

# Retroactivity and the General Anti-Avoidance Rule

Symposium: *The Supreme Court of Canada and the General Anti-Avoidance Rule*

November 18, 2005

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**ABSTRACT:** Subsection 245(4) of the *Income Tax Act* imposes a “misuse” or “abuse” limitation on the application of the general anti-avoidance rule (GAAR) to deny the tax benefits associated with an avoidance transaction. Subsection 245(4) was amended in the spring of 2005, with the amendment applying retroactively to transactions occurring after September 12, 1988, thereby purporting to affect transactions extending more than 16 years into the past. An underlying contention of this paper is that the amendment changed significantly the “misuse” or “abuse” limitation and therefore raises a number of difficult legal and policy issues relating to the retroactivity of legislation more generally. These issues were sidestepped without analysis by the Supreme Court of Canada in its recent judgment in *Canada Trustco*, with the Court refusing to apply the amended version of subsection 245(4). The paper proceeds in three stages. The first considers the law in Canada surrounding retroactive legislation. The second evaluates the Supreme Court’s handling of the amendment of subsection 245(4) in *Canada Trustco* in light of this legal context. The final stage draws on the tax policy literature in offering some thoughts on retroactivity and the GAAR more generally.

## I. Introduction

The general anti-avoidance rule (the “GAAR”) appears in s. 245 of the *Income Tax Act* (the “Act”).<sup>1</sup> The GAAR was introduced in 1988. Motivating its introduction was the concern expressed by the Department of Finance prior to its debut that “the existing provisions of the *Income Tax Act* are inadequate to deal with a number of blatant tax avoidance arrangements.”<sup>2</sup> The GAAR remedies this inadequacy, at least theoretically, by providing a ready-made generic statutory basis for denying a “tax benefit”<sup>3</sup> associated with an “avoidance transaction,”<sup>4</sup> provided

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<sup>1</sup> R.S.C. 1985, Chapter 1 (5th Supp.)

<sup>2</sup> See David Duff, *Canadian Income Tax Law* (Emond Montgomery, 2003) at 169-170, citing Canada, Department of Finance, *Tax Reform 1987: Economic and Fiscal Outlook* (Ottawa: Department of Finance, June 18, 1987).

<sup>3</sup> Subsection 245(1) defines “tax benefit” for the purposes of the GAAR:

“tax benefit” means a reduction, avoidance or deferral of tax or other amount payable under this Act or an increase in a refund of tax or other amount under this Act, and includes a reduction,

the avoidance transaction satisfies the threshold limitation—the statutory text of which has been recently amended—of being a “misuse” or “abuse” of the *ITA*, the Income Tax Regulations, the Income Tax Application Rules, a tax treaty, or any other enactment relevant to determining tax liability.<sup>5</sup> As the “misuse” or “abuse” limitation makes clear, the GAAR is intended to interfere only with abusive tax avoidance and not legitimate tax planning, which is consistent with the Department of Finance’s original concern with “blatant tax avoidance arrangements.”<sup>6</sup>

The statutory text of subsection 245(4), the basis of the “misuse” or “abuse” limitation on the denial of a tax benefit associated with an avoidance transaction, remained unchanged from the time the GAAR first took effect—on September 12, 1988—until it was amended by the *Budget Implementation Act, 2004, No. 2* (the “*BIA*”).<sup>7</sup> The *BIA* received Royal Assent on May 13, 2005. Subsection 55(5) of the *BIA* provided that the amended language of subsection 245(4) applies “with respect to transactions entered into after September 12, 1988.” Because the amendment to 245(4) was made by Parliament to apply retroactively to all transactions since the GAAR was introduced, it is arguable that the old language of subsection 245(4) is now entirely without purchase. This paper addresses some of the legal and normative considerations relating to the 16 year retroactive effect of the amended version of subsection 245(4).

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avoidance or deferral of tax or other amount that would be payable under this Act but for a tax treaty or an increase in a refund of tax or other amount under this Act as a result of a tax treaty...

<sup>4</sup> Subsection 245(3) defines “avoidance transaction” for the purposes of the GAAR:

An avoidance transaction means any transaction

(a) that, but for this section, would result, directly or indirectly, in a tax benefit, unless the transaction may reasonably be considered to have been undertaken or arranged primarily for bona fide purposes other than to obtain the tax benefit; or

(b) that is part of a series of transactions, which series, but for this section, would result, directly or indirectly, in a tax benefit, unless the transaction may reasonably be considered to have been undertaken or arranged primarily for bona fide purposes other than to obtain the tax benefit.

<sup>5</sup> See the discussion in Part III, *infra*.

<sup>6</sup> See Canada, Department of Finance, *supra* note 2. See also, Peter Hogg, Joanne Magee, Jinyan Li, *Principles of Canadian Income Tax, 5<sup>th</sup> ed.* (Thomson Carswell, 2005) at 599, who remark in a section entitled, “Identifying ‘bad’ avoidance” that “The idea seems to be to exclude from GAAR those transactions that are in accordance with the object and spirit of the scheme of the Act.”

<sup>7</sup> S.C. 2005, c. 19, s. 52.

The manner in which the Supreme Court of Canada dealt with the retroactivity issue in *Canada Trustco Mortgage Co. v. Canada*<sup>8</sup> is provocative. Despite the express provision for the retroactive effect of the new subsection 245(4) to transactions occurring after September 12, 1988, the Court in *Canada Trustco* rejected the idea that the amended language of 245(4) could apply to the transaction at issue in the appeal. At para. 7 of *Canada Trustco*, McLachlin C.J. and Major J. remarked:

A recent amendment to s. 245 [...] has no application to the judgments under appeal. Although this amendment was enacted to apply retroactively, it cannot apply at this stage of appellate review, after the parties argued their cases and the Tax Court judge rendered his decision on the basis of the GAAR as it read prior to the amendment. Furthermore, even if this amendment were to apply, it would not warrant a different approach to the issues on appeal. In our view, this amendment to s. 245 serves *inter alia* to make it clear that the GAAR applies to tax benefits conferred by Regulations enacted under the *Income Tax Act*.

In disposing of the amendment issue, the Court made two central claims. The first was that the new language of subsection 245(4) “cannot apply” to the appeal on the basis that the trial judgment had been rendered and the appellate review process had reached too advanced a stage. This is contestable. The Court did not expressly rely on any legal or philosophical authority for its conclusion, despite the conflicting views at various Courts of Appeal,<sup>9</sup> and the strong arguments that could be marshalled *for* the position the Court adopted based on philosophical conceptions of the rule of law,<sup>10</sup> and *against* the position the Court adopted based upon the Diceyan notion of Parliamentary supremacy.<sup>11</sup> The second claim, that even if the amendment

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<sup>8</sup> 2005 SCC 54 (“*Canada Trustco*”)

<sup>9</sup> See the discussion in Part II, *infra*.

<sup>10</sup> The two leading proponents of conceptions of the rule of law are Joseph Raz and Lon Fuller. Raz’s leading essay on the rule of law is “The Rule of Law and its Virtue” in *The Authority of Law* (Oxford University Press, 1979) at 210. Lon Fuller’s leading work is *The Morality of Law* (Yale University Press, 1969). For a treatment of Raz and Fuller in the tax and retroactivity context, see Geoffrey Loomer, “Taxing Out of Time: Parliamentary Supremacy and Retroactive Tax Legislation” (forthcoming 2006) *British Tax Review*.

<sup>11</sup> Albert Venn Dicey wrote that, “Parliament has, under the English constitution, the right to make any law whatever, and further, no person or body is recognised by the law of England as having a right to override or set

were to apply, it would not occasion a “different approach” to the resolving the case, is also contestable. The assertion that there would not be a “different approach” under the revised “misuse” or “abuse” subsection can be undermined on the basis that the new language substantially reduces the burden on the Minister to demonstrate a “misuse” or “abuse.”<sup>12</sup>

This paper seeks primarily to take up the first of these issues.<sup>13</sup> To this end, it proceeds in three stages. Part II sets out an account of the relevant law surrounding the effectiveness and applicability of retroactive legislation in Canada, outlining the general presumption against retroactive legislation and addressing how express terms can override this presumption in many (but not all) contexts. Particular attention is paid to how Canadian courts have approached the application of retroactive enactments to pending proceedings. Part III uses this background to evaluate the Court’s handling of the amendment of subsection 245(4) in *Canada Trustco*. Part IV draws on the tax policy literature in offering some thoughts on retroactivity and the GAAR more generally. Part V concludes.

## II. Statutory Retroactivity in Canadian Law

Generally speaking, legislation is effective immediately upon coming into force and remains so until repealed. This idea is referred to by one leading treatise on statutory interpretation as the principle of “simulactivity” or “simultaneous effect.”<sup>14</sup> Subsection 5(2) of the federal *Interpretation Act* provides that if legislation is silent as to when it comes into force,

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aside the legislation of Parliament.” See Albert Venn Dicey, *Introduction to the Study of the Law of the Constitution*, 10<sup>th</sup> ed. (1959) at 70.

<sup>12</sup> See David Duff, “The Supreme Court and the General Anti-Avoidance Rule: *Canada Trustco* and *Mathew*” (November 15, 2005), a paper also prepared for this symposium.

<sup>13</sup> The second issue has been discussed in depth elsewhere. See Duff, *ibid.*

<sup>14</sup> See Pierre-André Côté, *The Interpretation of Legislation in Canada* (Carswell, 2000) at 124. Ruth Sullivan does not use either of these terms, but the account of the relevant principles is equivalent: see Ruth Sullivan, *Sullivan and Driedger on the Construction of Statutes*, 4<sup>th</sup> ed. (Butterworths, 2002) at 523.

it is deemed to come into force with prospective application on the date it receives Royal Assent;<sup>15</sup> provincial *Interpretation Acts* contain similar provisions.<sup>16</sup>

There is a long-standing presumption in Canadian law that legislation does not have retroactive effect unless this is made explicit in the enactment or is a necessary implication of the language used.<sup>17</sup> Several of the decisions affirming the presumption of non-retroactivity have been tax cases.<sup>18</sup> A succinct expression of the presumption against retroactive effect appeared in the Supreme Court of Canada's 1977 decision in *Gustavson Drilling (1964) Ltd. v. M.N.R.*<sup>19</sup> Dickson J. (as he then was) wrote for a 3-2 majority of the Supreme Court of Canada that:

The general rule is that statutes are not to be construed as having retrospective operation unless such a construction is expressly or by necessary implication required by the language of the Act. An amending enactment may provide that it shall be deemed to have come into force on a date prior to its enactment or it may provide that it is to be operative with respect to transactions occurring prior to its enactment. In those instances the statute operates retrospectively.<sup>20</sup>

The Supreme Court has subsequently quoted this passage with approval in a number of its more recent decisions.<sup>21</sup>

The general presumption against retroactivity is not unique to Canadian law. Legal scholars have traced the presumption back through treaties of English law to Roman law, where it apparently appeared in several provisions of the *Corpus Juris Civilis*.<sup>22</sup> Some scholars have claimed that from its original appearance in Roman law the presumption has made its way into

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<sup>15</sup> See Sullivan, *ibid.*

<sup>16</sup> *Ibid.*

<sup>17</sup> See *Upper Canada College v. Smith* (1920), 61 S.C.R. 413 at 419.

<sup>18</sup> See, e.g., *Anderson Logging Co. v. The King*, [1925] S.C.R. 45; *M.N.R. v. Molson*, [1938] S.C.R. 213; *Fasken v. M.N.R.*, [1948] Ex. C.R. 580; *M.N.R. v. Massawippi Valley Railway Co.*, [1961] Ex. C.R. 191; *Agnew Estate v. The Queen*, [1978] 2 F.C. 776 (C.A.).

<sup>19</sup> [1977] 1 S.C.R. 271.

<sup>20</sup> *Ibid.* at 279.

<sup>21</sup> *The Manitoba Government Employees Assn. v. Manitoba*, [1978] 1 S.C.R. 1123; *Martin v. Perrie*, [1986] 1 S.C.R. 41 at para. 14; *Quebec (Attorney General) v. Quebec (Expropriation Tribunal)*, [1986] 1 S.C.R. 732; *Ford v. Quebec (Attorney General)*, [1988] 2 S.C.R. 712; *Brosseau v. Alberta (Securities Commission)*, [1989] 1 S.C.R. 301.

<sup>22</sup> See Elizabeth Edinger, "Retrospectivity in Law" (1995) 29 *U.B.C. L. Rev.* 5 at 12.

all contemporary Western legal systems,<sup>23</sup> though the strength of this claim is perhaps questionable given the intuitive attractiveness of the idea that the legal consequences associated with past conduct should not be alterable *ex post facto*.<sup>24</sup>

Consistent with this intuitive attractiveness, there is indeed strong justification for a presumption of non-retroactivity. Legal theorists, Joseph Raz and Lon Fuller among them, have made qualities such as prospectivity, knowability, openness, and clarity the central hallmarks of theories of the rule of law.<sup>25</sup> If the current law cannot be relied upon because future amendments can retroactively affect what the governing law is deemed to have been at any given time in the past, then logically there cannot *ever* be conclusive compliance with the law. At any moment in the future the law deemed to have been governing now or in the past can be changed, and it is thus impossible to safeguard current or past action from retroactive declarations of illegality and, therefore, impositions of liability. In this regard, in a late 19<sup>th</sup> century treatise on retroactive laws, William Pratt Wade remarked colourfully that,

In all retroactive laws there must be an element of surprise, by which persons whose rights are affected are taken unawares. They are called upon to act in a manner different from what they had been led by the settled state of the law to anticipate. So repugnant is such a system of legislation to our natural sense of justice, that it has been stigmatized as more unreasonable than that adopted by Caligula, who was said to have written his laws in a very small character and hung them upon high pillars, the more effectually to ensnare the people.<sup>26</sup>

This intuition of the injustice of retroactive laws has been developed and discussed at considerable length in the legal literature, particularly in the United States,<sup>27</sup> and to a lesser extent in Australia,<sup>28</sup> the United Kingdom<sup>29</sup> and Canada<sup>30</sup> as well.

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<sup>23</sup> *Ibid.*

<sup>24</sup> The suggestion is that a rule that makes intuitive sense is more likely to have arisen spontaneously in various legal systems without necessarily relying on earlier traditions.

<sup>25</sup> See Raz and Fuller, *supra* note 10.

<sup>26</sup> William Pratt Wade, *Retroactive Laws* (1880) at pp. 40-41; as quoted by Edinger, *supra* note 22 at 13.

<sup>27</sup> See, e.g., Bryant Smith, "Retroactive Laws and Vested Rights" (1927) 5 *Texas L. Rev.* 231; Bryant Smith, "Retroactive Laws and Vested Rights II" (1928) 6 *Texas L. Rev.* 409; Elmer E. Smead, "The Rule Against

The presumption that changes to the law will not apply retroactively is so important in some contexts—such as criminal law, where the liberty interests of individuals are at stake—that it has been specifically elevated to a constitutional principle. For example, paragraph 11(g) of the *Charter of Rights and Freedoms* provides the right, “not to be found guilty on account of any act or omission unless, at the time of the act or omission, it constituted an offence under Canadian or international law or was criminal according to the general principles of law recognized by the community of nations.”<sup>31</sup> It is also arguable that any enactment which threatens “life, liberty, or security of the person” through retroactive application would run afoul of s.7 of the *Charter*,<sup>32</sup> an implicit assumption being that giving retroactive effect to such a law would not be in accordance with the principles of fundamental justice.<sup>33</sup>

Nevertheless, where the stakes have been perceived to be lower (*i.e.* where liberty interests are not in play) Canadian courts have on many occasions espoused the view that Parliamentary supremacy carries with it the power for Parliament (or a provincial legislature within its jurisdiction)<sup>34</sup> to change the law with retroactive effect. For example, in *Air Canada v. British Columbia*,<sup>35</sup> the Supreme Court of Canada considered the ability of a province to

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Retroactive Legislation: A Basic Principle of Jurisprudence” (1935-1936) 20 *Minnesota L. Rev.* 775; Charles B. Hochman, “The Supreme Court and the Constitutionality of Retroactive Legislation” (1960) 73 *Harv. L. Rev.* 692; Stephen R. Munzer, “A Theory of Retroactive Legislation” (1982) 61 *Texas L. Rev.* 425; Andrew C. Weiler, “Has Due Process Struck Out? The Judicial Rubberstamping of Retroactive Economic Laws” (1992-1993) 42 *Duke L.J.* 1069.

<sup>28</sup> Frank Maher, “The Ghost in the Machine – Myths and Facts About Retrospectivity” (1983) 57 *Law Institute Journal* 183.

<sup>29</sup> See, *e.g.*, James Popple, “The Right to Protection from Retroactive Criminal Law” (1989) 13(4) *Criminal Law Journal* 251.

<sup>30</sup> See, *e.g.*, Elmer A. Driedger, “Statutes: Retroactive Retrospective Reflections” (1978) 56 *Can. Bar Rev.* 264; and Dianne Saxe, “Retrospective Liability for Environmental Contamination” (1992) 71 *Can. Bar Rev.* 491.

<sup>31</sup> Schedule B to the *Canada Act 1982* (U.K.) 1982, c. 11.

<sup>32</sup> See Côté, *supra* note 14 at 140-142; and Sullivan, *supra* note 14 at 542-543.

<sup>33</sup> See the discussion in Loomer, *supra* note 10.

<sup>34</sup> The term Parliament, when used *infra*, should be understood as also encompassing also provincial legislatures as appropriate.

<sup>35</sup> [1989] 1 S.C.R. 1161

establish a retroactive excise tax on the sale of gasoline. *La Forest J.* held for a majority of the Court that:

None of the judges in the courts below casts any doubt on the legislative power of the province to impose a retroactive tax [...] In common with these judges, I am unable to see any constitutional impediment [...] these provisions seem to be a proper exercise of its power to impose direct taxation in the province, the sole difference being that the 1981 provisions are given retroactive effect, a result that is not constitutionally barred.<sup>36</sup>

And as recently as September 2005, in *British Columbia v. Imperial Oil*,<sup>37</sup> Major J. affirmed this approach in stating at para. 69 for a unanimous Supreme Court of Canada:

Except for criminal law, the retrospectivity and retroactivity of which is limited by s. 11(g) of the *Charter*, there is no requirement of legislative prospectivity embodied in the rule of law or in any provision of our Constitution.<sup>38</sup>

Thus, from a legal perspective it is clear that absent specific constitutional objections relating primarily to the protection of liberty interests, so long as Parliament is direct and the enactment unambiguous, the doctrine of Parliamentary supremacy supports the ability to give any particular enactment retroactive effect. This power is particularly clear in the context of taxation, since the imposition of tax liability will rarely engage constitutional protections under s. 7 or paragraph 11(g) of the *Charter*.<sup>39</sup>

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<sup>36</sup> *Ibid.* at para. 51.

<sup>37</sup> 2005 SCC 49.

<sup>38</sup> *Ibid.* See also, *Cusson v. Robidoux*, [1977] 1 S.C.R. 650, at 655.

<sup>39</sup> In fact, property rights were deliberately not singled out for protection in the *Charter*, and subsequent attempts to establish constitutional protection of property rights have failed. See, e.g., Patrick Monahan, *Constitutional Law*, 2<sup>nd</sup> ed. (Irwin Law, 2002). Monahan states in fn 13 of Chapter 13:

Both the U.S Bill of Rights and the 1960 Canadian Bill of Rights ... had included protection for property rights, but a proposal to include a similar guarantee in s.7 was not proceeded with by the Trudeau government at the time of the *Charter's* enactment... In the 1980s, the N.B. and Ont. legislative assemblies supported the addition of property rights to the *Charter*, as did the House of Commons in 1988. The federal government proposed to add protection for property rights to the *Charter*, as part of a package of comprehensive proposals to amend the Constitution... However, the Parliamentary Committee that held hearings and sponsored a series of conferences on the government proposal heard a great deal of opposition to the proposal... Ultimately, the proposal to include property rights in the *Charter* did not find its way into the Charlottetown Accord. [references with the quoted text omitted]



A thornier issue surrounds precisely how the courts have approached amendments to legislation made applicable retroactively which do not involve questions of liberty and in which Parliament has expressed its intention clearly. In a passage that hints at the difficulty of the issues implicated, Ruth Sullivan writes,

The law governing the temporal application of legislation is notoriously difficult. There are several reasons for this. The problems addressed by transitional law are inherently complex and the general rules devised by the courts and legislatures to deal with these problems are often inadequate. There is a vast case law dealing with the temporal application of legislation and no shortage of academic commentary. Unfortunately, this body of material is confusing and often inconsistent. The fact is that transitional law lacks a coherent, well-established framework for analysis.<sup>40</sup>

To see this difficulty in the context of legislation that has been amended with retroactive effect, consider the two polar cases in which such legislation will apply. At one extreme is a fact situation which has not yet materialized. In a case in which an enactment which is retroactive is being applied prospectively, the fact that it also has retroactive application with respect to some other cases of course poses no issue whatsoever—it applies just as would any prospective enactment. At the other extreme, however, are cases where a retroactive enactment purports to affect the law applying to facts which not only have already occurred, but have already been fully adjudicated. In these cases one might legitimately question whether the retroactive enactment could, should, or would somehow “undo” what would be otherwise indisputable claims of *res judicata*.<sup>41</sup> At common law (and at civil law, since Article 2848 of the *Civil Code of Quebec* establishes a similar principle),<sup>42</sup> the doctrine of *res judicata* (translated from Latin: “a thing adjudged”) precludes retrying of a claim or issue which has already been adjudicated by a

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<sup>40</sup> Sullivan, *supra* note 14 at 543.

<sup>41</sup> A detailed treatment of *res judicata* is beyond the scope of this article. See generally Donald J. Lange, *The Doctrine of Res Judicata in Canada*, 2<sup>nd</sup> ed. (Butterworths, 2004).

<sup>42</sup> See, e.g., *Boucher v. Stelco Inc.*, 2005 SCC 64 at para. 32.

competent court or tribunal.<sup>43</sup> Ordinarily the doctrine of *res judicata* has been found to protect judgments in cases that have already been fully adjudicated in the absence of perfectly clear Parliamentary intention to the contrary.

This is consistent with the observation that Canadian courts have typically held that just as there is a presumption against retroactivity, there is also a presumption of minimal retroactivity. That is, even where an amendment is expressly stated to be applicable retroactively, the courts have on many occasions resisted retroactive application through the use of strict construction.<sup>44</sup> In *Kent v. The King*,<sup>45</sup> Duff J. (as he then was) stated that,

[W]here an enactment, admittedly retrospective, is expressed in language which leaves the scope of it open to doubt, and according to one construction it imposes retrospectively a new liability, while upon another at least equally admissible, it imposes no such burden, the latter construction is that which ought to be preferred.<sup>46</sup>

In making this statement, Duff J. was relying on an earlier English case, *Reid v. Reid*,<sup>47</sup> in which it was held that, “That is a necessary and logical corollary of the general proposition, that you ought not to give a larger retrospective ‘operation’ to a section, even in an Act which is to some extent intended to be retrospective, than you can plainly see the legislature meant.” In his treatise on statutory interpretation, Pierre-André Côté remarks that, “The general principle calls

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<sup>43</sup> See, e.g., *Zadvorny v. Saskatchewan Government Insurance* (1985), 38 Sask. R. 59 (C.A.) at 62, per Cameron J.: “To change a law of general application, retroactively, is one thing; to legislate the extinguishment of a judgment is another. To satisfy us that the Legislature intended to deprive the respondent of his judgment - and Mrs. Payne of hers, since counsel for the appellant conceded that her position was no different than this man's - would take the clearest of language. We are not saying the power to legislate a plaintiff out of the fruits of a successful suit does not exist (that was not argued before us) but we are saying, with the greatest of respect, that the Legislature cannot be taken to have done so in this case, involving this man, and his \$37,000 recovery. If the Legislature had intended to do that, we are quite confident it would have used more express language than what appears in the general amending enactment in issue.”

<sup>44</sup> See, e.g., *Dwyer v. Town of Port Arthur* (1893), 22 S.C.R. 241 (S.C.C.); *Schmidt and Froese v. Ritz and Widmeyer* (1901), 31 S.C.R. 602.

<sup>45</sup> [1924] S.C.R. 388.

<sup>46</sup> *Ibid.* at 397.

<sup>47</sup> [1886] 31 Ch.D. 402.

for restrictive interpretation of retroactive legislation. When in doubt, the meaning which most limits a statute's retroactive effect should be preferred."<sup>48</sup>

A particularly difficult circumstance arises when a legislative enactment is amended with clearly expressed retroactive effect *after* the relevant events with which the law is concerned have occurred, but *before* proceedings to determine the legal consequences of the relevant events have been dispositively concluded (*i.e.* before *res judicata* would unambiguously apply to shield the litigants in the absence of clear statutory language). One of the leading judgments in this regard is the decision of the British Columbia Court of Appeal in *Hornby Island Trust Committee v. Stormwell*.<sup>49</sup>

In *Hornby* the British Columbia Court of Appeal considered the validity of a municipal zoning by-law which at trial was held to be invalid because the municipality did not publish a synopsis of the by-law as required by s. 769 of the *Municipal Act*. In the interim between the trial judgment and the appeal, the legislature attempted to reverse this result by amending s. 769 of the *Municipal Act*, adding subsection 769(3). Subsection 769(3) provided that,

A bylaw [...] made before this section came into force that is invalid by reason only that it did not comply with section 769 of this Act [...] is conclusively deemed to have been validly made at the time it was made.

Lambert J.A. (Hutcheon J.A. concurring, MacDonald J.A. delivered separate reasons) refused to apply the new subsection 769(3), explaining that:

But even if a retroactive construction were to be given to the new ss. 769(3), it is my opinion that such a construction should not be applied to change the outcome of a lawsuit that had reached the stage of an entered judgment before the legislation was enacted, unless the legislature has specifically required such an application.

In this case the pleadings were prepared, the evidence was led, the trial was conducted, and the judgment was rendered, before the enactment of the statute.

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<sup>48</sup> Côté, *supra* note 14 at 513.

<sup>49</sup> (1988), 53 D.L.R. (4<sup>th</sup>) 435 ("*Hornby*").

Once the trial judgment was given, the issue between the parties could not be opened up in new litigation. It was *res judicata*. The matter had been contested on the basis of the law as it stood at all the relevant times. In that contest the defendants may have declined to advance defences that seemed to them to be unnecessary, on the basis of the law as it then stood. The defendants do not have a chance to resurrect those defences on the appeal if a change in the law has made it necessary for them to rely on the defences. They cannot do so because those defences were not pleaded at trial, and no evidence was led with respect to them.

Lambert J.A. went on to explain that although some cases will call for a new trial where the law has been amended retroactively in the interim period between a trial judgment being rendered and an appellate review process being concluded, *Hornby* was not one of them. This *obiter* comment begs the question—when will it be appropriate for an appellate court to call for a new trial in the wake of newly introduced retroactive legislation?

Lambert J.A. does not offer a conclusive answer. On the facts of *Hornby* he determined that the case should not be remanded for a new trial on the basis that subsection 769(3) did not clearly wrest away the property rights that had vested as a result of the trial judgment. In his opinion, retroactive legislation would have to make clear its intention to disturb decided cases on account of the common law presumption against the retroactive interference with “vested rights.” In support of this conclusion, Lambert J.A. quoted from the judgment of Duff C.J. in *Minchau v. Busse*,<sup>50</sup>

The statute is expressly declared to apply to mortgages made before or after the passing of it, but it is not in express terms made applicable to pending proceedings and, in my opinion, that is not the effect of it; it does not in terms declare the law to be applied in proceedings commenced prior to the passing of it. In this view of the statute we are governed in pronouncing judgment by the law as it stood when the Court of Appeal gave their judgment, by which the Court of Appeal itself was governed.

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<sup>50</sup> [1940] 2 D.L.R. 282 (S.C.C.)

Following this statement in *Minchau v. Busse*, conveniently not mentioned by Lambert J.A., Duff C.J. cited the decision of the Supreme Court of Canada in *Boulevard Heights v. Veilleux*.<sup>51</sup> In this earlier case, Duff J. (as he then was) refused to consider new amendments to the relevant legislation which had been in the period after the Alberta Court of Appeal had rendered its judgment. He explained:

There can be no doubt, I think, that if these amendments had been enacted before the hearing of the appeal by the Appellate Division of Alberta, that Court would have been governed by them in the disposition of the appeal [...] The question we have to consider is another question. [...] In my judgment, the appeal to this Court is an appeal strictly so called, not an appeal by way of re-hearing. The *Supreme Court Act* (sec. 51) expressly declares that this Court should give the judgment which ought to have been given by the Court below, and there are no words corresponding to those of [...] the *Judicature Rules*, which enable the Court of Appeal to “make any further or other order as the case may require.” Speaking generally [...] it is the duty of this Court to give the judgment which the Court below ought to have given according to the state of the law on which it was the duty of that Court to base its judgment.

In light of the chain of reasoning, it is interesting to observe that the *Supreme Court Act*<sup>52</sup> no longer restricts the Supreme Court of Canada to give the judgment “which ought to have been given by the court below.” Instead, the Court has broad discretion in exercising a variety of powers. For example, sections 46 and 46.1 provide:

46. On any appeal, the Court may, in its discretion, order a new trial if the ends of justice seem to require it, although a new trial is deemed necessary on the ground that the verdict is against the weight of evidence.

46.1 The Court may, in its discretion, remand any appeal or any part of an appeal to the court appealed from or the court of original jurisdiction and order any further proceedings that would be just in the circumstances.

If the Court had these powers in 1915, based on his judgment, it seems likely that Duff J. in *Boulevard Heights* would have not have decided the case the same way. Instead, he probably

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<sup>51</sup> (1915), 26 D.L.R. 333 (S.C.C)

<sup>52</sup> R.S. 1985, c. S-26.

would have (i) decided the appeal on the basis of the new amendments; (ii) remanded the case to the Alberta Court of Appeal; or (iii) ordered a new trial.

It might stand to reason that if *Boulevard Heights* had been decided differently, then so too would have *Minchau v. Busse*. And, so it would follow, Lambert J.A. would have had considerably less support for his conclusion that the legislature could not be taken to have interfered with vested rights in the absence of clear language to that effect. On the other hand, it is important to recognize that 25 years had passed between Duff J.'s judgment in *Boulevard Heights* and his judgment as Chief Justice in *Minchau v. Busse*.<sup>53</sup> Duff C.J.'s reasoning also changed, even though he cited the *Boulevard Heights* decision in *Minchau v. Busse*. While the conclusion in *Boulevard Heights* turned on the idea that the Alberta Court of Appeal did not strictly speaking err (since the amendments to the legislation had not yet been made), the reasoning in *Minchau v. Busse* is based on the idea that in order to affect the outcome of pending proceedings, retroactive legislation must by its terms make clear that it intends to do so.

Following *Hornby*, a number of cases have addressed the issue of retroactivity and pending litigation. In *C.I. Mutual Funds Inc. v. Canada*,<sup>54</sup> the retroactive application of an amendment to the *Excise Tax Act* was at issue. Linden J.A. of the Federal Court of Appeal approved the reasoning of Rip T.C.J., who at the Tax Court of Canada in the same case had held:

... there are ample authorities which stand for the proposition that the legislator need not refer specifically to pending actions in order for retroactive legislation to affect the rights of litigants [...] As such, there is no reason why the retroactive legislative amendments should not extinguish the appellants' purported vested right of having its refund claims adjudicated under the former legislation. I would add that I cannot see the logic of the proposition that a person who pursues an action in law is protected from retroactive legislation while a person in identical

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<sup>53</sup> The Right Honourable Sir Lyman Poore Duff served on the Supreme Court of Canada from 1906 to 1944, a period of 37 years and 3 months. This is a remarkable feat given that retirement was (and remains) mandatory at age 75.

<sup>54</sup> [1999] 2 F.C. 613 (F.C.A.) ("*C.I. Mutual Funds*").

circumstances, who has not taken an action, is not protected from such legislation.<sup>55</sup>

The 1999 decision of the Federal Court of Appeal in *C.I. Mutual Funds* is thus in direct conflict with the 1988 decision of the British Columbia Court of Appeal in *Hornby*.

In the period intervening between *Hornby* and *C.I. Mutual Funds*, the Supreme Court of Canada tangentially confronted issues similar to those raised in *Hornby* and *C.I. Mutual Funds* in *Community Economic Development Fund v. Canadian Pickles Corp.*<sup>56</sup> In that case a number of amendments had been made to the relevant legislation after the Court of Appeal had ruled but before the parties appeared before the Supreme Court. Iacobucci J. explained the timing and circumstances of the amended legislation (and the reaction of the parties to the amendments) toward the end of his judgment:

After the hearing of this appeal, it came to the attention of the court that several amendments to the Act were recently passed which materially altered many of the provisions discussed above. [...] On October 18, 1991, the court, through the registrar, formally asked for the views of the parties as to the effect of the legislative amendments on the issues in the appeal and why the amendments were not put before the court during argument. In their respective replies, counsel for the parties agree, in essence, that the amendments do not affect the issues before the court because the amendments do not specifically address pending litigation. [...] Counsel also candidly admitted they were unaware of the legislative changes when the appeal was argued. Accordingly, as the parties agree that the recently made amendments do not affect the outcome of this appeal, they need not under the circumstances be considered further.<sup>57</sup>

Given the obvious concern expressed about the amendment issue by the Supreme Court of Canada in *Canadian Pickles* it is surprising that the issues raised in *Canada Trustco* on a similar question received such short shrift. There is no indication that the parties in *Canada Trustco*

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<sup>55</sup> *C.I. World Bond Fund Trust v. Canada*, [1997] T.C.J. 1080 at para. 55. Among the “ample authorities” cited by Rip T.C.J. in the notes omitted from the excerpt were: *Craies on Statute Law*, 5th ed., (London: Sweet & Maxwell, 1952); *Gruen Watch Co. v. Atty.-Gen. of Can.*, [1950] O.R. 429 (H.C.), rev’d in part (sub nom. *Bulova Watch Co. v. A.-G. of Canada*), [1951] O.R. 360 (C.A.); *A.-G. Nova Scotia v. Davis*, [1937] 3 D.L.R. 673 (N.S.S.C.).

<sup>56</sup> [1991] 3 S.C.R. 388 (“*Canadian Pickles*”).

<sup>57</sup> *Ibid.* at paras. 64-65.

agreed that the amendments should not affect the appeal. The failure to address the issue is particularly lamentable given the conflicting decisions in *Hornby* and *C.I. Mutual Funds*.

### III. Assessing the Treatment of Retroactivity in *Canada Trustco*

In *Canada Trustco*, the Supreme Court of Canada rejected the idea that the amended language of 245(4) should apply to the transaction at issue in the appeal, even though the relevant events without question occurred during the period covered by the amendment. The Court made two claims in justification of its holding. The first was that the new language of subsection 245(4) could not apply to the appeal because the proceeding had reached too advanced a stage. The competing authorities of *Hornby* and *C.I. Mutual Funds*, and the discussion of the Supreme Court in *Canadian Pickles*, suggest that the issue is a serious one which should have been decided in a less cavalier fashion. Problematically, the Court did not expressly rely on or even refer to any authority, legal or otherwise, of any of its past decisions or those of any other court in support of this first claim.

In addition, in a move which, ironically, seems to affirm the looseness of the reasoning underlying the first claim, the Court argued in the alternative that even if the amended language of subsection 245(4) did apply, it would not have resulted in a “different approach” to the appeal. This second claim is more dubious than the first. Whether the amendment effected a substantial change to the meaning of subsection 245(4) merited a closer analysis. It is true, as the Court recognized, that explicitly extending the application of the GAAR beyond the *Act* itself to the Income Tax Regulations, the Income Tax Application Rules, and tax treaties, was an important change.<sup>58</sup> But there is a strong argument to be made that the amendment of subsection 245(4)

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<sup>58</sup> This alone is a significant change, since two earlier judgments had concluded that the GAAR did not apply to a misuse or abuse of the Income Tax Regulations. See *Rousseau-Houle v. R.*, [2001] DTC 250 (TCC); and *Fredette v. R.*, [2001] DTC 621 (TCC).



did more. The underlying contention adopted in this paper, which echoes the more extensive analysis conducted and reported elsewhere by David Duff, is that the amended language of subsection 245(4) has considerably lessened the burden borne by the government in seeking to apply the GAAR to deny a tax benefit.<sup>59</sup>

Prior to the amendment effected by the *BIA* on May 13, 2005 to subsection 245(4) of the *ITA*, the subsection read as follows:

For greater certainty, subsection 245(2) does not apply to a transaction where it may reasonably be considered that the transaction would not result directly or indirectly in a misuse of the provisions of this Act or an abuse having regard to the provisions of this Act, other than this section, read as a whole.

Subsection 245(4) was amended effective May 13, 2005, the date the *BIA* received Royal Assent.

The provision now reads:

Subsection (2) applies to a transaction only if it may reasonably be considered that the transaction

(a) would, if this Act were read without reference to this section, result directly or indirectly in a misuse of the provisions of any one or more of

- (i) this Act,
- (ii) the Income Tax Regulations,
- (iii) the Income Tax Application Rules,
- (iv) a tax treaty, or
- (v) any other enactment that is relevant in computing tax or any other amount payable by or refundable to a person under this Act or in determining any amount that is relevant for the purposes of that computation; or

(b) would result directly or indirectly in an abuse having regard to those provisions, other than this section, read as a whole.

Subsection 55(5) of the *BIA* provides that the amended language of subsection 245(4) applies “with respect to transactions entered into after September 12, 1988.”

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<sup>59</sup> See *e.g.* Duff, *supra* note 12.

Given the express provision in the *BIA* providing for the retroactive application of the new language of subsection 245(4), the old language is now (at least as a legal matter) without effect with respect to transactions occurring after September 12, 1988. Moreover, given the foregoing analysis, the changes to the GAAR with retroactive effect are correctly understood to have been entirely within Parliament's purview. Legally, it is uncontroversial that Parliament is entitled to make retroactive changes of this sort, since the only binding constraints (those which are constitutional in nature) are not impediments to the implementation of retroactive fiscal legislation (unlike the criminal law context, say, where individual liberty is at stake).

Given the dominance of Parliamentary supremacy in discussions of retroactivity in Canadian law, and the lack of any doubt that Parliament can legally pass retroactive tax legislation, some might be tempted to argue a different approach. This alternative approach would take the position that the previous wording of the GAAR provided a sufficient basis for a finding that there had been a legally binding contract between Parliament and taxpayers or, at least, that taxpayers by structuring their affairs around the previous language of 245(4) somehow gained a reliance interest vis-à-vis Parliament.<sup>60</sup> This is legally a non-starter, however, at least with respect to the amendment of the GAAR.

As an initial matter, it is unrealistic to think that most tax provisions involve an implicit promise that the tax law will not change or, if it does, that Parliament will provide compensation. There are probable exceptions to this general observation, however. Certain types of tax provisions by their nature put taxpayers in an expected and clearly anticipated position of reliance upon promises expressed by Parliament in the *ITA*; e.g. the provisions establishing

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<sup>60</sup> See e.g. Daniel Shaviro, *When Rules Change* (University of Chicago Press, 2000) at 19.

registered retirement savings plans (RRSPs).<sup>61</sup> These provisions differ in kind from the GAAR. The GAAR should not be considered a provision that invites taxpayers to rely on its wording in cobbling together ever more elaborate and creative abusive tax avoidance transactions. The existence of the GAAR itself suggests that relying on the specific provisions of the *ITA* is unwise<sup>62</sup> (or at least not protected) when one is contemplating an abusive tax avoidance scheme. This should *a fortiori* be considered the case when considering the text of the GAAR itself.

If the Court in *Canada Trustco* had engaged with the reasoning of the BC Court of Appeal in *Hornby* and that of the Federal Court of Appeal in *C.I. Mutual Funds*, and grappled with its own *obiter* comments in *Canadian Pickles*, it may well have reached the same conclusion as it ultimately did—that the amended language of 245(4) should not have applied to the appeal before the Court. The basis of the decision could even have been as simple as a reiteration of the strict construction approach to statutory interpretation frequently invoked by Canadian courts in response to retroactive legislation. Even if the Court had provided a statement to the effect that in order for amended legislation to apply to pending proceedings Parliament must expressly specify this result, the guidance would have been beneficial by providing relative certainty to lower courts, to provincial legislatures, and to Parliament.

It would also have been valuable for the Court to have addressed the reasoning of Rip T.C.J. at the Tax Court of Canada in *C.I. Mutual Funds* who concluded that “the legislator need not refer specifically to pending actions in order for retroactive legislation to affect the rights of litigants” on the basis that he could not “see the logic of the proposition that a person who

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<sup>61</sup> For example, if Parliament suddenly retroactively eliminated the deduction for RRSP contributions back to the introduction of the relevant provisions, a court might be inclined to find that reasonable reliance had given teeth to an estoppel argument vis-à-vis Parliament.

<sup>62</sup> It might not be unwise to run the risk of having the GAAR apply because there are no penalties associated with its application, and it will probably never be the case that all GAAR-able transactions will be detected and reversed, thereby rendering abusive tax avoidance an optimal strategy from a purely pecuniary perspective (*i.e.* disregarding any possible moral objections). This is a long-standing observation. Plato is said to have remarked that, “When there is an income tax, the just man will pay more and the unjust less on the same amount of income.”

pursues an action in law is protected from retroactive legislation while a person in identical circumstances, who has not taken an action, is not protected from such legislation.” It is regrettable that the Court did not supply this logic.

#### IV. Some Recommendations Concerning Retroactivity and the GAAR

The tax policy literature addressing the retroactivity question is extensive, sophisticated, and well-developed. A detailed treatment is beyond the scope of this paper. However, some of the insights of the literature will be used to help illuminate the question of whether amendments to the GAAR should be applied retroactively.

The literature on retroactivity in tax largely divides into two camps. The first camp maintains that it is generally undesirable to allow tax legislation to apply retroactively. The first camp can be further divided into two sub-camps: (i) those relying on conceptions of fairness, the rule of law, and the protection of taxpayer reliance;<sup>63</sup> and (ii) those relying on efficiency arguments.<sup>64</sup> A note in the *Harvard Law Review* in 1970, representative of the first sub-camp, stated that,

The primary factor militating against retroactive effect is taxpayer reliance on existing law. In the tax field precise knowledge of the law is commonly the basis for long-range planning. Indeed, such reliance is particularly strong here due to the taxpayer’s paramount desire for certainty in tax planning combined with the unique degree of specificity found in the tax laws. Retroactivity often defeats reliance and penalizes a taxpayer for acting in a manner which was previously permitted. This is both harsh and frequently inequitable.<sup>65</sup>

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<sup>63</sup> See, e.g., Loomer, *supra* note 10; Note, “Setting Effective Dates for Tax Legislation: A Rule of Prospectivity” (1970) 84 *Harvard Law Review* 436; Comment, “Limits on Retroactive Decision Making by the Internal Revenue Service” (1976) 23 *UCLA Law Review* 529.

<sup>64</sup> See, e.g., Martin S. Feldstein, “On the Theory of Tax Reform” (1976) 6 *J. Pub. Econ.* 77; Avishai Shachar, “From Income to Consumption Tax: Criteria for Rules of Transition” (1984) 97 *Harvard Law Review* 1581; Mark J. Ramseyer and Minoru Nakazato, “Tax Transitions and the Protection Racket: A Reply to Professors Graetz and Kaplow” (1989) 75 *Virginia Law Review* 1155; Daniel S. Goldberg, “Tax Subsidies: One Time v. Periodic, An Economic Analysis of the Tax Policy Alternatives” (1994) 49 *Tax Law Review* 305; and Kyle D. Logue, “Tax Transitions, Opportunistic Retroactivity, and the Benefits of Government Precommitment” (1996) 94 *Michigan Law Review* 1129.

<sup>65</sup> *Ibid.* at 439.

Martin Feldstein, whose writing is representative of the second sub-camp, explained that,

Tax changes make individuals uncertain about the future reliability of the tax laws. Their anticipation of future possible changes induces inefficient precautionary behavior.”<sup>66</sup>

What distinguishes those in this first camp from those in the second camp is the claim that taxpayers who have acted in the shadow of a given tax law regime should be accommodated in some way, whether it is through some form of grandfathering or through explicit compensation when tax laws change.

Those in the second camp focus almost exclusively on efficiency arguments in arguing that grandfathering or compensation is usually unnecessary since taxpayers can be assumed to anticipate and therefore “price-in” the risk of changes to the law in various ways.<sup>67</sup> This is equivalent to arguing that taxpayers cannot help but place bets on future tax policy whenever they engage in economic activities. The general insight, as explained by Michael Graetz, one of the earliest proponents of this view is that:

Because all changes in law, whether nominally retroactive or nominally prospective, will have an economic impact on the value of existing assets or on existing expectations, the distinctions commonly drawn between retroactive and prospective effective dates are illusory.<sup>68</sup>

On this basis, those in the second camp argue that accommodation is typically not desirable, since it can: (i) significantly delay or reduce the benefits associated with a change in the law; (ii) increase complexity and thus compliance costs; (iii) reward most those taxpayers who have taken

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<sup>66</sup> Feldstein, *ibid.* at 93.

<sup>67</sup> See, e.g., Michael Graetz, “Legal Transitions: The Case of Retroactivity in Income Tax Revision” (1977) 126 *University of Pennsylvania Law Review* 47; Michael Graetz, “Retroactivity Revisited” (1985) 98 *Harvard Law Review* 1820; Louis Kaplow, “An Economic Analysis of Legal Transitions” (1986) 99 *Harvard Law Review* 509; and Shaviro, *supra* note 60. Shaviro is not a perfect fit in this second camp; his analysis identifies changes for which it is appropriate to provide relief, though by and large his position does tend to favour the views of Graetz and Kaplow over the views of those in the first camp.

<sup>68</sup> *Ibid.* Graetz, “Retroactivity Revisited” at 1822.

the most aggressive tax avoidance positions; and (iv) can be wasteful where delayed or phased-in effective dates are viable alternatives.<sup>69</sup>

A recent book-length study of the consequences of changes to tax rules by Daniel Shaviro makes a significant contribution to the literature on retroactivity in tax law by clarifying the terminology and providing a clear framework for the analysis of issues relating to retroactivity.<sup>70</sup> The most relevant contribution Shaviro makes for the purposes of this paper is his analysis of the combined role of the desirability of the future anticipation of retroactivity and the steady-state desirability of a change to tax law. His conclusion in this regard is that, “Given multiple categories, one’s conclusions need to be context specific and to focus on exactly what the retroactive tax (as distinct from the steady-state new rule) actually does.”<sup>71</sup> Shaviro demonstrates that it is naïve to think that either the first camp or the second camp is always correct. Rather, any given proposed change to tax law must be analyzed independently and contextually.

Consider the retroactive amendment of subsection 245(4) of the GAAR. Any retroactive revision of the GAAR to make it more effective would come within the category Shaviro describes as, “Retroactive Tax Good if and Only if the Rule Change is Good.”<sup>72</sup> From the perspective of economic efficiency, amending the GAAR in order to make it more effective in combating abusive tax avoidance would be a good rule change. Such revisions constitute good rule changes because allowing abusive tax avoidance to occur unchecked invites additional abusive tax avoidance, which reduces tax revenues, increases rents paid to tax planners, generates deadweight losses, and inequitably increases the tax burden on those not engaging in

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<sup>69</sup> *Ibid.* at 1825.

<sup>70</sup> See Shaviro, *supra* note 60.

<sup>71</sup> *Ibid.* at 51.

<sup>72</sup> *Ibid.* at 48.

abusive tax avoidance.<sup>73</sup> Similarly, the retroactive amendment of the GAAR to increase its effectiveness should also be regarded as the type of change that Parliament would like taxpayers to anticipate, because such anticipation would tend to reduce the level of abusive tax avoidance engaged in by taxpayers. On this view, the retroactive application of changes to the GAAR would be anticipated. Consider the consequences. If individuals expect the GAAR to become more and more effective—retroactively—through consistent Parliamentary amendment after amendment, one might reasonably expect abusive tax avoidance to be dealt a serious blow, provided individuals form expectations about future retroactive changes to the GAAR rationally. In other words, if we assume that individuals are forward-looking, that they form expectations about future Parliamentary action rationally, and that they believe Parliament has an interest to making the GAAR as effective as possible in combating abusive tax avoidance, then abusive tax avoidance in the present will on average take into account the future retroactivity of changes to the GAAR. And if Parliament is serious about improving the effectiveness of the GAAR in a retroactive manner, this belief will entail dramatic reductions in abusive tax avoidance conduct.

There are some caveats to add to this observation. First, not everyone will form the appropriate expectations about future government action in the future. It is enough if expectations do not systematically diverge from the most likely outcome. Those who do engage in abusive tax avoidance transactions are really placing bets that at some stage there will be a breakdown in government action that precludes retroactive enforcement of a more effective GAAR. This breakdown could be at one of a number of stages: (i) Parliament might not amend the GAAR to make it more effective; (ii) if Parliament does amend the GAAR to make it more effective, it might not make the changes retroactive; (iii) even if Parliament does amend the

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<sup>73</sup> Even if tax rates do not increase in the near term to reflect the abusive tax avoidance, lost revenues will contribute to deficits, the accumulation of governmental debt, and increase the burden borne, at the least, by future generations.

GAAR to make it more effective and makes the change retroactive, if trial proceedings have begun under the old wording of the GAAR, then the retroactive change will not apply in the absence of clear language; (iv) the abusive tax avoidance might not be detected at the audit stage; (v) even if the abusive tax avoidance is detected at the audit stage, the GAAR committee might decide to not pursue the case; (vi) even if the GAAR committee decides to pursue the case, and the CRA reassesses the taxpayer, and the case is slated to go to trial, the case might not be pursued; (vii) even if the abusive tax avoidance scheme runs afoul of the GAAR, the trial court may erroneously conclude (assuming the error is not corrected on appeal) that the GAAR does not apply; and finally (viii) taxpayers might assume that Parliament will never implement a penalty retroactively on transactions running afoul of the GAAR sufficient to overcome the other breakdowns. If the probability of breakdown at each of these seven stages is only 10 per cent, the probability of engaging in abusive tax avoidance and having a retroactively more effective GAAR reverse the tax benefits will be  $(0.90)^7$  or 47.8 per cent—less than 50/50.

An interesting question therefore surrounds whether there will ever be a retroactive introduction of a GAAR penalty to combat the advantages rationally identified by taxpayers and tax planners associated with the cumulative possibility of any one of these breakdowns occurring in any given case. Even if the remainder of the GAAR provision remains the same, it is possible that Parliament would see fit to introduce a penalty retroactively on transactions which run afoul of the GAAR. So long as the penalty is restricted to economic interests, and not liberty, it is strongly arguable that it is within Parliament's power to introduce such a penalty, even retroactively. Tax planners would be wise to consider advising clients of the potential risk of Parliament introducing a GAAR penalty with retroactive effect, if only in order to appropriately



manage client expectations and safeguard themselves from potential liability if a GAAR penalty is ultimately introduced.

## V. Conclusion

The statutory text of subsection 245(4)—the “misuse” or “abuse” limitation on the application of the GAAR—remained unchanged from the time the GAAR first took effect on September 12, 1988 until May 13, 2005. However, as of May 13, 2005, the amended language of subsection 245(4) applies retroactively to transactions entered into after September 12, 1988. The manner in which the Supreme Court of Canada dealt with the retroactivity issue in *Canada Trustco* is provocative. The Court claimed that despite the express retroactivity of the amendment, the new language of subsection 245(4) could not apply to the appeal on the basis that the trial judgment had been rendered and the appellate review process had reached too advanced a stage. The current indeterminacy in the law presented an opportunity for the Supreme Court of Canada in *Canada Trustco* to assess the conflicting authority, and to clarify the appropriate legal approach. Unfortunately, the Court did not do so.

By drawing on the tax policy literature on retroactivity in tax legislation, some thoughts surrounding with the retroactive application of amendments to the GAAR are offered. The primary observation is that since the GAAR (by definition) combats abusive tax avoidance, it is desirable as a steady-state policy to improve the reach and effectiveness of the GAAR retroactively, and also for taxpayers to anticipate this continual retroactive improvement. This suggests that in the future Parliament should be less timid about making amendments to the GAAR effective retroactively, and that the retroactivity should extend to litigants at any stage of pending proceedings. On this view, any reliance on the previous wording of the GAAR is like placing a bet on the future tools Parliament will use to combat abusive tax avoidance. To the

extent that tax avoidance bets turn out badly, those who have bet and lost will no doubt complain noisily and at length. But the complaints are political objections, not legal arguments (or, to the extent they are legal arguments, they are not convincing).

Finally, in order to properly condition expectations in their clients, tax planners would be wise to consider the potential introduction of a retroactive penalty on transgressions of the GAAR and advise their clients that such a retroactive penalty is both legally possible and, given its sensibility, likely at some point in the future.