

The Peter A. Allard School of Law

Allard Research Commons

Faculty Publications

Faculty Publications

2020

General Anti-Avoidance Rules Revisited: Reflections on Tim Edgar's 'Building a Better GAAR'

David G. Duff

Allard School of Law at the University of British Columbia, duff@allard.ubc.ca

Follow this and additional works at: https://commons.allard.ubc.ca/fac_pubs



Part of the [Tax Law Commons](#)

Citation Details

David G Duff, "General Anti-Avoidance Rules Revisited: Reflections on Tim Edgar's 'Building a Better GAAR'" (2020) 68:2 Can Tax J 579.

This Article is brought to you for free and open access by the Faculty Publications at Allard Research Commons. It has been accepted for inclusion in Faculty Publications by an authorized administrator of Allard Research Commons. For more information, please contact petrovic@allard.ubc.ca, elim.wong@ubc.ca.

General Anti-Avoidance Rules Revisited: Reflections on Tim Edgar’s “Building a Better GAAR”

David G. Duff*

PRÉCIS

Outre l'exigence de la réalisation d'un avantage fiscal, l'application de la plupart des règles générales anti-évitement modernes repose sur deux éléments : ce qu'on appelle un « élément subjectif » qui tient compte de l'objet de l'opération entreprise ou de l'entente conclue donnant lieu à l'avantage fiscal; et un « élément objectif » qui tient compte du but ou de l'objet des dispositions pertinentes pour déterminer si l'avantage fiscal résultant de l'opération ou de l'entente est ou non compatible avec ce but ou cet objet.

Bien que ces deux éléments soient présents dans la plupart des RGAE modernes, la fonction de chaque élément dans ces règles et la relation entre eux sont souvent mal comprises. D'autres questions non résolues concernent les rôles du caractère artificiel et de la substance économique dans l'application de ces règles, et la relation, le cas échéant, entre ces concepts et les éléments « subjectif » et « objectif » des règles. Une dernière série de questions concerne l'incertitude que les RGAE peuvent engendrer, la capacité des juges à appliquer ces règles et principes de manière cohérente et constante, et la compatibilité de ces règles et principes avec la règle de droit.

Cet essai aborde ces questions en examinant l'article de Tim Edgar « Building a Better GAAR ». La partie I examine la justification d'une règle ou d'un principe général anti-évitement, en faisant valoir que cette règle ou ce principe représente non seulement une réponse politique utile aux conséquences néfastes de l'évitement fiscal (l'argument conséquentialiste que le professeur Edgar a fait sien), mais qu'il peut également se justifier d'un point de vue non conséquentialiste voulant qu'il protège l'intégrité des dispositions visées et respecte ainsi la règle de droit. La partie III s'appuie sur cette analyse pour examiner la conception d'une règle ou d'un principe général anti-évitement, en soutenant que cette règle ou ce principe devrait être codifié sous la forme d'une règle explicite, qu'il devrait inclure des éléments subjectif et objectif comme les

* Professor of Law and Director, Tax LLM Program, Peter A. Allard School of Law, University of British Columbia. This essay develops and expands on remarks presented at Re-Imagining Tax for the 21st Century: A Conference Inspired by the Scholarship of Tim Edgar, Osgoode Hall Law School, Toronto, on February 8-9, 2019. I am grateful to the organizers of the conference, particularly Jinyan Li, for inviting me to participate in this event to honour Tim's legacy, and above all to Tim himself—a friend and colleague, whose work on GAAR encouraged me to develop my own thinking on the subject.

exigences en matière d'objet et de détournement ou d'abus dans la RGAE canadienne, et qu'il devrait se fonder sur les concepts de caractère artificiel et de substance économique qui s'appliquent respectivement aux éléments subjectif et objectif de la règle. La partie IV présente la conclusion.

ABSTRACT

In addition to the requirement of a tax benefit or advantage, the application of most modern general anti-avoidance rules (GAARs) turns on two elements: a “subjective element,” which considers the purpose for which the transaction or arrangement resulting in the tax benefit or advantage was undertaken or arranged; and an “objective element,” which considers the object or purpose of the relevant provisions to determine whether the tax benefit resulting from the transaction or arrangement is consistent with this object or purpose.

Although these two elements are present in most modern GAARs, the function of each element within these rules and the relationship between them are often poorly understood. Other unresolved issues concern the roles of artificiality and economic substance in the application of these rules, and the relationship, if any, between these concepts and the “subjective” and “objective” elements of the rules. A final set of issues involves the uncertainty that GAARs may engender, the ability of judges to apply these rules and principles in a coherent and consistent manner, and the compatibility of these rules and principles with the rule of law.

The author addresses these issues by reflecting on Tim Edgar’s article “Building a Better GAAR.” The first part of the paper considers the rationale for a general anti-avoidance rule or principle, arguing that such a rule not only represents a useful policy response to the harmful consequences of tax avoidance (the consequentialist argument that Professor Edgar espoused), but also may be justified on the non-consequentialist grounds that it protects the integrity of the provisions at issue and thereby upholds the rule of law. In the second part of the paper, the author builds on this analysis to consider the design of a general anti-avoidance rule or principle, arguing that it should be codified in the form of an explicit rule, should include subjective and objective elements such as the “purpose” and “misuse or abuse” requirements in the Canadian GAAR, and should be informed by concepts of artificiality and economic substance that apply to, respectively, the subjective and objective elements of the rule.

KEYWORDS: AVOIDANCE ■ ANTI-AVOIDANCE ■ GAAR ■ GENERAL ANTI-AVOIDANCE RULE

CONTENTS

Introduction	581
Rationale	584
Consequentialist Arguments	584
Non-Consequentialist Arguments	589
Design	591
Codification	591
Subjective and Objective Elements	593
Purpose Test	593
Misuse or Abuse Test	602
Conclusion	610

INTRODUCTION

In addition to the existence of a tax benefit, which is generally quite easy to establish,¹ application of the Canadian general anti-avoidance rule (GAAR) turns on two elements: (1) a purpose test that excludes transactions that may reasonably be considered to have been undertaken or arranged primarily for bona fide non-tax purposes,² and (2) a misuse or abuse test providing that GAAR applies only to transactions that may reasonably be considered to result directly or indirectly in a misuse of specific provisions of the ITA or other relevant enactments or an abuse having regard to these provisions read as a whole.³ These two elements appear in most other modern GAARs,⁴ including the United Kingdom's general anti-abuse rule enacted in 2013,⁵ and

1 Income Tax Act, RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as "the ITA"), subsection 245(1), defining a "tax benefit" as "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" including where these tax consequences result from the application of a tax treaty. Although this language suggests that a tax benefit should be assessed in comparison to a "benchmark" transaction or arrangement that might reasonably have been undertaken or arranged but for the existence of the tax benefit, the Supreme Court of Canada lowered the threshold for a tax benefit in *Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54, at paragraph 20, stating that a deduction always results in a tax benefit "since a deduction results in [the] reduction of tax." According to the Federal Court of Appeal, on the other hand, a tax attribute like paid-up capital must be realized in the form of a reduction in tax before it constitutes a tax benefit under the ITA: *Wild*, sub nom. *1245989 Alberta Ltd. v. Canada (Attorney General)*, 2018 FCA 114. As well, where the tax benefit results from a series of transactions, the characterization of this series can also be at issue, although, here again, the Supreme Court of Canada has lowered the threshold to some extent by adopting a broad interpretation of the extended definition of a series of transactions in subsection 248(1) to include related transactions completed before or after an ordinary series. See, for example, *Coptborne Holdings Ltd. v. Canada*, 2011 SCC 63, at paragraphs 42-64.

2 ITA subsection 245(3).

3 ITA subsection 245(4).

4 For a recent survey, see Michael Lang et al., eds., *GAARs—A Key Element of Tax Systems in the Post-BEPS World* (Amsterdam: IBFD, 2016). Two notable exceptions are the New Zealand GAAR, which dates back to the 19th century but was substantially amended in 1974, and the Australian GAAR, which also dates back to the 19th century but was substantially amended in 1981. In New Zealand, courts have effectively created a misuse or abuse test through a "parliamentary contemplation test" that asks "whether the impugned arrangement, viewed in a commercially and economically realistic way, makes use of the specific provision in a manner that is consistent with Parliament's purpose." See *Ben Nevis Forestry Ventures Ltd v. Commissioner of Inland Revenue*, [2008] NZSC 115, at paragraph 109. For a useful discussion of the New Zealand GAAR, see Craig Elliffe, "Policy Forum: New Zealand's General Anti-Avoidance Rule—A Triumph of Flexibility Over Certainty" (2014) 62:1 *Canadian Tax Journal* 147-64. In Australia, a narrow exception from the definition of a "tax benefit" excludes the non-inclusion of income, the allowance of a deduction, the incurring of a capital loss or allowance, or a foreign tax credit that is "attributable to the making of an agreement, choice, declaration, election or selection, the giving of a notice or the exercise of an option expressly provided for" in the tax legislation—provided that "the scheme was not entered into or carried out by any person for the purpose of creating any circumstance or state of affairs the existence (Notes 4 and 5 are continued on the next page.)

the principal purpose test (PPT) in the Organisation for Economic Co-operation and Development (OECD) model convention and the multilateral instrument (MLI),⁶ as well as general anti-avoidance principles (GANTIPS) such as the OECD's "guiding principle" on tax treaty abuse, on which the PPT is based,⁷ and the anti-abuse principle developed by the European Court of Justice and subsequently codified in a European Council Directive laying down rules against tax-avoidance practices that directly affect the functioning of the internal market.⁸

of which is necessary to enable the declaration, agreement, election, selection, choice, notice or option to be made, given or exercised, as the case may be." See Income Tax Assessment Act 1936, No. 27, 1936, (herein referred to as "the Australian GAAR"), sections 177C(2)(i) and (ii). For a useful comparison of the Canadian and Australian GAARs, see Julie Cassidy, "To GAAR or Not To GAAR—That Is the Question: Canadian and Australian Attempts To Combat Tax Avoidance" (2005) 36:2 *Ottawa Law Review* 259-313.

- 5 Finance Act 2013 (UK), 2003, c. 29 (herein referred to as "the UK GAAR"), sections 206 to 215, which applies to "tax arrangements that are abusive" and in which a "tax arrangement" is defined as an arrangement if, having regard to all the circumstances, it would be reasonable to conclude that the obtaining of a tax advantage was the main purpose, or one of the main purposes, of the arrangement, and a tax arrangement is considered to be "abusive" if "the entering into or carrying out of the [tax arrangement] cannot reasonably be regarded as a reasonable course of action in relation to the relevant tax provisions, having regard to all the circumstances including—(a) where the substantive results of the arrangements are consistent with any principles on which those provisions are based (whether express or implied) and the policy objectives of those provisions, (b) whether the means of achieving those results involves one or more contrived or abnormal steps, and (c) whether the arrangements are intended to exploit any shortcomings in those provisions." See Judith Freedman, "Designing a General Anti-Abuse Rule: Striking a Balance" (2014) 20:3 *Asia-Pacific Tax Bulletin* 167-73, at 170.
- 6 Article 29(9) of Organisation for Economic Co-operation and Development, *Model Tax Convention on Income and on Capital: Condensed Version* (Paris: OECD, November 2017) (herein referred to as "the OECD model convention"); and article 7(1) of Organisation for Economic Co-operation and Development Multilateral Convention To Implement Tax Treaty Related Measures To Prevent Base Erosion and Profit Shifting, released on November 24, 2016 (herein referred to as "the MLI"). According to this provision, a benefit under the convention "shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention."
- 7 According to this principle, "the benefits of a double taxation convention should not be available where a main purpose for entering into certain transactions or arrangements was to secure a more favourable tax position and obtaining that more favourable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions." This principle was added to paragraph 9.6 of the commentary on article 1 of Organisation for Economic Co-operation and Development, *Model Tax Convention on Income and on Capital* (Paris: OECD, January 2003) (herein referred to as "the 2003 OECD model convention"). The same text appears in paragraph 61 of the commentary on article 1 of the current OECD model convention.
- 8 See article 6(1) of European Union, Council Directive 2016/1164/EU of 12 July 2016, Laying Down Rules Against Tax Avoidance Practices That Directly Affect the Functioning of the Internal Market, OJ L 193/1, July 19, 2016, which provides that Member States shall,

As a result, like most modern GAARs and GANTIPs, the Canadian GAAR includes a "subjective element" concerning the purpose of the transaction or arrangement that results in a tax benefit, and an "objective element" regarding the misuse or abuse of relevant provisions.⁹ While the first element demands an inquiry into the purposes for which the transaction was undertaken or arranged in order to determine the extent to which tax considerations played a role, the second involves an interpretive exercise to determine whether the tax benefit resulting from the transaction or arrangement is (or is not) consistent with the object, spirit, or purpose of the relevant provisions.¹⁰

Although these two elements are present in most modern GAARs and GANTIPs, the function of each element within these rules and principles and the relationship between these elements is often poorly understood. Some commentators, for example, have questioned the need for the first element,¹¹ while others have challenged the scope of the second.¹² Other unresolved issues concern the roles of

for the purpose of calculating corporate tax liability, "ignore an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law, are not genuine having regard to all relevant facts and circumstances." As explained by Rita de La Feria, "EU General Anti-(Tax) Avoidance Mechanisms," in Glen Loutzenhiser and Rita de la Feria, eds., *The Dynamics of Taxation: Essays in Honour of Judith Freedman* (Oxford, UK: Hart, 2020), this directive codifies the principles established in leading judgments of the European Court of Justice, including in particular *Halifax plc, Leeds Permanent Development Services Ltd., County Wide Property Investments Ltd. v. Commissioners of Customs & Excise*, Case C-255/02; [2006] ECR I-1609; and *Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd. v. Commissioners of Inland Revenue*, Case C-196/04; [2006] ECR I-7995. For further discussions of these cases, see Rita de la Feria, "Prohibition of Abuse of (Community) Law—The Creation of a New General Principle of EC Law Through Tax" (2008) 45:2 *Common Market Law Review* 395-442; and 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, UK: Hart, 2011), 365-80 (<http://dx.doi.org/10.5040/9781472565570.ch-025>). The use of the acronym GANTIP rather than GAAP to characterize these principles was proposed by Judith Freedman in order to avoid confusion with the acronym for generally accepted accounting principles. See Judith Freedman, "Defining Taxpayer Responsibility: In Support of a General Anti-Avoidance Principle" [2004] no. 4 *British Tax Review* 332-57.

9 The language of "subjective" and "objective" elements appears in the European Court of Justice decision in *Emsland-Stärke GmbH v. Hauptzollamt Hamburg-Jonas*, Case C-110/99; [2000] ECR I-11569. As explained in text accompanying *infra* notes 85-112, the so-called "subjective element" is properly assessed objectively.

10 *Canada Trustco*, *supra* note 1, at paragraph 55.

11 See, for example, Michael Lang, "Cadbury Schweppes' Line of Case Law from the Member States' Perspective," in *Prohibition of Abuse of Law*, *supra* note 8, at 435-58 (<http://dx.doi.org/10.5040/9781472565570.ch-030>).

12 Tim Edgar, "Building a Better GAAR" (2008) 27:4 *Virginia Tax Review* 833-905. A condensed version of this article also appears as Tim Edgar, "Designing and Implementing a Target-Effective General Anti-Avoidance Rule," in David G. Duff and Harry Erlichman, eds., *Tax Avoidance in Canada After Canada Trustco and Mathew* (Toronto: Irwin Law, 2007), 221-58.

artificiality and economic substance in the application of GAARs and principles, and the relationship, if any, between these concepts and the subjective and objective elements. A final set of issues involves the uncertainty that GAARs and principles may engender, the ability of judges to apply these rules and principles in a coherent and consistent manner, and the compatibility of these rules and principles with the rule of law.

In this paper, I address these issues by reflecting on Tim Edgar's article "Building a Better GAAR,"¹³ which was published shortly after the Supreme Court of Canada's first GAAR decisions in *Canada Trustco* and *Matthew*.¹⁴ In the first part of the paper, I consider the rationale for a general anti-avoidance rule or principle, arguing that such a rule not only represents an important policy response to the harmful consequences of tax avoidance (the consequentialist argument that Professor Edgar espoused), but also may be justified on the non-consequentialist grounds that it protects the integrity of the provisions at issue and thereby upholds the rule of law. In the second part of the paper, I build on this analysis to consider the design of a general anti-avoidance rule or principle, arguing that it should (1) be codified in the form of an explicit rule, (2) include subjective and objective elements such as the purpose and misuse or abuse requirements in the Canadian GAAR, and (3) be informed by concepts of artificiality and economic substance that apply to, respectively, the subjective and objective elements of the rule.

RATIONALE

Most arguments in favour of general anti-avoidance rules and principles emphasize the adverse effects of tax avoidance on tax revenues, economic efficiency, fairness, and tax compliance, and the advantages of a broad standard to limit tax avoidance in addition to more detailed provisions and specific anti-avoidance rules. In addition to these consequentialist arguments, a non-consequentialist rationale for general anti-avoidance rules and principles emphasizes the integrity of the provisions that could otherwise be circumvented by transactions that are undertaken or arranged in order to obtain tax benefits. Below, I review these consequentialist and non-consequentialist arguments, concluding that collectively they form a compelling argument for general anti-avoidance rules and principles as a general overlay on specific tax provisions.

Consequentialist Arguments

As Professor Edgar notes, the "most obvious consequential attribute" of tax avoidance is the revenue losses attributable to the substitution of lower-taxed transactions or arrangements for higher-taxed alternatives.¹⁵ Not surprisingly, therefore, concerns

13 Ibid.

14 *Canada Trustco*, supra note 1; and *Matthew v. Canada*, 2005 SCC 55 (sometimes cited sub nom. *Kaulius v. The Queen*, 2005 DTC 5538 (SCC)).

15 Edgar, "Building a Better GAAR," supra note 12, at 844.

about revenue losses are often identified as a primary reason to introduce or strengthen measures such as statutory GAARs to combat tax avoidance.¹⁶

From a consequentialist perspective, however, the fact that tax avoidance reduces government revenues is not itself a good reason to limit this behaviour. On the contrary, some have argued that to the extent that government spending is excessive, at least some tax avoidance may be desirable as a way to reduce the size of government.¹⁷ Similarly, it could be argued that tax avoidance improves the overall efficiency or fairness of the tax system where governments replace forgone revenues from an avoided tax with revenues from a more efficient or otherwise more attractive tax.¹⁸ As a result, the consequentialist argument for anti-avoidance measures to prevent revenue losses necessarily turns either on the assumption that the size of government is optimal or suboptimal and that the tax system is efficient, or on the conclusion that tax avoidance is an inferior way to regulate government spending and promote a better tax system, compared with more direct methods of pursuing these objectives. Whatever one may think about the size of government and the efficiency of the current tax system, it seems reasonable to conclude that tax avoidance is not the best way to address these issues.¹⁹

In addition to revenue losses, tax avoidance can be economically costly, distorting the allocation of economic resources,²⁰ encouraging investments in activities that may be marginally profitable at best,²¹ and diverting scarce resources from productive activities and investments to "the development, marketing, implementation and

16 See, for example, South African Revenue Service, *Discussion Paper on Tax Avoidance and Section 103 of the Income Tax Act, 1962 (Act No. 58 of 1962)* (Pretoria: SARS, November 2005), at 9. For a relatively recent report that estimates the global revenue loss from corporate tax avoidance at \$500 billion, see Alex Cobham and Petr Janský, *Global Distribution of Revenue Loss from Tax Avoidance: Re-Estimation and Country Results*, WIDER Working Paper no. 2017/55 (Helsinki: United Nations University World Institute for Development Economics Research, March 2017).

17 See, for example, Gary S. Becker and Casey B. Mulligan, "Deadweight Costs and the Size of Government" (2003) 46:2 *Journal of Law and Economics* 293-340. It is, of course, also possible that government spending is deficient or financed excessively by debt instead of taxation, in which case revenue losses from tax avoidance would only exacerbate these problems.

18 See the discussion in David A. Weisbach, "An Economic Analysis of Anti-Tax-Avoidance Doctrines" (2002) 4:1 *American Law and Economics Review* 88-115, at 110-13, emphasizing efficiency concerns rather than fairness considerations.

19 See, for example, Joel Slemrod, "My Beautiful Tax Reform," in Alan J. Auerbach and Kevin A. Hassett, eds., *Toward Fundamental Tax Reform* (Washington, DC: American Enterprise Institute, 2005), 135-48, at 136, arguing that there are better ways to achieve spending restraint than "purposely running an inefficient tax system"; and Weisbach, "An Economic Analysis of Anti-Tax-Avoidance Doctrines," supra note 18, at 111, arguing that tax avoidance is "often an inefficient method of repealing the tax."

20 See *Discussion Paper on Tax Avoidance*, supra note 16.

21 Peter Groenewegen, "Distributional and Allocational Effects of Tax Avoidance," in David Collins, ed., *Tax Avoidance and the Economy* (Sydney: Australian Tax Research Foundation, 1984), at 23.

subsequent defence of impermissible tax avoidance schemes.”²² Moreover, where revenue losses lead to a reduction in worthwhile government expenditures, an inappropriate increase in government debt, or the collection of revenues from other, less efficient taxes, tax avoidance can result in indirect or second-order efficiency costs as well as direct efficiency costs.²³ In each case, anti-avoidance measures can help reduce these efficiency costs by deterring economically wasteful investments in tax-avoidance activities and improving the efficiency of the tax as a means of raising revenue.²⁴ For this reason, consequentialist arguments for general anti-avoidance rules and doctrines typically emphasize efficiency considerations as well as revenue concerns.²⁵

A third consequentialist argument for anti-avoidance measures such as GAARs concerns the distributional impact of tax avoidance, which is affected not only by the reduced taxes that are paid by taxpayers who are willing and able to avoid taxes, but also by lower government spending, increased government borrowing, and/or increased taxes paid by other taxpayers who are less willing or able to avoid taxes.²⁶ To the extent that tax and spending policies are intended to accomplish a measure of distributive fairness, tax avoidance undermines these distributive goals, resulting in an unfair shifting of the tax burden (typically to less affluent and less mobile taxpayers) and a less equitable distribution of economic resources more generally.²⁷ For this reason, as Professor Edgar also emphasizes, the adverse impact of tax avoidance on “the pattern of income/wealth distribution” is an additional justification for a statutory GAAR.²⁸

22 *Discussion Paper on Tax Avoidance*, supra note 16, at 11-12, citing Joel Slemrod and Shlomo Yitzhaki, “The Cost of Taxation and The Marginal Efficiency Cost of Funds” (1996) 43:1 *International Monetary Fund Staff Papers* 172-98.

23 As Professor Edgar explains, where tax avoidance involves the imperfect substitution of a lower-taxed transaction or arrangement for a higher-taxed alternative, the economic costs of this behaviour are both direct and indirect; where a lower-taxed transaction or arrangement is a perfect substitute for the higher-taxed alternative, on the other hand, first-order costs are absent and the economic costs of tax avoidance involve only second-order costs attributable to reduced government expenditures or the collection of revenues from less efficient taxes. Edgar, “Building a Better GAAR,” supra note 12, at 842-51.

24 See, for example, Weisbach, “An Economic Analysis of Anti-Tax-Avoidance Doctrines,” supra note 18, at 93, explaining that anti-avoidance doctrines reduce the ability of the taxpayer to shift into tax-avoidance activities, thereby reducing the marginal elasticity of the tax and improving its efficiency as a method of raising revenue.

25 See, for example, David A. Weisbach, “Ten Truths About Tax Shelters” (2002) 55:2 *Tax Law Review* 215-54, at 222-25, analogizing tax planning to a negative externality that has no social benefit; and Edgar, “Building a Better GAAR,” supra note 12, at 853, who also argues that tax avoidance has the characteristics of a negative externality.

26 See, for example, Québec, Finance Québec, *Working Paper Aggressive Tax Planning* (Québec: Finance Québec, January 2009), at 21 (herein referred to as *Aggressive Tax Planning*).

27 See, for example, Reuven S. Avi-Yonah, “Globalization, Tax Competition and the Fiscal Crisis of the Welfare State” (2000) 113:7 *Harvard Law Review* 1573-1676, at 1578.

28 Edgar, “Building a Better GAAR,” supra note 12, at 852.

Another consequentialist argument for anti-avoidance measures such as GAARs is the corrosive effect that tax avoidance can have on tax compliance generally.²⁹ As David Weisbach explains, to the extent that social norms play an important role in taxpayers' voluntary compliance with tax laws, such that "whether your neighbor pays taxes affects whether you pay taxes," the avoidance of some taxes by some taxpayers could easily lead to the avoidance of many taxes by many taxpayers.³⁰ As a result, as the Quebec Department of Finance observes, "[l]ike a vicious circle, the perceived unfairness and injustice in such a system are such as to discourage . . . taxpayers to comply with the law, and consequently, increase the chances of damaging the integrity of the system."³¹ For this reason, Weisbach regards reduced tax compliance as the "most important" cost of tax avoidance, justifying anti-avoidance measures as a necessary response.³²

That these consequentialist considerations may justify measures to limit tax avoidance, however, does not explain why anti-avoidance measures should include general anti-avoidance rules or principles that apply to transactions and arrangements after the fact, as opposed to detailed legislation and specific anti-avoidance rules that reduce or eliminate opportunities for tax avoidance in advance. Indeed, to the extent that tax avoidance depends on the existence of gaps and inconsistencies in tax legislation, the minimization of these gaps and inconsistencies through structural reforms is presumably a more effective policy response than reliance on a GAAR.³³ As well, where particular avoidance strategies are easily anticipated, specific anti-avoidance rules aimed at these strategies are often more effective than a GAAR.

In the real world, however, all tax systems have gaps and inconsistencies, and the complexity of tax legislation and the transactions and arrangements to which it applies makes it virtually impossible to anticipate and foreclose all possible avoidance techniques before they are deployed. Although gaps and inconsistencies may reflect poor tax policy decisions, they are also the inevitable consequence of having to rely on legal concepts and proxies to measure economic outcomes such as income or

29 See, for example, Statement of Harold R. Handler, on behalf of the Tax Section, New York State Bar Association, before the Committee on Finance (27 April 1999), cited in United States, Department of the Treasury, *The Problem of Corporate Tax Shelters—Discussion, Analysis and Legislative Proposals* (Washington, DC: Department of the Treasury, July 1999), at 3.

30 See, for example, Weisbach, "An Economic Analysis of Anti-Tax-Avoidance Doctrines," supra note 18, at 111. For a useful introduction to the theoretical and empirical literature on the effect of "tax morale" on tax compliance, see Benno Torgler, *Tax Compliance and Tax Morale: A Theoretical and Empirical Analysis* (Cheltenham, UK: Edward Elgar, 2007).

31 Finance Québec, *Aggressive Tax Planning*, supra note 26, at 21.

32 Weisbach, "An Economic Analysis of Anti-Tax-Avoidance Doctrines," supra note 18, at 111.

33 See, for example, Graeme S. Cooper, "International Experience with General Anti-Avoidance Rules" (2001) 54:1 *SMU Law Review* 83-130, at 85, explaining that a GAAR is "implausible as a solution to structural problems in the tax system, and it is inappropriate as a means of dealing with murky lines and fuzzy categories that are drawn in the text of [tax] law."

consumption that are difficult to define perfectly and observe accurately,³⁴ and they also result from legitimate considerations in the design of any tax system such as reducing complexity, accommodating liquidity concerns, promoting social and economic policy objectives, and recognizing different tax policy choices made by different jurisdictions.³⁵ In addition, even where gaps and inconsistencies result from poor tax policy choices, these policies are often difficult or impossible to change on account of political considerations that necessarily shape the real world of tax policy making.³⁶

Finally, since it is impossible to foresee and prevent all tax avoidance before it occurs, the effectiveness of detailed legislation and specific anti-avoidance rules in reducing tax avoidance is necessarily limited,³⁷ unless this legislation were to apply retroactively, which would make tax rules grossly unpredictable and undermine important values associated with the rule of law.³⁸ As well, even if policy makers could anticipate all potential tax-avoidance strategies, the formulation of specific anti-avoidance rules to address all of these strategies would be enormously costly and would greatly increase the length and complexity of tax legislation,³⁹ thereby increasing the costs of tax administration and compliance as well as the likelihood of additional avoidance opportunities attributable to this “legislative layering.”⁴⁰ For

34 See, for example, Weisbach, “An Economic Analysis of Anti-Tax-Avoidance Doctrines,” supra note 18, at 91, referring, for example, to the realization requirement for recognizing taxable income.

35 Chris Evans, “Containing Tax Avoidance: Anti-Avoidance Strategies,” in John G. Head and Richard Krever, eds., *Tax Reform in the 21st Century, A Volume in Memory of Richard Musgrave* (Alphen aan den Rijn, the Netherlands: Kluwer Law International, 2009), 529-60, at 536.

36 See, for example, Claire Crawford and Judith Freedman, “Small Business Taxation,” in James Mirrlees, Stuart Adam, Tim Besley, Richard Blundell, Stephen Bond, Robert Chote, Malcolm Gammie, Paul Johnson, Gareth Myles, and James Poterba, eds., *Dimensions of Tax Design: The Mirrlees Review* (Oxford: Oxford University Press, 2010), 1028-99, at 1086. For a discussion in the Canadian context, see David G. Duff, “Income Taxation of Small Business: Toward Simplicity, Neutrality and Coherence,” in *The Dynamics of Taxation*, supra note 8, chapter 4.

37 See, for example, David A. Dodge, “A New and More Coherent Approach to Tax Avoidance” (1988) 36:1 *Canadian Tax Journal* 1-22, at 8.

38 For a brief discussion of efficiency and fairness arguments against retroactive tax legislation, see Benjamin Alarie, “Retroactivity and the General Anti-Avoidance Rule,” in *Tax Avoidance in Canada After Canada Trustco and Mathew*, supra note 12, 197-219, at 215-217.

39 See, for example, Stanley S. Surrey, “Complexity and the Internal Revenue Code: The Problem of the Management of Tax Detail” (1969) 34:4 *Law and Contemporary Problems* 673-710, at 707, note 31; and Cooper, supra note 33, at 95, arguing that “continuing design tinkering to surround individual provisions with further support will make the legislation too detailed and perhaps ultimately less secure.”

40 Chris Evans, “The Battle Continues: Recent Australian Experience with Statutory Avoidance and Disclosure Rules,” in Judith Freedman, ed., *Beyond Boundaries: Developing Approaches to Tax Avoidance and Risk Management* (Oxford: Oxford University Centre for Business Taxation, 2008), 37-46, at 43.

these reasons, as Weisbach concludes, an optimal approach to preventing tax avoidance is likely to include both specific anti-avoidance rules the application of which is defined *ex ante* and general anti-avoidance rules and doctrines based on a broad standard the application of which is determined *ex post*.⁴¹

Non-Consequentialist Arguments

In addition to these consequentialist arguments, another rationale for general anti-avoidance rules and principles emphasizes legislative intent and the integrity of the provisions that could otherwise be circumvented by transactions or arrangements that defeat the object or purpose of the law. According to Judith Freedman, for example, the key function of a GAAR is "to give full effect to parliamentary intention and prevent the frustration of specific legislation."⁴² Similarly, the Aaronson Report that recommended a GAAR for the United Kingdom concluded that such a provision would "[f]irst and foremost . . . deter (and, where deterrence fails, counteract) contrived and artificial schemes which are widely regarded as an intolerable attack on the integrity of the UK's tax regime . . . [and] make a mockery of the will of Parliament."⁴³ As a result, as David Weisbach himself acknowledges, the essential function of anti-avoidance rules is not to make the tax system more efficient, but "to ensure that duly enacted taxes are collected."⁴⁴

Unlike other arguments for GAARs, these arguments for a statutory GAAR are non-consequentialist in the sense that they refer to normative criteria such as legislative intent and the integrity of the relevant provisions that are internal to the law, not normative goals such as efficiency or equity that are external to the law and pursued through the law.⁴⁵ As a result, they appeal to what Lon Fuller has called the "inner morality of law" rather than the "substantive aims" that are incorporated into law.⁴⁶

For Fuller, the inner morality of law suggests that laws should ideally be general in their application, publicly promulgated, non-retroactive, clear and coherent, non-contradictory, capable of being obeyed, relatively stable over time, and applied in

41 Weisbach, "An Economic Analysis of Anti-Tax-Avoidance Doctrines," *supra* note 18, at 93.

42 Judith Freedman, "Interpreting Tax Statutes: Tax Avoidance and the Intention of Parliament" (2007) 123:1 *Law Quarterly Review* 53-90, at 90.

43 Graham Aaronson, *GAAR Study: A Study To Consider Whether a General Anti-Avoidance Rule Should Be Introduced into the UK Tax System* (London: HM Treasury, November 2011) (herein referred to as "the UK Aaronson report"), at paragraph 1.7(i) (https://webarchive.nationalarchives.gov.uk/20130402163458/http://www.hm-treasury.gov.uk/d/gaar_final_report_111111.pdf).

44 Weisbach, "An Economic Analysis of Anti-Tax-Avoidance Doctrines," *supra* note 18, at 112.

45 See generally Mark P. Gergen, "The Common Knowledge of Tax Abuse" (2001) 54:1 *SMU Law Review* 131-47.

46 Lon L. Fuller, *The Morality of Law* (New Haven, CT: Yale University Press, 1969), at 42.

accordance with the law as declared.⁴⁷ Properly understood as aspirational aims rather than categorical imperatives,⁴⁸ these criteria express what Fuller calls an “ideal of legality”⁴⁹ according to which “a system of rules for governing human conduct must be constructed and administered if it is to be efficacious and at the same time remain what it purports to be.”⁵⁰ For this reason, they are widely regarded as core constituents of the rule of law and necessary prerequisites to individual freedom and human dignity.⁵¹

From this perspective, it is often argued that general anti-avoidance rules and principles contradict the rule of law because they rely on vague and uncertain standards to distinguish between unacceptable tax avoidance and legitimate tax minimization.⁵² A related concern is that the application of these standards is determined retrospectively after an impugned transaction or arrangement has already occurred, making it difficult for taxpayers to plan their affairs with certainty as to the taxes that these transactions or arrangements will attract.

One response to these objections is that values of individual freedom and human dignity must be balanced against other values such as fairness and efficiency, such that general anti-avoidance rules and principles may be justified even if they contradict the rule of law.⁵³ More persuasively, I believe, non-consequentialist arguments

47 Ibid., at 46-91.

48 Ibid., at 104, describing the inner morality of law as “chiefly a morality of aspiration, rather than duty.”

49 Ibid., at 147.

50 Ibid., at 97.

51 See, for example, Joseph Raz, “The Rule of Law and Its Virtue” (1977) 93:2 *Law Quarterly Review* 195-211, at 204, explaining that the rule of law contributes to individual freedom by allowing persons to make plans and act upon them without subsequent legal disruption, thereby respecting human dignity by respecting the rights of individuals to shape their own futures.

52 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) 55:21 *Saint Louis University Law Journal* 21-45, at 28-30; and Colin Masters, “Is There a Need for General Anti-Avoidance Legislation in the United Kingdom?” [1994] no. 6 *British Tax Review* 647-73, at 671, arguing that a GAAR “violates perhaps the most important and fundamental principle of tax law: that the tax legislation must impose tax in clear and unambiguous terms and that a person must not be taxed unless he comes within the letter of the law.”

53 Prebble and Prebble, supra note 52, at 38-41. Indeed, it is sometimes argued that the uncertainty created by these rules and principles is a positive virtue, since it discourages taxpayers from engaging in aggressive tax planning. See, for example, Erik M. Jensen, “Legislative and Regulatory Responses to Tax Avoidance: Explicating and Evaluating the Alternatives” (2012) 57:1 *Saint Louis University Law Journal* 1-58, at 38, suggesting that “some uncertainty is valuable for the tax system” since “it deters taxpayers from getting too close to abusive territory.” Although some uncertainty may be inevitable with a GAAR, introducing

for GAARs suggest that these rules, when properly designed, are not only compatible with the rule of law but actually support the "ideal of legality" to which the rule of law aspires by discouraging and counteracting transactions or arrangements that undermine the integrity of the relevant provisions and contradict their objects and purposes. For this reason, as Mark Gergen explains, although the standards embodied in general anti-avoidance rules and principles are less predictable than detailed rules,⁵⁴ and although their application is necessarily determined *ex post* rather than *ex ante*,⁵⁵ they "mediate between our desire that tax law be coherent and principled and our desire that it be rule-bound" and are thus "a product of a commitment to law by imperfect rules" rather than "an abnegation of the rule of law."⁵⁶ In order to best advance this ideal of legality, however, it is important that a GAAR should be designed in a manner that is consistent with the principles on which this ideal is based.⁵⁷ The next part of this paper is directed toward this task.

DESIGN

Although the rationale for a general anti-avoidance rule or principle may be based on consequentialist or non-consequentialist arguments, the most persuasive rationale undoubtedly includes both. As I explain below, however, non-consequentialist considerations are paramount when it comes to the way in which these rules and principles are properly expressed in law.

Codification

The first issue to address in formulating a general standard to discourage and counteract unacceptable tax avoidance is whether this standard should be judicially defined or codified in the form of an explicit rule. Although this question is obviously academic in jurisdictions like Canada, where courts have refused to adopt broad anti-avoidance principles or doctrines,⁵⁸ there are good reasons why these standards are best codified in domestic tax legislation and international tax treaties instead of being left to judicial formulation.

and designing a GAAR in order to deliberately create legal uncertainty diminishes the value of legal certainty and undermines the rule of law. In addition, there are other and better ways to discourage aggressive tax planning, such as disclosure rules and promoter penalties, which can be carefully designed to ensure their consistency with the rule of law.

54 Gergen, *supra* note 45, at 137.

55 *Ibid.*, at 143.

56 *Ibid.*, at 131.

57 See, generally, Chris Atkinson, "General Anti-Avoidance Rules: Exploring the Balance Between the Taxpayer's Need for Certainty and the Government's Need To Prevent Tax Avoidance" (2012) 14:1 *Journal of Australian Taxation* 1-56.

58 *Stuart Investments Ltd. v. The Queen*, [1984] 1 SCR 536.

First, as Judith Freedman has argued, in jurisdictions like Canada and the United Kingdom, in which courts have traditionally held that taxpayers have a quasi-constitutional right to arrange their affairs in order to minimize tax,⁵⁹ a statutory (or treaty-based) general anti-avoidance rule or principle affirms the “constitutional source and authority” of this standard as a legitimate overlay on more specific tax provisions.⁶⁰ Second, as opposed to judicially developed principles and doctrines that are inevitably open-ended and changeable,⁶¹ explicit statutory or treaty rules can provide a clear and consistent framework for applying a general anti-avoidance standard.⁶² Therefore, as the UK Aaronson Report concluded, a general anti-avoidance rule or principle “should be imposed by legislation” in order to be “consistent with the rule of law.”⁶³

For these reasons, it is not surprising that several jurisdictions have introduced statutory GAARs, and that others have codified judicially developed anti-avoidance principles and doctrines.⁶⁴ Nor is it surprising that the OECD has codified the anti-abuse principle that was added to the commentary on the OECD model tax convention in 2003 by adding the PPT to the model convention and the MLI.⁶⁵ Although the rationale for codification may involve consequentialist considerations such as the efficiency of a statutory rule or its impact on tax compliance, the primary reason for codification involves non-consequential considerations regarding legitimacy and legal clarity and consistency.

59 See, for example, *Inland Revenue Commissioners v. Westminster (Duke)*, [1936] AC 1 (HL) (herein referred to as “*Duke of Westminster*”).

60 Freedman, *supra* note 42, at 63.

61 See, for example, the review of the pre-GAAR tax avoidance jurisprudence in the United Kingdom in Freedman, *supra* note 42, at 55-70; the review of the European Court of Justice’s anti-abuse jurisprudence in de la Feria, “EU General Anti-(Tax) Avoidance Mechanisms,” *supra* note 8; and Jenson, *supra* note 53, at 24, noting that a “compelling” argument for codification of the economic substance doctrine in the United States is that courts “had not been consistent in their understanding of the components of that doctrine.”

62 Freedman, *supra* note 42, at 70.

63 UK Aaronson report, *supra* note 43, at paragraph 3.4.

64 See Article 6(1) of Council Directive 2016/1164/EU, *supra* note 8, which codifies the principles established in leading judgments of the European Court of Justice; and section 7701(o) of the Internal Revenue Code of 1986, as amended, which codifies the US economic substance doctrine. For useful reviews of the US economic substance doctrine, arguing it should more clearly include a reference to the object and purpose of the legislation, see Leandra Lederman, “W(h)ither Economic Substance?” (2010) 95:2 *Iowa Law Review* 389-444; and Orly Sulami, “Tax Abuse—Lessons from Abroad” (2012) 65:3 *SMU Law Review* 555-91.

65 See article 29(9) of the OECD model convention and article 7(1) of the MLI, which are based on the “guiding principle” set out in paragraph 9.6 of the commentary on article 1 of the 2003 OECD model convention.

Subjective and Objective Elements

As noted earlier, the Canadian GAAR and most modern GAARs include a subjective element concerning the purpose of the transaction or arrangement that results in a tax benefit, and an objective element regarding the misuse or abuse of the relevant provisions. The following discussion explains the role of each element within an ideal GAAR, the way in which each requirement should be understood, and the extent to which concepts of artificiality and economic substance are relevant to the interpretation and application of these requirements.

Purpose Test

It is not surprising that a GAAR would include a purpose test, requiring that a transaction or arrangement that is subject to the rule have been undertaken or arranged in order to obtain a tax benefit. After all, the very concept of "avoidance" involves a purposeful act to "get around" or "get out of" something.⁶⁶ Synonyms for the word "avoid" include "circumvent," "dodge," "duck," "sidestep," "elude," "escape," "shun," and "eschew"⁶⁷—all of which involve an element of purpose on the part of the person or persons participating in avoidance. As a result, as the Carter commission observed, "motive would seem to be an essential element of tax avoidance."⁶⁸

According to Professor Edgar, a purpose test is integral to the efficiency of a GAAR, prohibiting transactions and arrangements for which marginal social costs in terms of revenue losses, efficiency costs, and distributional impacts exceed marginal private benefits in terms of taxes reduced.⁶⁹ Indeed, on the "plausible assumption" that the marginal social costs of tax avoidance always equal or exceed marginal private benefits,⁷⁰ Edgar argued that "there is no level of tax-avoidance behavior that policymakers should accept, . . . and the policy goal must be the elimination of all tax avoidance"⁷¹—subject to a limited exception for transactions that are explicitly encouraged through tax-incentive provisions.⁷² On this account, he concluded that

66 Microsoft Word Thesaurus.

67 Ibid.

68 Canada, *Report of the Royal Commission on Taxation*, vol. 3 (Ottawa: Queen's Printer, 1966) (herein referred to as "the Carter commission"), at 537-38, explaining that a taxpayer "who adopts one of several possible courses because one will save him the most tax *must* be distinguished from the taxpayer who adopts the same course for business or personal reasons." I return to the distinction between the concepts of motive and purpose in text accompanying *infra* notes 85-89.

69 Edgar, "Building a Better GAAR," *supra* note 12, at 852-71.

70 This assumption is premised on the further assumption that tax avoidance is not an effective way to control excessive government spending or promote a more efficient tax system. *Supra* note 19 and accompanying text.

71 Edgar, "Building a Better GAAR," *supra* note 12, at 864.

72 Ibid., at 881.

a GAAR based on a purpose test represents “the expression of a behavioral prohibition that targets the entire range of tax-avoidance transactions whose consequential attributes justify prohibition.”⁷³

In contrast, others have suggested that the purpose for which a transaction is undertaken or arranged is irrelevant to how it should be treated for tax purposes.⁷⁴ According to Judith Freedman, for example, if taxpayers are generally entitled to arrange their affairs in order to minimize tax,⁷⁵ “the relevance of [the taxpayer’s] purpose is hard to discern, since it can be argued that it is the transaction that should be taxed, and the way in which similar transactions are taxed should not vary with the purpose of the taxpayer.”⁷⁶ Michael Lang arrives at a similar conclusion in a different way, arguing that a subjective element is irrelevant to the application of tax legislation if it is properly interpreted in a teleological manner in accordance with its object and purpose.⁷⁷

In response to these arguments, one might begin by noting that many tax provisions make the purpose of a transaction or arrangement an explicit requirement for a particular tax result.⁷⁸ In addition, even if a provision does not include an explicit purpose test, it is arguable that the purpose of a transaction or arrangement may be relevant to the object and purpose of the provision at issue, and should therefore be taken into account in determining whether it applies.⁷⁹ More generally, if

73 Ibid., at 873. Since this formulation would include tax-induced changes in what economists call “real economic behaviour” (such as the decision to work fewer hours or to consume rather than spend) as well as tax-induced responses to structural features of tax law that accord different tax outcomes to different legal relationships (for example, employee versus independent contractor) or organizational forms (for example, incorporated or unincorporated enterprises), it appears to be overbroad. However, Edgar would exclude these behavioural adjustments from the scope of a GAAR on the consequentialist grounds that the informational requirements to determine the efficiency of these behavioural responses to taxation is beyond the institutional competence of the judiciary. Ibid., at 851.

74 See, for example, Walter J. Blum, “Motive, Intent, and Purpose in Federal Income Taxation” (1967) 34:3 *University of Chicago Law Review* 485-544; and Alan Gunn, “Tax Avoidance” (1978) 76:5 *Michigan Law Review* 733-67, at 765, concluding that “the question whether particular conduct was tax-motivated should be irrelevant to the decision whether that conduct should be taxed in a certain way.”

75 See, for example, *Duke of Westminster*, supra note 59.

76 Freedman, “The Anatomy of Tax Avoidance Counteraction,” supra note 8, at 374.

77 Lang, supra note 11, at 449.

78 Obvious examples in the ITA include paragraph 18(1)(a), which limits the deduction of an outlay or expense in computing a taxpayer’s income from a business or property “to the extent that it was made or incurred by the taxpayer for the purpose of gaining or producing income from the business or property” and the requirement in subparagraph 20(1)(c)(i) that interest on borrowed money must be “used for the purpose of earning income from a business or property” in order to be deductible in computing the taxpayer’s income from this business or property.

79 This is the interpretive approach that the US Supreme Court adopted in *Gregory v. Helvering*, 293 US 465 (1935), concluding that the “plain intent” of a provision permitting a tax-free

one assumes that tax provisions are typically intended to apply to transactions and arrangements that are carried out for bona fide commercial or personal purposes, not to transactions or arrangements that are undertaken or arranged in order to obtain tax benefits, a purpose test may be an integral aspect of a teleological approach to the interpretation of tax legislation and tax treaties generally.⁸⁰ On this account, therefore, a GAAR that includes a purpose requirement could be construed as an explicit expression of a teleological approach to the interpretation of tax law as a whole.

At the same time, although the modern approach to the interpretation of tax provisions requires that they be construed *in light of* their objects and purposes,⁸¹ this interpretive approach does not allow courts to rely on these objects and purposes to *override* the text of these provisions once they are properly construed in light of their objects and purposes.⁸² On the contrary, as Denis Weber has explained in the context of EU law, once the meaning of a provision is properly construed under ordinary methods of interpretation, principles of legality and legal certainty prohibit "the setting aside of legislation . . . merely by invoking the fact that the [tax] advantage is in conflict with the objective of the legislation."⁸³ Where a transaction or arrangement is undertaken or arranged in order to obtain a tax benefit, on the other hand, these principles are legitimately superseded by a general anti-abuse principle, and the object and purpose of the relevant provisions may be relied upon to supplant their meaning as ordinarily construed.⁸⁴ As a result, whether or not a purpose

corporate reorganization was limited to permitting the reorganization of "corporate business," not "an operation having no business or corporate purpose." *Ibid.*, at 469.

80 This is the broader significance of the decision in *Gregory v. Helvering*, *ibid.*, and the foundation of a general "business purpose test" in US tax law. See, for example, *Bazley v. CIR*, 331 US 737 (1947); and *Goldstein v. CIR*, 364 F. 2d 734, at 740 (2d Cir. 1966); certiorari denied 385 US 1005 (1967). See, for example, Brian J. Arnold, "In Praise of the Business Purpose Test," in *Report of Proceedings of the Thirty-Ninth Tax Conference*, 1987 Conference Report (Toronto: Canadian Tax Foundation, 1988), 10:1-34.

81 See, for example, *Stubart*, *supra* note 58, at 578, citing page 87 of E.A. Driedger, *Construction of Statutes*, 2d ed. (Toronto: Butterworths, 1983), according to whom "the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament"; and article 31(1) of the Vienna Convention on the Law of Treaties, signed at Vienna on May 23, 1969, UN doc. A/Conf. 39/27, providing that a treaty "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."

82 See, for example, Leonard Hoffman, "Tax Avoidance" [2005] no. 2 *British Tax Review* 197-206, at 205, explaining that "[i]t is one thing to give the statute a purposive construction. It is another to rectify the terms of highly prescriptive legislation in order to include provisions which might have been included but are not actually there."

83 Dennis Weber, "Abuse of Law in the Context of Indirect Taxation: Why We Need the Subjective Intention Test, When Is Combating Abuse an Obligation and Other Comments," in *Prohibition of Abuse of Law*, *supra* note 8, 395-406, at 398 (emphasis in original).

84 I return to this point at text accompanying *infra* note 144.

test contributes to the efficiency of a GAAR, it is an essential element of a general anti-avoidance rule or principle that is compatible with the non-consequentialist ideal of legality.

From this perspective, it is tempting to regard the subjective element of a GAAR as the tax law equivalent of the *mens rea* requirement in criminal law. As Graeme Cooper explains, however, the purpose test in a GAAR is very different from the intention requirement in criminal law, which depends on a person's conscious mental state, even if this mental state must be inferred through external indicia.⁸⁵ Indeed, although the Carter commission referred to "motive" as an essential element of tax avoidance,⁸⁶ it is notable that modern GAARs use the word "purpose," which emphasizes the aim or object to be attained by a particular action,⁸⁷ rather than "motive," which refers to the reasons why a person engages in a particular action.⁸⁸ As well, modern GAARs generally assess the purposes for which transactions are undertaken or arranged objectively (that is, according to a standard of reasonableness), not subjectively (according to the specific purposes of the persons involved). As a result, the so-called subjective element of a GAAR properly considers the purposes that may reasonably be attributed to the transaction or arrangement, not the subjective intentions of the person or persons who carry it out.⁸⁹

According to the Canadian GAAR, for example, the provision does not apply to transactions that "may reasonably be considered to have been undertaken or arranged . . . for *bona fide* purposes other than to obtain a tax benefit."⁹⁰ As a result, as Brian Arnold and James Wilson explain, the provision asks "not what was in the taxpayer's mind but what a reasonable taxpayer would have considered to be the purpose of the transaction."⁹¹ Similar language appears in the UK GAAR,⁹² as well as the PPT,⁹³ suggesting that the purpose tests in these provisions must also be assessed

85 Graeme Cooper, "The Role and Meaning of 'Purpose' in Statutory GAARs," in Nigar Hashimzade and Yuliya Epifantseva, eds., *The Routledge Companion to Tax Avoidance Research* (Abingdon, UK: Routledge, 2017), 78-96, at 86.

86 Carter commission, *supra* note 68.

87 See *Concise Oxford Dictionary*, 7th ed., defining "purpose" as "object to be attained."

88 *Ibid.*, defining "motive" as "what induces a person to act."

89 For a contrary view, see David Weisbach, "Ten Truths About Tax Shelters," *supra* note 25, at 251-53, who in my view wrongly equates the purpose requirement in general anti-avoidance rules and doctrines with the concepts of motive and intent.

90 ITA subsection 245(3).

91 Brian J. Arnold and James R. Wilson, "The General Anti-Avoidance Rule—Part 1" (1988) 36:4 *Canadian Tax Journal* 829-87; and ". . . Part 2," (1988) 36:5 *Canadian Tax Journal* 1123-85, at 1369-1410, and 1157.

92 UK GAAR, *supra* note 5, section 207(1).

93 *Supra* note 6.

objectively, by reference to what a reasonable person would conclude.⁹⁴ Australian courts have adopted an identical approach even in the absence of explicit statutory direction to this effect, concluding that the purpose test in the Australian GAAR is to be applied “by analysis of objective criteria without regard to the actual purpose or motive, ultimate or otherwise, of the relevant scheme participants.”⁹⁵ Here too, therefore, the purpose test is assessed objectively, by reference to what “a reasonable person, who implemented the acts actually undertaken by the taxpayer and confederates, [would] have been seeking to accomplish.”⁹⁶ In this respect, as Graeme Cooper observes, the purpose test of a GAAR operates much like the “reasonable person” standard in tort law.⁹⁷

Although courts generally look for objective manifestations of subjective purpose when they are required to consider a taxpayer’s purpose,⁹⁸ an objective approach is essential for a GAAR, which would be rendered largely ineffective if persons could rely on assertions of subjective non-tax purposes to escape its application.⁹⁹ An objective assessment of the purposes for which a transaction is undertaken or arranged is also consistent with the fact that the function of a GAAR is not to assign moral culpability to the persons involved in a tax-avoidance transaction, but to ensure that the transaction is subject to tax in accordance with the object and purpose of the relevant provisions.¹⁰⁰ As a result, an objective approach to the application of the subjective element is not only essential to the effectiveness of a GAAR but also compatible with non-consequentialist considerations associated with the rule of law.

In addition to this objective approach, some GAARs refer to the purposes of arrangements or transactions themselves,¹⁰¹ rather than the purposes for which transactions were undertaken or arranged (as in the Canadian GAAR)¹⁰² or the purpose of the person or persons who entered into or carried out the transactions (as in

94 See, for example, paragraph 179 of the commentary on article 29 of the OECD model convention, stating that the purposes of an arrangement or transaction “must be objectively considered.”

95 *Orica Limited v. Commissioner of Taxation*, [2015] FCA 1399, at paragraph 19.

96 Cooper, “The Role and Meaning of ‘Purpose’ in Statutory GAARs,” supra note 85, at 87.

97 Ibid.

98 See, for example, *Symes v. Canada*, [1993] 4 SCR 695, at 736, stating that courts in these cases should not “be guided only by a taxpayer’s statements, *ex post facto* or otherwise,” but should instead “look for objective manifestations of purpose” which is “ultimately a question of fact to be decided with due regard for all of the circumstances.”

99 Freedman, “The Anatomy of Tax Avoidance Counteraction,” supra note 8, at 375.

100 See, for example, *Copthorne*, supra note 1, at paragraph 65, emphasizing that the GAAR should not be interpreted as “implying moral opprobrium regarding the actions of a taxpayer to minimize tax.”

101 See, for example, the UK GAAR, supra note 5; and the PPT, supra note 6.

102 ITA subsection 245(3).

the Australian GAAR).¹⁰³ Although it is absurd to imagine that arrangements or transactions can have their own purposes apart from those of the persons who arrange them and carry them out,¹⁰⁴ this language reaffirms the objective nature of the inquiry, and ensures that the GAAR can apply to arrangements and transactions that are arranged by persons (such as tax specialists) other than those who obtain the resulting tax benefits, who may themselves have little or no knowledge of these tax benefits or how they are obtained.¹⁰⁵

Since the effectiveness of a GAAR would be greatly diminished if it were to apply only to transactions or arrangements that are entered into by persons who fully appreciate the resulting tax benefits,¹⁰⁶ an emphasis on the purpose of the transaction or arrangement may be useful, though it would be conceptually more precise to refer to the purposes of the persons involved in arranging or carrying out the transaction or arrangement or the purposes for which the transaction or arrangement was undertaken or arranged (as in the Canadian GAAR). Although some might suggest that it would be unfair to impugn a transaction or arrangement that is entered into by a person who is unaware of the purposes of others,¹⁰⁷ it is important to recall that the application of a GAAR depends not on a taxpayer's mental state or moral culpability but on an objective assessment that the transaction or arrangement itself can reasonably be considered to have been undertaken or arranged in order to obtain a tax benefit. As a result, the application of a GAAR to "innocent" taxpayers is not only necessary to the effectiveness of a GAAR but also justifiable, given the function and effect of a GAAR, which (to repeat) is not to assign moral culpability but to ensure that tax-avoidance transactions or arrangements are subject to tax in accordance with the object and purpose of the relevant provisions.

For this reason, moreover, several GAARs also include objective factors that courts may or must take into account in determining the purposes for which a transaction or arrangement was undertaken or arranged. According to the Australian

103 Australian GAAR, *supra* note 4, section 177D(1).

104 See, for example, Cooper, "The Role and Meaning of 'Purpose' in Statutory GAARs," *supra* note 85, at 88, observing that "arrangements cannot have purposes" and rejecting the idea that "inanimate legal constructs" can have purposes as "linguistic nonsense." Notwithstanding the reference to the purposes of an arrangement or transaction in the PPT, the commentary on this provision in the OECD model convention supports the conclusion that arrangements cannot have purposes, stating that it is important to consider "the aims and objects of *all persons involved* in putting the arrangement or transaction in place or being a party to it" to determine whether the PPT applies. See paragraph 178 of the commentary on article 29 of the OECD model convention (emphasis added).

105 As Cooper explains, for example, "the taxpayer who invests in a marketed tax shelter may well be motivated exclusively by the higher commercial return being promised, oblivious to the fact that tax plays any part in how it arises." See Cooper, "The Role and Meaning of 'Purpose' in Statutory GAARs," *supra* note 85, at 90.

106 *Ibid.*, at 88.

107 *Ibid.*

GAAR, for example, the purpose test is to be applied having regard to eight considerations, including "the manner in which the scheme was carried out," "the form and substance of the scheme," and "the length of the period during which the scheme was carried out."¹⁰⁸ As Graeme Cooper explains, these factors generally involve an element of artificiality, including a lack of commercial substance and other characteristics that "are suggestive of artifice."¹⁰⁹ Although factors such as commercial or economic substance are arguably more relevant to the misuse and abuse requirement of a GAAR,¹¹⁰ the concept of artificiality is consistent with an objective approach to the purpose requirement in a GAAR—an attempt, as Cooper states, "to ground the GAAR in something observable about the features of the transaction or structure, and definitely more concrete than a mere state of mind."¹¹¹ Indeed, it is precisely this function that the concept of artificiality served in the leading European Court of Justice decision on the anti-abuse principle: as an objective factor that supported the court's conclusion that "the essential aim of the transactions concerned is to obtain a tax advantage."¹¹²

As is often noted, of course, tax law is itself artificial,¹¹³ and an element of artificiality is inherent in a multitude of common commercial dealings.¹¹⁴ As a result, as Judith Freedman emphasizes, "[a]rtificiality alone cannot be said to be a hallmark of [tax] avoidance when so much about tax is artificial."¹¹⁵ So long as the relevance of artificiality is limited to the subjective element of a GAAR, however, artificiality *alone* should not cause a GAAR to apply, but only to elicit a further inquiry into the objective element of the GAAR to determine whether the artificial transaction or arrangement contradicts the object and purpose of the relevant provisions.

While the Canadian GAAR does not explicitly refer to artificiality, the 1987 Department of Finance white paper that introduced the rule stated that it was "intended to prevent artificial tax avoidance arrangements,"¹¹⁶ and the original draft

108 Australian GAAR, *supra* note 4, sections 177(D)(2)(a), (b), and (c).

109 Cooper, "The Role and Meaning of 'Purpose' in Statutory GAARs," *supra* note 85, at 90.

110 See *infra* notes 150-159 and accompanying text. As explained at *infra* note 155, these factors have been incorporated into the purpose test in the Australian GAAR because it does not contain an explicit misuse or abuse test.

111 Cooper, "The Role and Meaning of 'Purpose' in Statutory GAARs," *supra* note 85, at 90.

112 *Halifax*, *supra* note 8, at paragraph 75.

113 Gergen, *supra* note 45, at 144.

114 Cooper, "The Role and Meaning of 'Purpose' in Statutory GAARs," *supra* note 85, at 90, referring to sale-leaseback arrangements, repurchase agreements, and financing leases. An excellent example in the Canadian context is a butterfly reorganization, which, as David Dodge noted when the GAAR was first enacted, is highly artificial but explicitly sanctioned by paragraph 55(3)(b) of the ITA. Dodge, *supra* note 37, at 7.

115 Freedman, "Defining Taxpayer Responsibility," *supra* note 8, at 343.

116 Canada, Department of Finance, *Tax Reform 1987: Income Tax Reform* (Ottawa: Department of Finance, June 18, 1987), at 129.

legislation included a general interpretive provision indicating that the purpose of GAAR was “to counter artificial tax avoidance.”¹¹⁷ This interpretive provision was deleted from the final version, however, and replaced by the misuse or abuse requirement, which had not appeared in the original draft.¹¹⁸ As the senior assistant deputy minister of finance noted at the time, since some pre-GAAR cases had interpreted the word artificial to mean “simulated” or “fictitious,”¹¹⁹ a reference to artificiality might have suggested that “a particularly high level of abuse” was required.¹²⁰ For this reason, although some jurisdictions might find it useful for a GAAR to refer to objective factors such as artificiality in order to reinforce the objective nature of the purpose test, this seems inadvisable in the Canadian context. Nonetheless, it could be useful to add a list of objective factors that are indicative of artificiality, such as the participation of accommodating parties, or the creation and termination of a single-purpose entity or relationship within a relatively short period of time, which often suggest that a transaction or arrangement was undertaken or arranged in order to obtain a tax benefit.¹²¹

A final issue with respect to the purpose test in a GAAR concerns the degree to which a tax purpose is required in order to satisfy this test when a transaction or arrangement is undertaken or arranged for tax and non-tax purposes, as is generally the case with most transactions and arrangements.¹²² Although the Canadian GAAR excludes transactions that may reasonably be considered to have been undertaken or arranged “primarily” for purposes other than to obtain a tax benefit,¹²³ some GAARs refer to the “sole” purpose of an arrangement or transaction,¹²⁴ while others refer only

117 Ibid., at 214.

118 Arnold and Wilson, “. . . Part 2,” supra note 91, at 1163.

119 See, for example, *Spur Oil Ltd. v. The Queen*, 81 DTC 5168 (FCA), at 5170, interpreting former subsection 245(1) of the ITA, which disallowed a deduction “in respect of a disbursement or expense made or incurred in respect of a transaction or operation that, if allowed, would unduly or artificially reduce” a taxpayer’s income. See also *Des Rosiers v. The Queen*, 75 DTC 5298 (FCTD), suggesting that the rule in former subsection 245(1) was no different than the judicial sham doctrine.

120 Dodge, supra note 37, at 7.

121 For useful examples in the Canadian context, consider the surplus-stripping transactions with accommodating parties in *McNichol et al. v. The Queen*, 97 DTC 111 (TCC) and *RMM Canadian Enterprises Inc. v. The Queen*, 97 DTC 302 (TCC); and the treaty-shopping transactions in *MIL (Investments) SA v. The Queen*, 2006 TCC 460; aff’d 2007 FCA 236; *Alta Energy Luxembourg SARL v. The Queen*, 2018 TCC 152; aff’d 2020 FCA 43.

122 Although purely tax-driven transactions are rare, examples might include some transactions that are undertaken in order to obtain a tax benefit in the form of a deduction, loss, or tax credit that can be used to shelter other income from tax—a category of tax-avoidance transactions that Professor Edgar characterized as “tax-attribute creation” transactions. See text accompanying infra note 168.

123 ITA subsection 245(3).

124 See, for example, Income Tax Act 58 of 1962, section 80A (herein referred to as “the South African GAAR”), which refers to the “sole or main purpose” of an avoidance arrangement.

to "the" purpose of the arrangement or transaction—which is generally interpreted to mean the "dominant" purpose.¹²⁵ Other GAARs (for example, the UK GAAR and the PPT) adopt a lower threshold based on "one of the principal purposes" of the arrangement or transaction¹²⁶—which is generally interpreted as a "significant" or "important" purpose.¹²⁷ As a result, most GAARs include a sole purpose test, a primary (or dominant) purpose test, or a significant (or important) purpose test.¹²⁸

According to Professor Edgar, the consequentialist rationale for a GAAR favours a "predominant or primary purpose" test as a "target effective standard" that "includes the entire range of behavioral adjustments that are characteristic of the concept of tax avoidance in law."¹²⁹ Although not entirely clear, the intuition behind this conclusion appears to be that the marginal social costs of transactions or arrangements that are primarily tax-motivated always exceed their marginal private benefits, while the marginal private benefits of transactions and arrangements that are motivated primarily by non-tax considerations always exceed the marginal social costs attributable to revenue losses, efficiency costs, and distributional impacts.¹³⁰ On this basis, he maintains, "the discontinuity that this test creates is not arbitrary, since small changes in nontax attributes result in a change in tax treatment that is justified in terms of the associated consequential attributes."¹³¹

From a non-consequentialist perspective, on the other hand, the relevant question is not whether a primary purpose test is more or less efficient than a sole purpose test or a significant purpose test but at what point a transaction or arrangement is sufficiently influenced by tax considerations that the object and purpose of the

125 See, for example, the Australian GAAR, *supra* note 4.

126 UK GAAR, *supra* note 5; PPT, *supra* note 6.

127 See, for example, *Lloyds Equipment Leasing (No 1) Ltd v. Revenue & Customs*, [2012] UKFTT 47 (TC), at paragraph 388, which was affirmed by the Court of Appeal in *Revenue and Customs v. Lloyds TSB Equipment Leasing (No 1) Ltd*, [2014] EWCA Civ 1062, at paragraph 52; and *Travel Document Service & Ladbroke Group International v. Revenue & Customs (Rev 1)*, [2018] EWCA Civ 549, at paragraph 48.

128 New Zealand's GAAR is a notable outlier in this respect, applying where an arrangement "has tax avoidance as its purpose or effect" or "[one] of its purposes or effects, whether or not any other purpose or effect is referable to ordinary business or family dealings, if the tax avoidance purpose or effect is not merely incidental," and defining "tax avoidance" to include "directly or indirectly altering the incidence of any income tax." See Income Tax Act 2007, 2007 No. 97, section YA 1. As Michael Littlewood explains, this rule could "produce absurd results" by applying to virtually any transaction that results in a reduction of tax. See Michael Littlewood, "The Possibility of Amending New Zealand's Anti-Avoidance Rule" (2013) 25:3 *New Zealand Universities Law Review* 522, at 527. As a result, the courts in New Zealand have limited the scope of the rule through a broad "parliamentary contemplation test" that excludes arrangements that are consistent with the object and purpose of the legislation. Elliffe, *supra* note 4, at 154-55.

129 Edgar, "Building a Better GAAR," *supra* note 12, at 890-91.

130 *Ibid.*, at 865, figure 1.

131 *Ibid.*, at 891.

relevant provisions may be relied on to deny a tax benefit that would otherwise be obtained if the relevant provisions are construed according to ordinary methods of interpretation. While some tax law scholars argue that this departure from the principle of legal certainty is justified only if the sole or dominant purpose for which a transaction or arrangement is undertaken or arranged is to obtain a tax benefit,¹³² it is not obvious that the presence of a significant or important tax purpose should not be sufficient to trigger this result.¹³³ After all, the GAAR only applies if the objective element of the rule is also satisfied. As a result, although the PPT in the Canadian GAAR has not been a significant impediment to its application, it would not be unreasonable to lower this standard to a standard based on “one of the principal purposes” of the transaction—particularly since this is the standard adopted in the PPT that will modify most of Canada’s tax treaties, and consistency between these tests might be desirable since either provision could apply to the abuse of a tax treaty.¹³⁴

Misuse or Abuse Test

Since the meaning of “avoidance” involves a purposeful act to get around or get out of something, this concept logically includes not only a purposeful act on the part of the person or persons who engage in avoidance, but also “something” that is avoided. Because a GAAR applies as “a provision of last resort” only where a benefit would otherwise be obtained under the provisions of domestic tax legislation or a tax treaty,¹³⁵ it follows that the avoided “thing” to which a GAAR applies is not the provisions themselves, at least as they are ordinarily construed. On the contrary, as the objective element of general anti-avoidance rules and principles suggests, the avoided thing to which these rules and principles apply is the object or purpose of these provisions.¹³⁶

132 See, for example, Eric C.C.M. Kemmeren, “Where Is the EU Law in the OECD BEPS Discussion?” (2014) 23:4 *EC Tax Review* 190-93; and Luc De Broe, “Tax Treaty and the EU Law Aspects of the LOB and PPT Provision Proposed by BEPS Action 6,” in Robert Danon, ed., *Base Erosion and Profit Shifting: Impact for European and International Tax Policy* (Zurich: Shulthess, 2016), 197-253.

133 See, for example, Dennis Weber, “The Reasonableness Test of the Principal Purpose Test Rule in OECD BEPS Action 6 (Tax Treaty Abuse) Versus the EU Principle of Legal Certainty and the EU Abuse of Law Case Law” (2017) 10:1 *Erasmus Law Review* 48-59.

134 For a detailed analysis of the purpose test in the PPT, see David G. Duff, “Tax Treaty Abuse and the Principal Purpose Test—Part 2” (2018) 66:4 *Canadian Tax Journal* 947-1011, at 975-85.

135 *Canada Trustco*, supra note 1, at paragraph 21.

136 See, for example, *CIR v. Willoughby*, [1997] 4 All ER 65, at 73, per Lord Nolan, explaining that the “hall mark” of tax avoidance is that “the taxpayer reduces his liability to tax without incurring the economic consequences that Parliament intended to be suffered by any taxpayer qualifying for such reduction in his liability.” In contrast to this view, Professor Edgar states that tax avoidance “in its broadest (and perhaps most simplistic sense) . . . refers to any

According to the Canadian GAAR, for example, the provision applies to an avoidance transaction only if it may reasonably be considered that the transaction would result in a misuse of relevant provisions of domestic legislation or a tax treaty or an abuse having regard to these provisions read as a whole.¹³⁷ Subsequently included in the GAARs of several other countries,¹³⁸ this misuse or abuse test requires courts to determine whether the tax benefit resulting from the impugned transaction is consistent with the object, spirit, or purpose of the relevant provisions.¹³⁹ The UK GAAR also includes an abuse requirement, which it defines, in an unfortunately convoluted way, as “arrangements the entering into or carrying out of which cannot reasonably be regarded as a reasonable course of action in relation to the relevant tax provisions, having regard to all the circumstances”—including, among others, “whether the substantive results of the arrangements are consistent with any principles on which those provisions are based (whether express or implied) and the policy objectives of those provisions.”¹⁴⁰ In contrast to these provisions, the objective elements in the PPT and the European Council Directive codifying the European Court of Justice anti-abuse principle simply refer to the object and purpose of the relevant provisions.¹⁴¹

However these requirements may be expressed in law, their role within the structure of a general anti-avoidance rule or principle is the same: to draw a line between legitimate tax planning or tax minimization and unacceptable or abusive tax avoidance by means of an interpretive exercise that excludes from the scope of the rule or principle transactions or arrangements that are consistent with the object, spirit, or purpose of the relevant provisions.¹⁴² In this respect, therefore, the objective element of a GAAR applies the teleological interpretive approach that would otherwise

change in behavior that occurs as a response to the change in price of particular activities, assets, or transactions occasioned by the imposition of taxation.” Edgar, “Building a Better GAAR,” supra note 12, at 843, citing Michael Brooks and John G. Head, “Tax Avoidance: In Economics, Law and Public Choice,” in Graeme S. Cooper, ed., *Tax Avoidance and the Rule of Law* (Amsterdam: IBFD, 1997), 53-91, at 71-74. Although acknowledging that “the concept of tax avoidance used in law is a narrower one that consists of an apparently imprecise subset of this broader range of behavioral adjustments,” Edgar takes the view that “the identification of tax-avoidance transactions appropriately subject to prohibition has absolutely nothing to do with perceptions of legislative intent.” See Edgar, “Building a Better GAAR,” supra note 12, at 843 and 882.

137 ITA subsection 245(4).

138 See, for example, Income Tax Act, 1961 (India), section 96(1)(b); Taxes Consolidation Act, 1997 (Ireland), section 811(3)(b); and the South African GAAR, supra note 124, section 80A(c)(ii).

139 *Canada Trustco*, supra note 1, at paragraph 55.

140 UK GAAR, supra note 5, section 207(2).

141 PPT, supra note 6 and Council Directive 2016/1164/EU, supra note 8.

142 See, for example, *Canada Trustco*, supra note 1, at paragraphs 16 and 54-55.

contradict principles of legality and legal certainty,¹⁴³ but is justified when a transaction or arrangement is undertaken or arranged in order to obtain a tax benefit.¹⁴⁴

As a result, as the Supreme Court of Canada has stated, a GAAR is “a legal mechanism whereby Parliament has conferred on the court the unusual duty of going behind the words of the legislation to determine the object, spirit or purpose of the provision or provisions relied upon by the taxpayer.”¹⁴⁵ Judith Freedman makes a similar point, noting that the interpretive exercise required by a general anti-avoidance rule or principle is “an unusual form of interpretation” that “goes beyond” what is normally understood as statutory interpretation.¹⁴⁶ Since the object, spirit, or purpose of tax provisions is not always clear, and since the policies and principles underlying these provisions may be incomplete or inconsistent, this can be a difficult task.¹⁴⁷ Consequently, as the Supreme Court of Canada stated in *Canada Trustco*,¹⁴⁸ the line that the GAAR draws between legitimate tax minimization and abusive tax avoidance is “far from bright.”¹⁴⁹

As an aid to this interpretive exercise, it is often suggested that the commercial or economic substance of a transaction or arrangement should be an important consideration.¹⁵⁰ Indeed, since tax law generally relies on legal concepts in order to assess economic outcomes,¹⁵¹ and since tax-avoidance transactions and arrangements commonly exploit differences between the legal form of these transactions and arrangements and their economic character,¹⁵² it is arguable that the economic

143 See text accompanying supra note 83.

144 See text accompanying supra note 84.

145 *Copthorne*, supra note 1, at paragraph 66, per Rothstein J.

146 Freedman, “The Anatomy of Tax Avoidance Counteraction,” supra note 8, at 375-76.

147 Atkinson, supra note 57, at 40, noting that “tax statutes are often drafted in significant detail, leaving little or no room beyond the express words for an inference as to the purpose of a provision” and that “tax provisions are often unclear, incoherent or lacking of a consistent policy framework, such that it is difficult to discern any underlying parliamentary purpose.”

148 See *Canada Trustco*, supra note 1.

149 *Ibid.*, at paragraph 16.

150 See, for example, Brian J. Arnold, “The Long, Slow, Steady Demise of the General Anti-Avoidance Rule” (2004) 52:2 *Canadian Tax Journal* 488-511, at 504-10; and Jinyan Li, “‘Economic Substance’: Drawing the Line Between Legitimate Tax Minimization and Abusive Tax Avoidance” (2006) 54:1 *Canadian Tax Journal* 23-56.

151 See, for example, Freedman, “Defining Taxpayer Responsibility,” supra note 8, at 343, observing that the tax system is based on legal reality rather than economic reality “because that is the only practical and operable way to construct a tax system.”

152 Consider, for example, the arrangement in *Duke of Westminster*, supra note 59, which converted what was in economic substance a non-deductible salary payment to the Duke’s gardener into what was in legal form a payment under a deed of covenant that was effectively deductible for tax purposes; and the transactions in *Gregory v. Helvering*, supra note 79, which sought to convert what was in economic substance a taxable corporate distribution into what was in legal form a tax-free corporate reorganization.

substance of a transaction or arrangement is always relevant in deciding whether a transaction or arrangement results in a misuse or abuse of the provisions at issue.¹⁵³ Thus, although some tax provisions, such as tax incentive provisions, may contemplate or encourage transactions or arrangements lacking any economic substance in order to promote specific policy objectives, it seems reasonable to conclude that most transactions or arrangements with little or no economic substance contradict the object, spirit, or purpose of most tax provisions.¹⁵⁴

For this reason, several GAARs explicitly refer to commercial or economic substance, or objective factors indicative of economic substance, that may be taken into account in determining whether the GAAR should apply. According to the Australian GAAR, for example, application of the provision should be determined "having regard to" various matters, including "the form and substance of the scheme" and "any change in the financial position of the relevant taxpayer that has resulted, will result, or may reasonably be expected to result, from the scheme."¹⁵⁵ The South African GAAR goes further, stipulating "in the context of business" that the provision applies to a tax-motivated arrangement that "lacks commercial substance,"¹⁵⁶ taking into account "characteristics . . . that are indicative of a lack of commercial substance" such as an inconsistency between "the legal form of [the] individual steps" of an arrangement and "[its] legal substance" or effect "as a whole,"¹⁵⁷ and further stipulating that an avoidance arrangement lacks commercial substance if it would (but for the GAAR) result in a significant tax benefit for a party "but does not have a significant effect upon either the business risks or net cash flows of that party apart

153 See, for example, Arnold, "The Long, Slow, Steady Demise of the General Anti-Avoidance Rule," *supra* note 150, at 507, concluding that "it is difficult to see how transactions could be considered to be abusive if the economic substance of what the taxpayer did cannot be considered"; and Cassidy, "To GAAR or Not To GAAR," *supra* note 4, at 304, concluding that the misuse or abuse test will be "nugatory" if courts "cannot look at the substance of the transaction to determine if there is a misuse or abuse."

154 Tax incentive provisions are an obvious example of tax provisions that may contemplate or encourage transactions with little or no economic substance, but so are other provisions that are not properly characterized as tax incentives, such as provisions that allow transactions to facilitate the consolidation of losses among related entities.

155 Australian GAAR, *supra* note 4, section 177D(2). Since the Australian GAAR does not include an explicit misuse or abuse test, it takes these factors into account in determining the purpose for which a person or persons entered into or carried out the tax-avoidance scheme. Although these factors may be relevant to the purpose test of a GAAR, it is arguable that they are more relevant to the concepts of misuse or abuse. For a similar argument concerning the role of economic substance in the application of the PPT, see Duff, *supra* note 134, at 983 and 993-98.

156 South African GAAR, *supra* note 124, section 80(A)(a)(ii). In this context, the commercial substance test displaces the misuse or abuse test.

157 *Ibid.*, section 80(C)(2)(a). See also *ibid.*, section 80(C)(2)(b), referring to "the inclusion or presence of (i) round trip financing as described in section 80(D); or (ii) an accommodating or tax indifferent party as described in section 80(E); or (iii) elements that have the effect of offsetting or cancelling each other."

from any effect attributable to the tax benefit that would be obtained but for the provisions” of the tax legislation.¹⁵⁸ The UK GAAR adopts a similar but more flexible approach, providing a list of factors that “might indicate that tax arrangements are abusive,” including that the arrangements result in “an amount of income, profits or gains for tax purposes that is significantly less than the amount for economic purposes” or in “deductions or losses of an amount for tax purposes that is significantly greater than the amount for economic purposes”—provided, however, that “it is reasonable to assume that such a result was not the anticipated result when the relevant tax provisions were enacted.”¹⁵⁹

Although the Canadian GAAR does not include any reference to the economic substance of a transaction, or objective factors that might indicate the presence of economic substance, the Department of Finance explanatory notes that accompanied the introduction of the Canadian GAAR in 1988 stated that the misuse or abuse test “recognizes that the provisions of the Act are intended to apply to transactions with economic substance, not to transactions intended to exploit, misuse or frustrate the Act to avoid tax.”¹⁶⁰ For this reason, one might have thought that Canadian courts would rely on this concept as an interpretive aid to the misuse or abuse test in GAAR. In *Canada Trustco*,¹⁶¹ however, the Supreme Court of Canada rejected this approach, concluding that the concept of economic substance “has little meaning in isolation from the proper interpretation of specific provisions of the Act” and can therefore only be “considered in relation to the proper interpretation of the specific provisions that are relied upon for the tax benefit.”¹⁶² On this basis, as Brian Arnold observed in a critical comment on the decision, “unless a provision of the Act on which the taxpayer is relying refers to economic substance, lack of economic substance is not an indication of abuse.”¹⁶³ As a result, although a subsequent Federal Court of Appeal decision appears to have relied on a broad concept of economic

158 Ibid., section 80(C)(1).

159 UK GAAR, supra note 5, section 207(4).

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

161 *Canada Trustco*, supra note 1.

162 Ibid., at paragraph 76, concluding that the taxpayer could deduct capital cost allowance on assets that it had acquired at little or no economic cost pursuant to a complicated series of circular transactions on the grounds that the CCA provisions generally allow deductions based on the legal cost of assets, irrespective of their real economic cost, and depart from this approach only in specifically limited circumstances. In this respect, the court appears to have concluded that the transactions were not abusive on the grounds that they were contemplated by the relevant statutory provisions.

163 Brian J. Arnold, “Policy Forum: Confusion Worse Confounded—The Supreme Court’s GAAR Decisions” (2006) 54:1 *Canadian Tax Journal* 167-209, at 192. For a similar conclusion, see David G. Duff, “The Supreme Court of Canada and the General Anti-Avoidance Rule: *Canada Trustco* and *Mathew*,” in *Tax Avoidance in Canada After Canada Trustco and Mathew*, supra note 12, at 36, arguing that the court’s failure to recognize a broad concept of economic

substance to conclude that a series of transactions resulted in a misuse or abuse of specific provisions that do not specifically incorporate language of economic substance,¹⁶⁴ the status of economic substance as an interpretive guide to the Canadian GAAR is highly uncertain.

For this reason, some commentators have suggested that the Canadian GAAR should be amended to include an explicit reference to objective factors such as economic substance in order to provide guidance as to the kinds of considerations that should be taken into account in determining whether a transaction or arrangement results in a misuse or abuse.¹⁶⁵ According to Judith Freedman, this approach "would have a double function of reminding the legislator to consider and spell out the basis of new legislation as well as supplying direction to the courts to enable them to apply the specific legislation before them in the way intended by Parliament."¹⁶⁶ In addition, as with the codification of GAAR itself, explicit reference to objective factors such as economic substance would enhance the legitimacy of these criteria and increase the likelihood that they are applied in a clear and consistent manner. As a result, the addition of these objective factors would not only improve the effectiveness of GAAR, but also contribute to its consistency with a non-consequentialist ideal of legality.

These objective factors could be based in part on those identified in the GAARs of other jurisdictions, particularly those enacted after Canada introduced its GAAR—for example, the UK GAAR, which does not actually use the words "economic substance" but instead identifies objective factors indicating a lack of economic substance, such as "an amount of income, profits or gains for tax purposes that is significantly less

substance is closely related to its narrow interpretation of the concept of an abuse "having regard to" provisions of the ITA and other relevant enactments "read as a whole," which it merged with the narrower concept of a misuse of specific provisions themselves.

164 *Triad Gestco Ltd. v. Canada*, 2012 FCA 258, at paragraphs 39 and 41, concluding that a series of transactions that created "a loss on paper only in the sense that no economic loss was suffered" resulted in a misuse and abuse of specific provisions for taxing capital gains on the basis that "the capital gain system is generally understood to apply to real gains and real losses."

165 See, for example, Arnold, "The Long, Slow, Steady Demise of the General Anti-Avoidance Rule," supra note 150, at 511; and Freedman, "Interpreting Tax Statutes," supra note 42, at 75 and 79, observing that "[t]he legislature must take some of the blame" for the decision in *Canada Trustco* "for not spelling out the principles sufficiently in the body of the GAAR, despite referring to economic substance in the explanatory notes to the legislation."

166 Freedman, "Interpreting Tax Statutes," supra note 42, at 75. Freedman also argues that a GAAR should be accompanied by express statements of the principles underlying detailed legislative provisions that would provide further guidance to the object and purpose of these provisions. *Ibid.*, at 87, stating that "the drafting of specific legislation needs to become more explicit about the underlying principles of the legislation." For more detailed discussions about principles-based approaches to the drafting of tax legislation, see John F. Avery Jones, "Tax Law: Rules or Principles?" [1996] no. 6 *British Tax Review* 580-600; Graeme S. Cooper, "Legislating Principles as a Remedy for Tax Complexity" [2010] no. 4 *British Tax Review* 334-60; and Judith Freedman, "Improving (Not Perfecting) Tax Legislation: Rules and Principles Revisited" [2010] no. 6 *British Tax Review* 717-36.

than the amount for economic purposes” or “deductions or losses of an amount for tax purposes that is significantly greater than the amount for economic purposes.”¹⁶⁷ In the Canadian GAAR, as in the UK GAAR, these factors would operate as interpretive guidelines or presumptions, and would be subject to an exception when it is reasonable to consider that the tax benefit was intended or anticipated when the relevant provisions were enacted.

Further guidance might also be derived from the valuable “taxonomy” of tax-avoidance transactions that Professor Edgar devised, noting that tax-avoidance transactions that lack economic substance can generally be categorized into one of three types:

1. transactions that create a tax attribute such as a deduction, loss, or tax credit that can be used to shelter income from tax (“tax-attribute creation”);
2. transactions that transfer tax attributes, such as income, deductions, losses, or tax credits, from one taxpayer to another in order to obtain a joint tax benefit that can be shared between the taxpayers (“tax-attribute trading”); and
3. transactions and arrangements whose non-tax characteristics closely replicate those of an alternative transaction or arrangement, but result in substantially less tax than the alternative (“transactional substitutions”).¹⁶⁸

As Professor Edgar observed, these kinds of transactions are familiar to most tax professionals and represent the vast majority of tax-avoidance cases that appear before the courts.¹⁶⁹ For these reasons, it makes sense to draw upon criteria that courts have considered abusive in order to devise objective factors of misuse or abuse. As with factors derived from the GAARs of other jurisdictions, these factors would also operate as interpretive guidelines or presumptions and be subject to an exception when it is reasonable to consider that the tax benefit was intended or anticipated when the relevant provisions were enacted.

167 UK GAAR, supra note 5, section 207(4).

168 Edgar, “Building a Better GAAR,” supra note 12, at 848-50.

169 For a useful categorization of Canadian GAAR according to these categories up to 2006, see Edgar, “Designing and Implementing a Target-Effective General Anti-Avoidance Rule,” supra note 12, at 257-58. An updated list of notable Canadian cases in each category include: (1) transactions like those in *Triad Gestco*, supra note 164, that create offsetting gains and losses, the former of which are deferred and/or tax-preferred or non-taxable, while the latter are used to shelter current income from tax; (2) income-shifting transactions like those in *Canada v. 594710 British Columbia Ltd.*, 2018 FCA 166, that allocate income from one taxpayer to another who is either taxable at a lower rate or has losses or other deductions that shelter this income from tax, and deduction-shifting transactions like those in *Canada Trustco*, supra note 1 and *Matthew*, supra note 14, that transfer losses or other deductions from one taxpayer to another to whom these deductions are more valuable; and (3) surplus-stripping transactions, like those in *McNichol* and *RMM*, supra note 121, that convert what would otherwise be taxable dividends into tax-preferred capital gains, and treaty-shopping arrangements, like those in *MIL*

Although Professor Edgar recommended that GAAR should be amended to include a concept of economic substance based on these three categories of tax avoidance,¹⁷⁰ he would have rejected the suggestion that objective factors based on these categories should operate as interpretive guidelines or presumptions rather than fixed rules, and would have criticized the idea that these factors should draw on criteria that courts themselves have considered abusive. On the contrary, he argued, the harmful consequences attributable to these transactions (assuming that they are primarily tax-motivated) are such that they should all be subject to GAAR without having to “engage in a generalized exercise in statutory interpretation to determine whether the particular tax avoidance transaction is acceptable.”¹⁷¹ In addition, he suggested, it is “simply not clear that the judiciary has the kind of institutional competence to engage in the policy-based inquiry implicated by a statutory interpretation exercise.”¹⁷² For these reasons, he concluded that the role of statutory interpretation in the application of GAAR should be “significantly diminished” or eliminated altogether by amending GAAR in two ways: (1) deeming all tax-attribute-creation and tax-attribute-trading transactions to constitute a misuse or abuse “unless there is an explicit legislative regime sanctioning the transaction,”¹⁷³ and (2) adding an economic substance concept “as tantamount to the synthetic replication of a higher-taxed transaction . . . to enable the judiciary to address a limited range of transactional substitutions.”¹⁷⁴

For the purpose of this paper, it is less important to address the details of these recommendations than it is to explain why they differ from my own recommendations for amending GAAR and how they relate to alternative conceptions regarding the essential purposes of a GAAR. From Professor Edgar’s consequentialist perspective, the function of a GAAR is to ensure an efficient level of tax avoidance by balancing its marginal costs and benefits—a task for which the judiciary is (with the deepest of respect) obviously unsuited. From a non-consequentialist perspective, on the other hand, the ultimate purpose of a GAAR is to protect the integrity of the tax provisions at issue by discouraging and counteracting transactions and arrangements that contradict their objects or purposes. Although this is not an easy task, and is

(Investments) SA and *Alta Energy*, supra note 121, that enable taxpayers to obtain benefits under a tax treaty that would otherwise be unavailable.

170 Edgar, “Building a Better GAAR,” supra note 12, at 904.

171 *Ibid.*, at 880.

172 *Ibid.*, at 841. See also *ibid.*, at 837: “It is utterly hopeless to leave it to the judiciary to articulate a behavioral prohibition that is neither under-inclusive nor over-inclusive in its identification of prohibited transactions. Trained as lawyers, and not public policy analysts, judges (and the lawyers appearing before them) simply do not have the institutional competence to execute this important task.”

173 *Ibid.*, at 895.

174 *Ibid.*, at 903.

best assisted by legislative guidance on the kinds of objective factors that may constitute a misuse or abuse of the relevant provisions, it is a quintessentially judicial function for which courts are clearly competent.¹⁷⁵

CONCLUSION

General anti-avoidance rules and principles have an important role to play in domestic tax legislation and tax treaties, not only to prevent adverse consequences such as revenue losses, efficiency costs, inequitable shifting of tax burdens, and the erosion of voluntary tax compliance, but also to uphold the rule of law by discouraging and counteracting transactions and arrangements that undermine the integrity of tax laws and contradict the object and purpose of these laws. These rules and principles may be consistent with the ideal of legality to which the rule of law aspires, but this is the case only if they are designed in a manner that is also consistent with the principles on which this ideal is based. To this end, I have argued in this paper that

1. the standard that is adopted to discourage and counteract unacceptable tax avoidance should be codified in the form of an explicit rule in domestic tax legislation and tax treaties;
2. this rule should include (a) a “subjective element” or purpose test and (b) an “objective element” or misuse and abuse test, the second of which determines whether the transaction or arrangement at issue is consistent with the object and purpose of the relevant provisions, and the first of which justifies the application of this interpretive approach in place of the ordinary interpretive approach on which taxpayers can otherwise rely on the basis of a principle of legal certainty;
3. the “subjective element” or purpose test (a) should be assessed objectively by reference to what a reasonable person would consider the purposes of a transaction or arrangement to be (not the subjective purposes of the person or persons involved), (b) may reasonably be satisfied where one of the principle purposes for which the transaction or arrangement was undertaken or arranged was to obtain a tax benefit, and (c) may be informed by objective indicia of artificiality;
4. the “objective element” or misuse or abuse test should be informed by objective factors that are indicative of economic substance and should be expressly incorporated into a GAAR;

175 Brian J. Arnold, “Reflections on the Relationship Between Statutory Interpretation and Tax Avoidance” (2001) 49:1 *Canadian Tax Journal* 1-39, at 31. See also Arnold, “The Long, Slow, Steady Demise of the General Anti-Avoidance Rule,” note 150, at 502, explaining that the object, spirit, and purpose of legislation are “concepts [that] should be familiar to the courts because they form part of the modern approach to statutory interpretation as mandated by the Supreme Court of Canada.”

5. these objective factors should be informed by factors included in the GAARs of other jurisdictions (for example, the UK GAAR), as well as criteria that courts have considered abusive in the various types of tax-avoidance cases that they have considered—cases that Professor Edgar very usefully categorized as tax-attribute-creation cases, tax-attribute-transfer cases, and transactional substitution cases;
6. these objective factors should operate not as fixed rules, but as guidelines or presumptions to which courts can refer to determine whether a transaction or arrangement results in a misuse or abuse of the provisions at issue;
7. courts have the institutional competence to carry out the interpretive exercise that is required under a misuse or abuse test, particularly if assisted by these objective factors; and
8. the addition of these objective factors would improve the consistency of GAAR decisions and promote legal certainty.

In this way, finally, this paper has argued that a GAAR is not only consistent with, but essential to, the ideal of legality to which the rule of law aspires.

Although I disagree in this paper with Professor Edgar's consequentialist approach to GAARs, my argument was inspired and shaped by a serious engagement with his approach—the kind of engagement that I believe most academics hope to stimulate through their scholarship. I hope that this essay honours his legacy and is a fitting tribute to the influence of his scholarship.

