the shares that were used to make payments of principal and interest on the promissory notes.

<sup>98</sup> *Evans*, *supra* note 97, at paragraph 30.

<sup>99</sup> Although the dividends were included in computing the income of the taxpayer's minor children, tax otherwise payable on the dividends was sheltered by the personal tax credit and the dividend tax credit. As a result, the transactions did not actually strip the corporate surplus but shifted the tax on the surplus to the taxpayer's children. This aspect of the transactions is an interesting issue that was not addressed by the court.

In *Landrus v. The Queen*,<sup>100</sup> the minister disallowed the taxpayer's share of a terminal loss realized by a limited partnership of which he was a member on the basis that the loss was "only a paper loss" resulting from a disposition of the property to another limited partnership in which the taxpayer acquired an interest.<sup>101</sup> The Tax Court rejected the Crown's argument that specific stop-loss provisions (none of which specifically applied to the transactions) evidenced a "general policy" to disregard losses on dispositions of property within "the same economic unit."<sup>102</sup> According to the court, "the particularity with which Parliament has specified the relationship that must exist between the transferor and transferee for the purpose of each stop-loss rule ... is more indicative that these rules are exceptions to a general policy of allowing losses on all dispositions."<sup>103</sup>

In *Collins & Aikman Products Co. v. The Queen*,<sup>104</sup> the taxpayer carried out a series of transactions that allowed it to increase cross-border paid-up capital (PUC) from CAD 475,000 to CAD167 million without the investment of tax-paid funds and then to distribute CAD104 million as a tax-free return of capital.<sup>105</sup> The Tax Court relied on *Canada Trustco*

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However, it is notable that the transactions would have been subject to the tax on split income if they had been carried out after the TOSI was enacted in 1999.

<sup>100</sup> 2008 TCC 274, aff'd. 2009 FCA 113 (*Landrus*).

<sup>101</sup> *Ibid.*, at paragraph 83.

<sup>102</sup> *Ibid.*, at paragraph 114.

<sup>103</sup> *Ibid.*, at paragraph 120.

<sup>104</sup> 2009 TCC 299, aff'd. 2010 FCA 251 (*Collins & Aikman*).

<sup>105</sup> The specific transactions involved the sale by the taxpayer (a US company) to a newly incorporated Canadian company (Newco) of low-PUC and high fair market value (FMV) shares of a non-resident holding company (Holdco) that held shares of Canadian operating companies (Opcos), the continuation of Holdco into Canada, its amalgamation with the Opcos, the payment of an inter-corporate dividend to Newco, and the payment of CAD104 million by Newco to the taxpayer as a return of capital. Although section 212.1 would have reduced the PUC of the Newco shares issued to the taxpayer in exchange for the Holdco shares if Holdco had been resident in Canada at the time, it did not apply because Holdco had not yet continued into Canada. Although paragraph 128.1(1)(c.1) would now deem Holdco to have received a dividend equal to the difference between the FMV and the PUC of the Opcos shares when it became resident in Canada, the transactions occurred before this provision was enacted in 1998.

to dismiss the Crown’s argument that the transactions were contrary to a statutory scheme against surplus stripping. Citing *Canada Trustco* for the proposition that the GAAR cannot be applied based on an overriding policy that is not based on a textual, contextual, and purposive analysis of the relevant provisions,<sup>106</sup> the court rejected the Crown’s assertion that the Act includes a scheme against surplus stripping on the grounds that this premise “is not evidenced in the legislation,” nor in extrinsic aids to its interpretation.<sup>107</sup>

Similarly in *Gwartz v. Canada*,<sup>108</sup> where the taxpayer engaged in a series of transactions to convert dividends that would otherwise have been subject to the tax on split income (TOSI) under section 120.4 into capital gains that were not subject to the TOSI during the years at issue,<sup>109</sup> the Tax Court rejected the minister’s argument that the transactions abusively circumvented this provision on the grounds, among others, that “a broad policy in the *ITA* against income splitting, grounded in specific provisions of the *ITA*, other than subsection 120.4, has not been recognized.”<sup>110</sup> Like *Collins & Aikman*, this decision adhered closely to the text of the relevant provisions, concluding that the existence of specific statutory provisions to prevent income splitting and surplus stripping suggests that “Parliament was well aware” of opportunities to circumvent section 120.4 by converting dividends into capital gains,<sup>111</sup> as a result of which it followed that “the

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<sup>106</sup> *Collins & Aikman*, supra note 105, at paragraph 61.

<sup>107</sup> *Ibid.*, at paragraph 65.

<sup>108</sup> 2013 TCC 86 (*Gwartz*).

<sup>109</sup> The specific transactions involved the payment by a company controlled by the taxpayer of stock dividends with low PUC and high FMV to a family trust of which the taxpayer’s minor children were beneficiaries, the sale by the trust of these shares to the taxpayer in exchange for a promissory note (triggering capital gains that were allocated to the trust’s minor beneficiaries), the sale by the taxpayer of the shares to a company controlled by his spouse in exchange for a promissory note, the redemption of the shares by the taxpayer’s wife’s company, the use of the proceeds from the share redemption to repay the promissory note owing to the taxpayer, and the use of these proceeds by the taxpayer to repay the promissory note owing to the trust. The gains at issue in the case were realized in 2003, 2004 and 2005 before the enactment of subsections 120.4(4) and (5), which made capital gains from non-arm’s-length share disposition subject to the TOSI.

<sup>110</sup> *Gwartz*, supra note 109, at paragraph 53.

<sup>111</sup> *Ibid.*, at paragraph 67.

transactions ... did not circumvent the application of section 120.4 in a manner that constituted abusive tax avoidance for the purpose of subsection 245(4).”<sup>112</sup>

In contrast, in *Copthorne*,<sup>113</sup> the Supreme Court applied the GAAR on the basis of a statutory scheme with respect to PUC. The taxpayer engaged in a series of transactions to convert what would otherwise have been a vertical amalgamation subject to a reduction in PUC under subsection 87(3) into a horizontal amalgamation that was not subject to this PUC grind, allowing it to distribute a non-taxable return of capital in excess of capital invested in the corporate group. The Supreme Court held that the transactions were subject to the GAAR on the basis that subsection 87(3) is part of a statutory scheme (“the PUC scheme of the Act”) the purpose of which is to “allow ... for a return of tax-paid investment” in a corporation “without inclusion in income” while “precluding the preservation of PUC where such preservation would allow for a withdrawal, without liability for tax, of an amount in excess of the investment made with tax-paid funds.”<sup>114</sup> Rejecting the taxpayer’s argument that the specificity of detailed PUC reductions in the Act excluded the application of the GAAR to transactions that were not themselves subject to a specific provision,<sup>115</sup> the court observed that this “implied exclusion” argument would render the GAAR meaningless, since the GAAR applies only to transactions that are not subject to provisions as ordinarily interpreted.<sup>116</sup> As a result, it concluded that, while a close adherence to the text of the relevant provisions is appropriate in “a case of traditional statutory interpretation,”<sup>117</sup> this approach is misplaced in a GAAR analysis, which relies on “the underlying rationale or object, spirit, and purpose of the legislation” not “the text of the statute.”<sup>118</sup>

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<sup>112</sup> *Ibid.*, at paragraph 79.

<sup>113</sup> *Supra* note 11.

<sup>114</sup> *Ibid.*, at paragraph 96.

<sup>115</sup> *Ibid.*, at paragraph 108, arguing that “the detail of the PUC provisions, such as s. 87(3) suggest that where the taxpayer’s actions are not caught by a provision, the actions cannot abuse the purpose of a provision.”

<sup>116</sup> *Ibid.*, at paragraph 111, citing *OSFC*, *supra* note 55, at paragraph 63.

<sup>117</sup> *Copthorne*, *supra* note 11, at paragraph 108.

<sup>118</sup> *Ibid.*, at paragraph 109.

Based on *Copthorne*, one might reasonably question the conclusions in *Collins & Aikman* and *Gwartz* that the GAAR did not apply. In *Collins & Aikman*, the transactions may not have been subject to specific provisions of the Act but they clearly contradicted the PUC scheme of the Act identified in *Copthorne*, since they allowed the taxpayer to withdraw, without any tax, an amount greatly exceeding its investment with tax-paid funds. In *Gwartz*, the court's conclusion that the transactions did not contradict the object, spirit, and purpose of section 120.4 turns on the same type of implied-exclusion argument that the Supreme Court explicitly rejected in *Copthorne*. Indeed, subsequent cases have applied the GAAR to surplus-stripping and income-splitting transactions partly on the basis that these transactions contradict statutory schemes in the Act.<sup>119</sup>

In contrast, it is difficult to disagree with the court's conclusion in *Landrus* that the particularity of the various stop-loss rules in the Act does not support the existence of a general policy or scheme to disregard losses on dispositions of property within the same economic unit, regardless of how this concept may be defined. As a result, it is not surprising that the court's conclusion on this issue has been reaffirmed in more than one subsequent GAAR case.<sup>120</sup>

Based on *Copthorne*, one might also challenge the Federal Court of Appeal's conclusions in *OSFC* that the loss-trading transactions at issue did not contradict the object, spirit, and purpose of the stop-loss rule in subsection 18(13) (as it then read) or the partnership allocation rules in subsection 96(1). Although the court held that the

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<sup>119</sup> See, for example, *1245989 Alberta Ltd. v. Canada*, sub nom. *Wild v. Canada*, 2017 TCC 51, rev'd. 2018 FCA 114 (on other grounds) (*Wild*), referring to the PUC scheme of the Act to deny a tax benefit that would otherwise have resulted from a series of transactions designed to extract corporate surpluses on a tax-free basis; and *Gervais v. Canada*, 2016 TCC 180, aff'd. 2018 FCA 3, referring to the scheme of the Act governing transfers of property and the attribution of income between spouses to conclude that a series of transactions designed to split income was subject to the GAAR.

<sup>120</sup> See, for example, *1207192 Ontario Ltd. v. The Queen*, 2011 TCC 383 at paragraph 81; and 2012 FCA 258 (*Triad Gestco*).

transactions had not misused subsection 18(13) on the grounds that the purpose of the provision at the time was not only to preclude the realization of a superficial loss on the disposition of property to a non-arm's length person, but also to preserve the loss "for recognition on a later occasion by the non-arm's length transferee,"<sup>121</sup> this conclusion was based on a close textual analysis of the provision that contradicts the broader purposive approach mandated by *Copthorne*. The court's conclusion that loss trading did not contradict the partnership allocation rules in subsection 96(1) was also based on a textual analysis of this provision,<sup>122</sup> as well as on the implied exclusion principle that *Copthorne* dismissed as unsuitable in a GAAR analysis.<sup>123</sup>

Therefore, not surprisingly, these conclusions were rejected in subsequent GAAR cases. In *Mathew*,<sup>124</sup> which involved the same series of transactions as those in *OSFC*, the Supreme Court criticized the Federal Court of Appeal's "narrow textual analysis" of subsection 18(13),<sup>125</sup> concluding instead that the purpose of this provision was to disallow and preserve a loss by transferring it to a non-arm's-length transferee "because it essentially remains in the transferor's control,"<sup>126</sup> and that the transactions "frustrated Parliament's purpose of confining the transfer of the losses ... to a non-arm's-length partnership."<sup>127</sup> In *Canada v. 594710 British Columbia Ltd.*,<sup>128</sup> the taxpayer participated in a series of

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<sup>121</sup> *OSFC*, supra note 55, at paragraph 77.

<sup>122</sup> *Ibid.*, at paragraph 99, stating that the partnership allocation rules contained "no restrictions on loss trading at the relevant time."

<sup>123</sup> *Ibid.*, at paragraph 100, concluding that the rule against loss trading with foreign partnerships in subsection 96(8) "highlights the fact that in the case of partnerships other than foreign partnerships, accumulated losses, prior to the entry of a new partner, are available to that partner."

<sup>124</sup> *Supra* note 45, at paragraph 42.

<sup>125</sup> *Ibid.*, at paragraph 42.

<sup>126</sup> *Ibid.*, at paragraphs 53 and 54. This distinction between the purpose of the provision and the method by which the purpose is achieved is effectively illustrated by subsequent amendments to subsection 18(13) and most other stop-loss rules to preserve the disallowed loss in the hands of the transferor to be realized when the transferee disposes of the property to an unaffiliated person.

<sup>127</sup> *Ibid.* at paragraph 62.

<sup>128</sup> 2018 FCA 116 (*594710 British Columbia*).

transactions intended to allocate taxable income of a partnership to an arm's length corporation with accumulated non-capital losses. The Federal Court of Appeal concluded that the transactions were contrary to the object, spirit, and purpose of subsection 96(1), on the grounds that the purpose of this provision is to allocate income or losses among the members of a partnership who are entitled to these amounts because they were members of the partnership when the transactions occurred,<sup>129</sup> and not "to allocate taxable income in a manner that does not assist the organizational structure of the partnership or the efficient conduct of the partnership business."<sup>130</sup>

Similarly, in *Canada v. Oxford Properties Group Inc.*,<sup>131</sup> where the taxpayer carried out an elaborate series of transactions in order to avoid recapture of depreciation on the sale of real estate properties by transferring them on a tax-deferred basis through a tiered partnership structure, increasing the adjusted cost base of the partnership interests, and selling these interests to tax-exempt purchasers, the Federal Court of Appeal criticized the Tax Court's GAAR analysis on the basis that it was based narrowly on the text of the provisions rather than on their object, spirit, and purpose.<sup>132</sup> According to the Court, the purpose of excluding depreciable capital property from the bump provisions in subsections 88(1) and 98(3) is to prevent "property that is taxed on the basis of a 50% rate of inclusion to augment the [tax cost] of property that is taxed on the basis of a 100% rate of inclusion,"<sup>133</sup> and that a purpose of subsection 100(1) is to ensure that tax is paid on the

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<sup>129</sup> *Ibid.*, at paragraphs 52 to 54, citing the House of Commons debates prior to the introduction of section 30 of the Income War Tax Act, RSC 1927, c. 97, on which subsection 96(1) is based, and stating that the notion of entitlement "reflects the foundational principle of the Act that taxpayers are to be taxed on their own earnings, and not the earnings of someone else."

<sup>130</sup> 594710 *British Columbia.*, supra note 129, at paragraph 59.

<sup>131</sup> 2018 FCA 30.

<sup>132</sup> *Ibid.*, at paragraphs 88 and 101.

<sup>133</sup> *Ibid.*, at paragraph 78. These provisions generally allow taxpayers to increase the adjusted cost base of non-depreciable capital property on the windup of a subsidiary into a parent and the dissolution of a partnership to the extent that the adjusted cost base of the parent's shares of the subsidiary or the partner's interest in the partnership exceeds the cost amount of property received by the parent on the windup of the subsidiary or the partner on the dissolution of the partnership.

latent recapture with respect to a partnership's depreciable property "which would otherwise go unpaid on a subsequent sale of the depreciable property by the tax-exempt purchaser."<sup>134</sup> On this basis, it held that the transactions frustrated the purpose of subsection 100(1) to the extent that they allowed the taxpayer to avoid tax on the latent recapture,<sup>135</sup> defeated the rationale for excluding depreciable property from the bump provisions since property subject to tax on the basis of a 50 percent rate of inclusion was used to prevent recapture on property subject to a 100 percent rate of inclusion,<sup>136</sup> and abused the rollover provisions in subsections 97(2) and (4) because the subsequent transactions converted the deferred recapture on the transfer of the real estate properties to the partnerships into a permanent exclusion.<sup>137</sup> Therefore, as in *Copthorne*, the application of the GAAR turned on a broad contextual and purposive analysis of the relevant statutory provisions.

The decision in *Copthorne* also confirms that it is misleading to suggest, as some GAAR decisions have done, that the GAAR cannot be applied to deny tax benefits resulting from a gap in the legislation.<sup>138</sup> Although such a conclusion is appropriate in cases where a presumed scheme (such as disallowing losses on dispositions of property within the same "economic unit") is not sufficiently well-established to determine that the transaction at

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<sup>134</sup> *Ibid.*, at paragraph 101. This provision applies, among other circumstances, where a taxpayer disposes of a partnership interest to a tax-exempt entity, deeming the capital gain to be the total of (a) one-half of the capital gain as may reasonably be regarded as attributable to increases in the value of non-depreciable capital property held directly by the partnership or indirectly through one or more other partnerships, and (b) the whole of the remaining portion of the capital gain.

<sup>135</sup> *Ibid.*, at paragraph 101.

<sup>136</sup> *Ibid.*, at paragraph 112.

<sup>137</sup> *Ibid.*

<sup>138</sup> See *Geransky v. Canada*, 2001 D.T.C. 243 (TCC) at paragraph 42, stating that the minister cannot rely on the GAAR to "fill in any gaps not covered by the multitude of specific anti-avoidance provisions" in the Act when they are applied "in accordance with their terms;" *Landrus*, supra note 101, at paragraph 124, concluding that the minister's use of the GAAR to "fill the gaps left by Parliament in subsection 85(5.1) ... is an inappropriate use of the GAAR"; and *Collins & Aikman*, supra note 105, at paragraph 109, stating that the use of the GAAR "to fill in what [the Minister] perceives to be a possible gap left by Parliament ... would be an inappropriate use of the GAAR".

issue results in a misuse or abuse of the relevant provisions, it is incorrect where the existence of a statutory scheme (such as the PUC scheme of the Act) is clear enough to conclude that the transaction contradicts the object, spirit, and purpose of the relevant provisions.<sup>139</sup> As a result, while the Federal Court of Appeal has rightly held that the Crown’s burden to establish that a transaction results in a misuse or abuse cannot be discharged “*merely* by asserting that the transaction was not foreseen or that it exploits a previously unnoticed legislative gap,”<sup>140</sup> the identification of a statutory scheme may suggest that the exploitation of a previously unnoticed legislative gap constitutes abusive tax avoidance. In this circumstance, as the Tax Court has stated, the purpose and effect of the GAAR is “to close the gaps that sophisticated tax plans seek to exploit.”<sup>141</sup>

## **(2) Deficiencies of the Single Unified Approach**

Although *Copthorne* established that the GAAR can be applied based on a contextual analysis of a statutory scheme without relying on an “overriding policy”, it did not challenge the “single unified approach” adopted in *Canada Trustco* which emphasizes “the specific provisions in issue” rather than the broader statutory scheme of which they may be a part.<sup>142</sup> As a result, although the contextual analysis of a statutory scheme may inform a court’s interpretation of the object, spirit, and purpose of the relevant provisions, the application of the GAAR appears to depend on a conclusion that the avoidance transaction at issue contradicts the object, spirit, and purpose of one or more specific provisions, rather than the scheme itself.

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<sup>139</sup> In other words, as the Tax Court stated in *Gwartz*, supra note 109, at paragraph 48, “it is inappropriate, where the transactions do not otherwise conflict with the object, spirit and purpose of the provisions of the *ITA*, to rely on the GAAR to deny a tax benefit resulting from a taxpayer’s reliance on a previously unnoticed legislative gap.” (emphasis added).

<sup>140</sup> *Lehigh Cement Ltd. v. Canada*, 2010 FCA 124, at paragraph 37 [emphasis added].

<sup>141</sup> *Wild*, supra note 120, at paragraph 101.

<sup>142</sup> *Canada Trustco*, supra note 4, at paragraph 41.

For example, in *Copthorne*, the court’s conclusion that the transactions resulted in a misuse or abuse within the meaning of subsection 245(4) did not depend directly on a conclusion that they were contrary to the object, spirit, and purpose of the PUC scheme of the Act, but instead, that they were contrary to the object, spirit, and purpose of the PUC reduction for vertical amalgamations in subsection 87(3) – which the court interpreted in light of its contextual analysis of the statutory scheme for PUC. Similarly, in *Triad Gestco*<sup>143</sup> where the transactions entered into by the taxpayer created an offsetting capital gain and loss, but only the loss was realized for tax purposes, the Federal Court of Appeal held that the transactions were subject to the GAAR not because the creation of a paper loss was contrary to the “underlying policy” of the statutory scheme for capital gains and losses to recognize “real gains and losses” that affect a taxpayer’s “economic power,”<sup>144</sup> but because they resulted in “an abuse and misuse of the relevant provisions, specifically paragraphs 38(b), 39(1)(b) and 40(1)(b).”<sup>145</sup>

Although the decision in each of these cases, namely, that the GAAR should apply is justified, the analysis is unsatisfactory, since it reads into otherwise relatively mechanical provisions of the Act an object, spirit, and purpose that properly inheres in the statutory scheme as a whole rather than in the individual provisions themselves.<sup>146</sup> Therefore, it would have been more persuasive for the courts to have concluded that these transactions abused the provisions of the relevant statutory schemes read as a whole, instead of concluding that they abused or misused specific provisions. For this reason, the single unified approach adopted in *Canada Trustco* impedes the coherent application of the GAAR.

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<sup>143</sup> *Supra* note 121.

<sup>144</sup> *Ibid.*, at paragraphs 47 and 41-42.

<sup>145</sup> *Ibid.*, at paragraph 50.

<sup>146</sup> For a similar point, see Darro and Fournier, *supra* note 53, at 37:12, explaining that a purposive analysis is “generally unhelpful” for technical or computational provisions, the underlying rationale of which is best disclosed by contextual analysis of other provisions comprising a statutory scheme.

## ***Conclusion***

This chapter has examined the interpretive exercise under the GAAR, contrasting this interpretive exercise with ordinary interpretation under the TCP approach, and critically evaluating the interpretive framework that the Supreme Court has established for this interpretive exercise in *Canada Trustco* and *Copthorne*.

As the first part of the chapter explains, although the TCP approach and the interpretive exercise under the GAAR both consider the text, context, and purpose of the provisions at issue, the aim and function of these interpretive exercises differ, since the TCP approach relies on textual, contextual, and purposive analysis in order to determine the meaning of the words at issue, while a GAAR analysis employs this method of interpretation to determine the “the rationale that underlies the words” that is relied upon to deny a tax benefit that would otherwise result from an avoidance transaction that contradicts the object, spirit, and purpose of the relevant provisions or the broader scheme of which they are a part. As a result, the TCP approach is constrained by the text of the relevant provisions in a way that a GAAR analysis is not – reflecting rule-of-law principles of legislative supremacy and legal certainty, the latter of which is legitimately superseded by an anti-abuse principle in the context of a GAAR.

As the second part of the chapter explains, the single unified approach adopted by the Supreme Court in *Canada Trustco* disregards the text of subsection 245(4), which clearly distinguishes between a misuse of specific provisions and an abuse having regard to these provisions read as a whole, downplays the relevance of broader statutory schemes in the application of the GAAR, and conflates the interpretive exercise under the GAAR with the ordinary interpretation of tax provisions under the TCP approach thereby exaggerating the role of textual considerations in a GAAR analysis. To the extent that *Copthorne* modified this interpretive framework by lessening the influence of textual considerations and increasing the influence of contextual considerations in GAAR analysis, it is a welcome development that has had a significant impact on GAAR decisions. However, continued adherence to the single unified approach adopted in *Canada*

*Trustco* is contrary to the text of subsection 245(4) and may also impede the coherent application of the GAAR.