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

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I. Introduction

On 19 October 2005, the Supreme Court of Canada released the first decisions in which it has considered the general anti-avoidance rule (GAAR) in section 245 of the federal *Income Tax Act* (ITA).[1] Effective for transactions entered into on or after 13 September 1988, this rule was enacted as a deliberate response to the Supreme Court of Canada decision in *Stubart Investments Ltd. v. The Queen,*[2] and intended to reduce what the Court had described as "the action and reaction endlessly produced by complex, specific tax measures aimed at sophisticated business practices, and the inevitable, professionally guided and equally specialized taxpayer reaction."[3] Designed "to distinguish between legitimate tax planning and abusive tax avoidance,"[4] the GAAR operates to deny a "tax benefit" that would otherwise result from an "avoidance transaction" or "series of transactions" of which the avoidance transaction is a part,[5]

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[1] R.S.C. 1985, c. 1 (5th Supp.) (as amended).

[2] [1984] C.T.C. 294, 84 D.T.C. 6305 (S.C.C.) [hereafter *Stubart Investments*]. Although rejecting the traditional "strict construction" approach to the interpretation of tax statutes, the *Stubart Investments* decision also reaffirmed the traditional approach adopted in *C.I.R. v. Duke of Westminster*, [1936] A.C. 1 (H.L.) that tax consequences should be based on the legal character of transactions and relationships regardless of their economic or commercial substance and the absence of any non-tax purpose for their existence.

[3] *Stubart*, *ibid*. at para. 66, cited in Canada, Department of Finance, *Tax Reform 1987: Economic and Fiscal Outlook*, (Ottawa: Department of Finance, 18 June 1987), reproduced in *White Paper on Tax Reform*, (Don Mills, ON: CCH, 1987) at 211.

[4] Hon Michael H. Wilson, Minister of Finance, *Explanatory Notes to Legislation Relating to Income Tax,* (June 1988) at p. 461 [hereafter Explanatory Notes].

[5] See subsection 245(2) of the ITA, according to which: "Where a transaction is an avoidance transaction, the tax consequences to the person shall be determined as is reasonable in the circumstances in order to deny a tax benefit that, but for this section, would result, directly or indirectly, from that transaction or from

provided that the transaction results in a misuse of provisions of the ITA, the *Income Tax Regulations*, the *Income Tax Application Rules*, a tax treaty, or any other relevant enactment, or an abuse having regard to those provisions read as a whole.[6]

Although the ITA defines the concepts of a tax benefit,[7] an avoidance transaction,[8] and a series of transactions,[9] it is up to the courts to decide if these requirements are satisfied in the context of specific transactions and whether an avoidance transaction results in a misuse or abuse within the meaning of the statutory rule. In its unanimous decisions in *Canada Trustco Mortgage Company v. Canada*[10] and *Mathew v. Canada*,[11] the Supreme Court of Canada considers each of these issues, providing important guidance on the interpretation and application of the GAAR.

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a series of transactions that includes that transaction." See also subsection 245(5) of the ITA, which sets out various ways in which the tax consequences to a person may be determined in order to deny a tax benefit that would otherwise result from an avoidance transaction.

[6] ITA, subsection 245(4). As originally enacted, this provision stipulated that the GAAR would 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 in 2005, with retroactive application to the date when the GAAR came into effect, by specifying that the GAAR would apply to a misuse or abuse of the *Income Tax Regulations*, the *Income Tax Application Rules*, a tax treaty, or any other relevant enactment, as well as the ITA, and by converting the double negative language of the initial provision to a positive test stipulating that the GARR "apples to a transaction only if it may reasonably be considered that the transaction … would … result … in a misuse … or … abuse …." The implications of this amendment are considered later in this comment.

[7] See subsection 245(1) of the ITA, which defines 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 "a reduction, avoidance or deferral of tax or other amount that would be payable under this Act but for a tax treaty or an increase in a refund of tax or other amount under this Act as a result of a tax treaty."

[8] See subsection 245(3) of the ITA, which defines an avoidance transaction as "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." See also subsection 245(1) of the ITA, which defines a "transaction" to include "an arrangement or event."

[9] See subsection 248(10) of the ITA, which stipulates that a series of transactions is "deemed to include any related transaction or events completed in contemplation of the series."

[10] 2005 SCC 54 [hereafter *Canada Trustco*].

[11] 2005 SCC 55 [hereafter *Mathew*].

This comment reviews the decisions in *Canada Trustco* and *Mathew* in light of previous Supreme Court of Canada tax jurisprudence and lower court pronouncements on the operation of the GAAR. Part II outlines the facts of each case and the grounds on which the Crown sought to apply the GAAR. Part III summarizes the decisions reached in each case by the Tax Court of Canada and the Federal Court of Appeal. Part IV examines the Supreme Court of Canada decisions, considering the Court's general approach to tax law and the GAAR and its application of this approach to the facts of each case. Part V summarizes the conclusions of this examination.

II. Facts

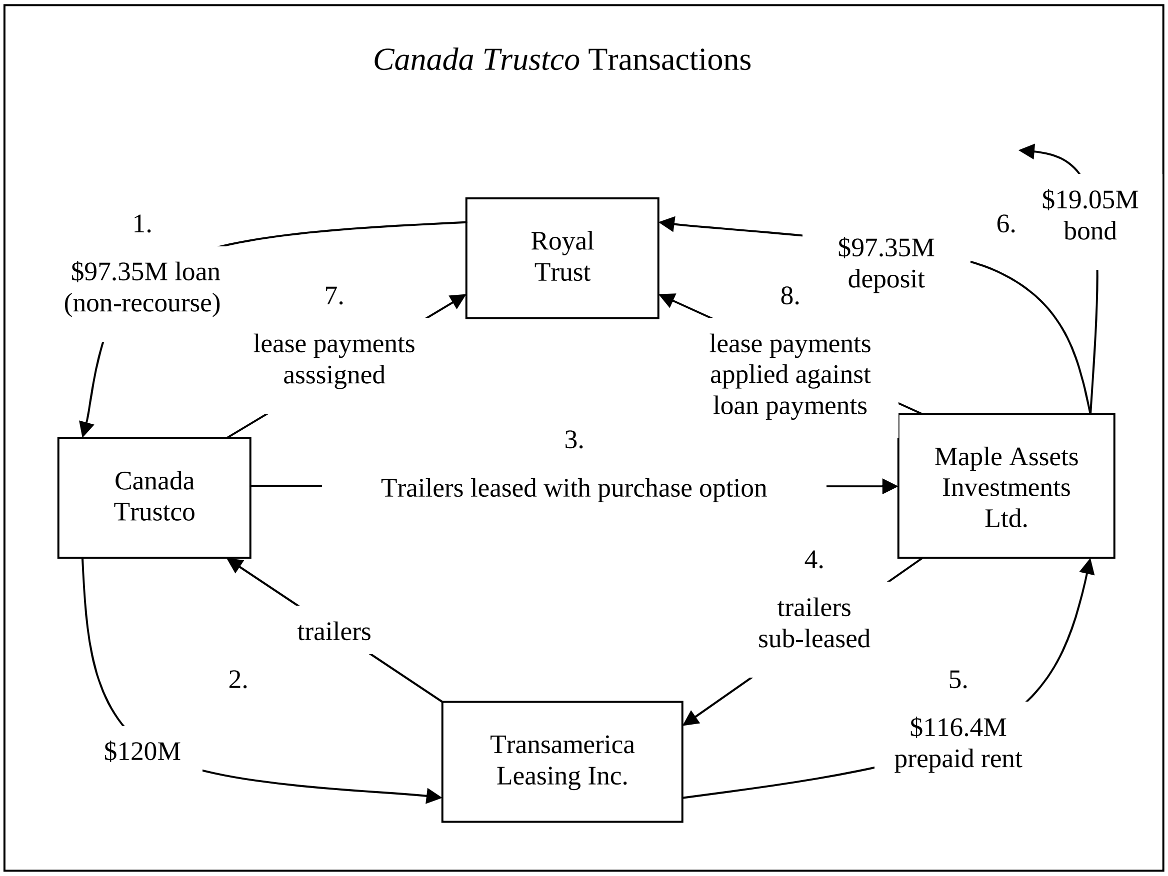
Like many tax avoidance cases, the transactions at issue in *Canada Trustco* and *Mathew* are numerous and complex. *Canada Trustco* involved a leveraged sale-leaseback of depreciable property, as a result of which the taxpayer sought to defer tax on leasing income by deducting capital cost allowance (CCA) in respect of property for which it assumed little or no economic risk. *Mathew* involved several transactions through which an insolvent trust company sought to transfer accrued losses on various mortgages to arm's length purchasers through the use of a partnership.

A. *Canada Trustco*

In *Canada Trustco*, the taxpayer was a large diversified financial institution holding a portfolio of loans and leases to government agencies and large companies.[12] In order to obtain additional CCA deductions to shelter leasing income that it anticipated, it

[12] *Canada Trustco Mortgage Company v. The Queen*, [2003] 4 CTC 2009, 2003 DTC 587 (TCC) at para. 4.

entered into a number of transactions with other parties, which were pre-arranged and completed on 17 December 1996.[13]



First, the taxpayer borrowed $97.35 million from the Royal Bank of Canada (RBC). Second, the taxpayer used these borrowed funds and $22.65 million of its own money to purchase a number of trailers from a U.S. company called Transamerica Leasing Inc. (TLI) at a fair market value of $120 million. Third, the taxpayer leased these trailers to a Jersey company called Maple Assets Investments Limited (MAIL) under an agreement whereby MAIL could purchase the trailers on December 1, 2005. Fourth, MAIL sub-leased the trailers back to TLI on terms that were essentially identical to those in the head lease. Fifth, TLI transferred $116.4 million to MAIL in prepayment of its

[13] These transactions are explained in more detail in *ibid*. at paras. 4-14, and in the Appendix to *Canada*

obligations under the sublease. Sixth, MAIL deposited $97.35 million of these prepaid funds with RBC for the purpose of making lease payments to the taxpayer, and used the remainder to purchase a Government of Ontario bond maturing on December 1, 2005 at $33.5 million, which it pledged to the taxpayer as security to support its purchase option under the lease. Finally, the taxpayer assigned all lease payments owing from MAIL to RBC, which agreed to apply the assigned payments against installments of interest and principal owing under its loan to the taxpayer and to limit its recourse in respect of the loan to these payments.

In computing its income for its 1997 taxation year, the taxpayer included approximately $6 million in rental income from the trailers and deducted over $31 million as CCA on the trailers under paragraph 20(1)(a) of the ITA, using the excess deduction to shelter other leasing income as allowed under the "leasing property" rules in subsections 1100(15) to (20) of the *Income Tax Regulations* (Regulations)[14] and relying on the designation of trailers as "exempt property" in subparagraph 1100(1.3)(a)(v) of the *Regulations* to avoid the application of the "specified leasing property" rules in subsections 1100(1.1) to (1.3) of the Regulations which would have limited allowable CCA deductions if they had applied.[15] The Minister disallowed the CCA deduction on the grounds that the taxpayer had either failed to acquire title to the trailers or was subject to

Trustco, *supra* note 10.

[14] According to these rules, the aggregate of CCA deductions in respect of depreciable property that is "leasing property" is generally limited to the aggregate income earned from renting, leasing or earning royalties from leasing properties, computed without regard to CCA deductions.

[15] According to these rules, sale-leaseback of specified leasing property is generally deemed to be a loan of the purchase price by the lessor to the lessee, rental payments under the lease are deemed to be blended payments of interest and principal on this deemed loan, and CCA deductions in respect of the leased property are limited to the notional principal amount of the deemed loan that is deemed to be repaid each year. Paragraph 1100(1.13)(a) of the Regulations exempts various kinds of property from these rules, including in subparagraph (v) "a trailer that is designed for hauling freight and to be hauled under normal operating conditions by a truck or tractor …."

the GAAR.[16] The Crown abandoned the first of these arguments before the hearing at trial and proceeded solely on the basis that the GAAR applied to disallow the deduction,[17] arguing that: (1) the taxpayer obtained a "tax benefit" in the form of a deferral of tax resulting from the CCA deductions[18]; (2) the transactions constituted a "pre-ordained series" that was "entered into primarily for the purpose of obtaining the tax benefit and sheltering other income"[19]; and (3) the arrangement resulted in a misuse or abuse of the CCA regime because the taxpayer did not incur any "true cost" to acquire the trailers[20] and a misuse or abuse of the exempt property exception to the specified leasing property rules because the sale-leaseback transactions did not provide financing for the lessee "to acquire assets for operational purposes."[21]

B. *Mathew*

In *Mathew*, the taxpayers were individual and corporate investors who acquired interests in a partnership called SRMP Realty and Mortgage Partnership (SRMP), which had itself acquired a 99 percent interest in another partnership called STIL II Partnership (STIL II), to which Standard Trust Company (Standard) had transferred a number of mortgages the value of which was substantially less than their original cost. As Standard was insolvent and had no income against which the accrued losses could be deducted if realized, the company's liquidator devised a plan whereby: (1) Standard would incorporate a wholly-owned subsidiary; (2) Standard and the subsidiary would form a

[16] *Canada Trustco Mortgage Company v. The Queen*, *supra* note 12 at para. 4. The first of these arguments turned on the fact that the sale-leaseback was treated as a financing in the U.S., such that TLI was held not to have disposed of the trailers to Canada Trustco. As a result, TLI was not subject to recapture on the transaction and both TLI and Canada Trustco were able to deduct CCA, making the arrangement a classic example of a double dip.
[17] *Ibid*.
[18] *Ibid*. at para. 31.
[19] *Ibid*. at para. 32.
[20] *Ibid*. at para. 43.

partnership; (3) Standard would transfer its mortgage portfolio to this non-arm's length partnership, relying on the stop-loss rule in subsection 18(13) of the ITA as it read at the time to preserve the accrued losses in the hands of the partnership[22]; and (4) Standard would sell its partnership interest to arm's length investors who could use the losses to shelter other income when they were realized by the partnership and flowed through to the partners.[23] Pursuant to this plan, Standard carried out the first three transactions in October 1992 and the fourth in May 1993 – incorporating a wholly-owned subsidiary on 21 October 1993, entering into a partnership agreement with the subsidiary to create STIL II on 23 October 1992, transferring various mortgages to STIL II in exchange for a 99 percent partnership interest on the same day, and selling this 99 percent interest to an arm's length company called OSFC Holdings Ltd. (OSFC) on 31 May 1993. In July 1993, OSFC sold its 99 percent partnership interest to SRMP, units of which were acquired by the taxpayers.

At the end of its fiscal year on September 30, 1993, STIL II reported a net loss of $52,674,376 resulting from the sale of some mortgages and a write-down of its remaining inventory of mortgages. For its fiscal year ended October 31, 1993, SRMP reported a net

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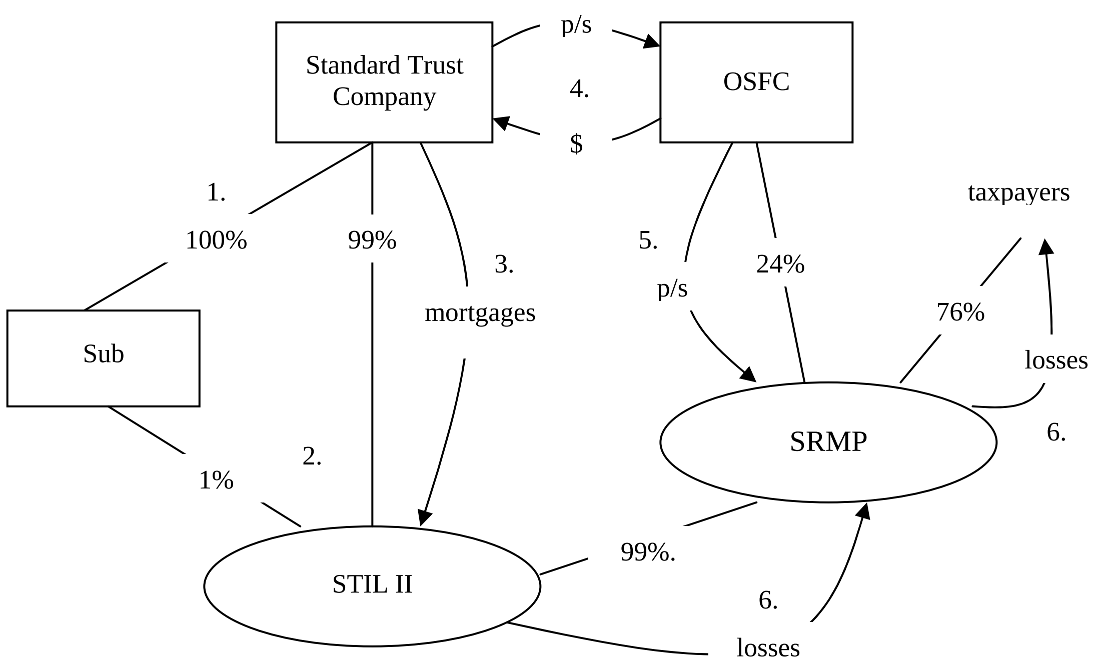
[21] *Ibid*. at para. 45.

[22] According to this provision, where a resident taxpayer engaged in a business of lending money had incurred a loss on the disposition of qualifying property (including mortgages) used or held in the business, and the taxpayer or a person or partnership that did not deal at arm's length with the taxpayer had acquired or agreed to acquire the same or identical property ("substituted property") during the period commencing 30 days before and ending 30 days after the disposition, and owned or had a right to acquire this substituted property at the end of this period, the loss was disallowed and added in computing the cost to the taxpayer, person or partnership of the substituted property. For dispositions taking place after April 26, 1995, subsection 18(13) no longer adds the disallowed loss in computing the cost of the substituted property to a subsequent owner, but preserves the loss in the hand of the original owner to be deducted when the subsequent owner disposes of the substituted property. Although explanatory information accompanying the revised language states that the amendments "maintain the provision's original objective of denying the recognition of superficial losses", their effect is to ensure this result while simultaneously preventing the transfer of accrued but unrealized losses to a subsequent owner, as Standard sought to do in *Mathew*.

loss of $52,384,474, most of which was attributable to its share of the STIL II losses. These losses were allocated among the members of SRMP and deducted in computing their incomes in 1993 and 1994.

Mathew Transactions



The Minister disallowed these deductions on the basis that the transactions were caught by the GAAR. At trial, the Crown argued that the various transactions comprised a series of transactions that resulted in a tax benefit in the form of the deductions claimed by the taxpayers,[24] that the primary purpose of SRMP's acquisition of the 99 percent partnership interest in STIL II and the taxpayers' acquisition of units of SRMP was to

[23] Under subsection 96(1) of the ITA, the income or loss of a partnership is computed at the partnership level and allocated among partners at the end of the partnership's fiscal period based on their respective shares of the partnership.
[24] *Mathew v. The Queen*, [2003] 1 CTC 2045, 2002 DTC 1637 (TCC) at paras. 140 and 154-55.

obtain the tax benefit,[25] that the transactions resulted in a misuse of subsection 18(13) of the ITA as it then read[26] and an abuse of the scheme of the ITA according to which income is computed separately for each taxpayer and the transfer of losses is generally prohibited.[27]

III. Tax Court and Federal Court of Appeal Decisions

The Tax Court of Canada allowed the taxpayer's appeal in *Canada Trustco* and dismissed the taxpayers' appeals in *Mathew*.[28] These decisions were upheld by the Federal Court of Appeal,[29] and again by the Supreme Court of Canada.[30] As a result, and also because the Supreme Court strongly emphasizes the factual nature of most GAAR decisions and the correspondingly limited role for appellate tribunals, it is particularly important to review the decisions at trial.

A. *Canada Trustco*

The trial judgment in *Canada Trustco* was delivered by Miller TCJ. Adopting the "analytical path" recommended by the Federal Court of Appeal in two earlier cases,[31] his

[25] *Ibid*. at paras. 159-68.
[26] *Ibid*. at para. 184. According to this argument: "it is evident from subsection 18(13) that it was enacted as a 'stop-loss provision', the object of which is to prevent taxpayers who are in the money-lending business from artificially realizing losses on assets which have declined in market value by transferring those assets to a person with whom they do not deal at arm's length, while maintaining control of the assets through the non-arm's-length nature of their relationship. In [the Crown's] opinion, subsection 18(13)'s purpose is not to effect the transfer of unrealized losses from a taxpayer who has no income against which to offset those losses to a taxpayer that does not have such income. On the contrary, the transfer of superficial losses to the transferee is merely a consequential rule allowing the superficial loss to be utilized by the transferee rather than being lost altogether. Accordingly, it is counsel's position that if one uses subsection 18(13) to transfer losses to an arm's length party, one is using it for a purpose for which it is not intended and is therefore misusing it."
[27] *Ibid*. at paras. 201-205.
[28] *Canada Trustco Mortgage Company v. The Queen*, *supra* note 12; *Mathew v. The Queen*, *supra* note 24.
[29] *Canada Trustco Mortgage Company v. The Queen*, [2004] 2 CTC 276, 2004 DTC 6119 (FCA); *Mathew v. The Queen*, [2004] 1 CTC 115, 2003 DTC 5644 (FCA).
[30] *Canada Trustco*, *supra* note 10; *Mathew*, *supra* note 11.
[31] *Canada Trustco Mortgage Company v. The Queen, supra* note 12 at para. 48, citing *OSFC Holdings Ltd. v. The Queen*, [2001] 4 CTC 82, 2001 DTC 5471 (FCA) [hereafter *OSFC Holdings*], and *Water's Edge*

analysis addressed three issues: (1) whether the deferral of tax resulting from the CCA deductions was a tax benefit[32]; (2) whether the arrangement that resulted in the deferral could reasonably be considered to have been entered into primarily for *bona fide* purposes other than to obtain the tax benefit[33]; and (3) whether there was a misuse of provisions of the ITA or an abuse of the ITA as a whole.[34]

Beginning with the concept of a tax benefit, the Court rejected the taxpayer's argument that the arrangement should be compared to a standard sale-leaseback transaction, which would have yielded identical CCA deductions that presumably would not have been characterized as a tax benefit.[35] Emphasizing that "[t]he definition of tax benefit should not be determined in a vacuum, but should be determined in the context of the question of whether there is an avoidance transaction,"[36] Miller TCJ concluded that the inseparability of tax and commercial aspects of the transactions at issue made such a comparison inappropriate in this case.[37] As a result, he held, the characterization of a tax benefit should be assessed "not in comparison to some hard-to-establish normative transaction, but in comparison to the taxpayer's position before the purported avoidance

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Village Estates (Phase II) Ltd. v. The Queen, [2002] 4 C.T.C. 1, 2002 D.T.C. 7172 (FCA) [hereafter *Water's Edge*]. For a review of the Federal Court of Appeal decision in *OSFC Holdings*, see See David G. Duff, "Judicial Application of the General Anti-Avoidance Rule in Canada: *OSFC Holdings Ltd. v. The Queen*" (2003), 57 *Bulletin for International Fiscal Documentation* 278.

32 *Canada Trustco Mortgage Company v. The Queen, supra* note 12 at paras. 49-52.

33 *Ibid*. at paras. 53-57.

34 *Ibid*. at paras. 58-92. At the time, subsection 245(4) did not refer to the *Income Tax Regulations*, the *Income Tax Application Rules*, a tax treaty, or any other relevant enactment. See *supra* note 6.

35 *Ibid*. at para. 15.

36 *Ibid*. at para. 52.

37 *Ibid*. at para. 50, observing that: "This is not a case of a commercial venture whose very essence is readily separable from any tax implications, which can be compared to a like venture with tax implications then overlaid. The difficulty with this transaction is that the tax is integral to the very commerciality of the deal – there is no simple tax-untainted transaction to compare to."

transaction."[38] On this basis, it followed, the deferral of tax resulting from the CCA deductions constituted a tax benefit within the meaning of subsection 245(1) of the ITA.

Turning to the second issue regarding the taxpayer's purposes for entering into the transactions, the Court rejected both the Crown's argument that the sale-leaseback arrangement was motivated solely for tax reasons and the taxpayer's argument that the tax purpose was "incidental" to the commercial purposes of lease financing and asset diversification.[39] Although acknowledging that the transactions resulted in "a profitable investment in a commercial context,"[40] Miller TCJ relied on the fact that the taxpayer specifically acquired property that was exempt from the specified leasing property rules[41] and on planning documents highlighting the tax benefits resulting from the tax shelter[42] to conclude that "the tax benefit drove the deal."[43] As a result, he held, the transactions could not reasonably be considered to have been undertaken or arranged primarily for *bona fide* purposes other than to obtain the tax benefit.

Having thus concluded that the taxpayer had carried out an avoidance transaction with the meaning of subsection 245(3) of the ITA,[44] the Court proceeded to the last issue concerning a misuse or abuse. Sidestepping the taxpayer's argument that the GAAR as it

[38] *Ibid*. at para. 52.
[39] *Ibid*. at para. 54.
[40] *Ibid*. at para. 57.
[41] *Ibid*. at para. 56, observing that "Canada Trust had approximately $100 million to be put out, and it sought exempt property investments. Why? Because it had $51 million of leasing income that it needed to shelter and only certain assets were still available to provide that CCA shelter."
[42] *Ibid*., noting that the officer of the taxpayer who recommended the transactions to the Board reported that: "The transaction provided very attractive returns, by generating CCA deductions which can be used to shelter other taxable lease income generated by Canada Trust."
[43] *Ibid*.
[44] *Ibid*. at para. 56. In reaching this conclusion, the Court did not specify which of the many transactions in the pre-arranged series was the avoidance transaction, apparently viewing the series itself as a composite avoidance transaction. Whether this approach is consistent with the language of subsection 245(3), which refers to an individual transaction that is part of a series of transactions, is doubtful.

then read did not apply to the Regulations that govern the deduction of CCA,[45] Miller TCJ employed the "two-stage analytical process" adopted by the majority of the Federal Court of Appeal in *OSFC Holdings*,[46] according to which the court should first "identify … the relevant policy of the provisions or the Act as a whole" and second "assess … the facts to determine whether the avoidance transaction constituted a misuse or abuse having regard to the identified policy."[47] In the first stage of this analysis, the decision suggested, "[t]here is no onus to be satisfied by either party," but "from a practical perspective, the Minister should … set out the policy with reference to the provisions of the Act or extrinsic aids upon which he relies."[48] In the second stage, on the other hand, the judgment stated that "the onus remains on the taxpayer to prove the necessary facts to refute the Minister's assumptions of fact that the avoidance transaction in question results in a misuse or abuse."[49] More generally, it emphasized, since the effect of the GAAR is to "invok[e] … a policy to override the words that Parliament has used" in specific provisions, "to deny a tax benefit where there has been strict compliance with the Act, on

[45] This argument was accepted by Archimbault TCJ in *Rousseau-Houle v. The Queen*, 2001 CarswellNat 500, 2001 D.T.C. 250 (Fr.) (TCC) [hereafter *Rousseau-Houle*] and *Fredette v. The Queen*, [2001] 3 C.T.C. 2468, 2001 D.T.C. 621 (TCC) [hereafter *Fredette*]. According to Miller TCJ: "If I allow the appeal solely on the basis that GAAR is not applicable to *Regulations*, I run the risk that the Federal Court of Appeal overturns *Rousseau-Houle* and likewise effectively overrules my decision. I prefer proceeding on the basis that any policies surrounding the availability of CCA stems from the *Act* itself, as paragraph 20(1)(a) incorporates *Regulations* in the legislation, and therefore the misuse/abuse analysis is warranted in this case." *Canada Trustco Mortgage Company v. The Queen, supra* note 12 at para. 58. As explained at *supra* note 6, subsection 245(4) was amended in 2005, with retroactive application to the date when the GAAR came into effect, to specify among other things that the GAAR would apply to a misuse or abuse of the Regulations as well as the Act.

[46] *Supra* note 31.

[47] *Ibid*. at para. 67.

[48] *Ibid*. at para. 68, adding that "Otherwise he places the taxpayer and the Court in the difficult position of trying to guess the relevant policy at issue."

[49] *Ibid*.

the grounds that the avoidance transaction constitutes a misuse or abuse, requires that the relevant policy be clear and unambiguous."[50]

With respect to the relevant policy, the framing of which Miller TCJ described as "critical" but "tricky",[51] the Court began by noting that the object and spirit of the general CCA rules is "to provide for the recognition of money spent to acquire qualifying assets to the extent that they are consumed in the income earning process under the Act."[52] To these basic provisions, however, the leasing property rules were enacted in 1976 to prevent the use of CCA deductions on leasing properties to shelter non-leasing income, and the specified leasing property rules were enacted in 1989 to further limit CCA deductions from leased property other than "exempt property" which is "commonly leased for operational purposes of for which CCA reasonably approximates actual depreciation."[53] Viewing these rules as a whole, Miller TCJ concluded:

> The object and spirit of the relevant provisions is to limit the generous CCA treatment in lease financing arrangements to a recognition of money invested to acquire property leased for operational purposes, and for which CCA reasonably approximates actual depreciation, to the extent that such property is consumed in an income-earning process, such consumption limited to deductions against leasing income.[54]

Based on this interpretation of the relevant policy, the Court concluded that the transactions at issue did not result in a misuse or abuse within the meaning of subsection 245(4) of the ITA.[55] Rejecting the Crown's first argument that the taxpayer had misused

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[50] *Ibid*. at para. 69.
[51] *Canada Trustco Mortgage Company v. The Queen, supra* note 12 at para. 59.
[52] *Ibid*. at para. 63, citing *Water's Edge, supra* note 31 at para. 44.
[53] *Canada Trustco Mortgage Company v. The Queen, supra* note 12 at para. 67.
[54] *Ibid*. at para. 68.
[55] Given his interpretation of the relevant policy, Miller TCJ considered it unnecessary to distinguish between a misuse of specific provisions and an abuse having regard to those provisions read as a whole. See *ibid*. at para. 90: "As framed, the policy already incorporates the more general policy of the scheme of CCA. In effect, the analysis of the misuse of the provisions and the analysis of the abuse having regard to the provisions of the *Act* read as a whole are inseparable. This arises due to the identification of the policy."

or abused the CCA rules by claiming deductions on property in respect of which it had incurred "no real economic cost,"[56] Miller TCJ stated that "[t]here is no specific legislative provision requiring cost to be determined on any economic reality test for purposes of the application of the Act's CCA regime in the context of sale-leaseback-like arrangements,"[57] and held that the GAAR could not be used to recharacterize the cost of the trailers in order to determine whether there had been a misuse or abuse.[58] Rejecting the Crown's second argument that the sale-leaseback arrangement misused or abused the exempt property exception to the specified leasing property rules by failing to provide financing for the lessee "to acquire assets for operational purposes," he observed that the transactions converted the lessee's assets into cash and netted it $3.6 million after pre-paying the lease,[59] and determined that the arrangement was "not so dissimilar from an ordinary sale-leaseback as to take it outside the object and spirit of the relevant provisions of the *Act*."[60] As a result, the Court concluded, the transactions were not subject to the GAAR.[61]

In an extremely brief decision delivered orally, the Federal Court of Appeal upheld the trial decision.[62] According to Evans JA (Rothstein and Pelletier JJA

[56] *Ibid*. at para. 69.
[57] *Ibid*. at para. 71.
[58] *Ibid*. at para. 69: "To accept the Repondent's position would be to recharacterize the legal form and substance of the transaction, for the purposes of then determining whether there has been a misuse or abuse. The GAAR provisions cannot be applied in that way." See also *ibid*. at para. 77: "GAAR is not to be imposed lightly. It should not permit a recharacterization of a transaction to find the transaction is abusive in its recharacterized form. The transaction must be viewed in its legal context and if found abusive, only then recharacterized to determine the reasonable tax consequences."
[59] *Ibid*. at para. 87, concluding that the predetermined lease prepayment "does not shift the nature of the cash it received away from a form of financing: a conversion of its assets into cash."
[60] *Ibid*. at para. 89: "The policy applies to a lease financing arrangement, and that is what we have here. All elements of the policy have been met: lease financing arrangement, money invested, acquisition of exempt property, consumption of such property in an income earning process and limitation of CCA to leasing income."
[61] *Ibid*. at para. 93.
[62] *Canada Trustco Mortgage Company v. The Queen, supra* note 29.

concurring), the Court was "not persuaded that the Tax Court Judge made a reviewable error when he concluded that … the transactions in question … did not constitute a misuse of a provision of the Act, or an abuse of the capital cost allowance ("CCA") scheme as a whole."[63] Rejecting the Crown's argument that the scheme of the CCA rules allowed deductions only in respect of the "real" or "economic" cost incurred to acquire an asset,[64] the Court stated that "counsel was unable to refer to any source that satisfied us that there is a clear and unambiguous policy underlying paragraph 20(1)(a), or the CCA scheme when read as a whole, that renders it a misuse or an abuse of those provisions for the taxpayer to claim CCA in this case."[65]

B. *Mathew*

The trial judgment in *Mathew* was delivered by Dussault TCJ, whose analysis, like that of Miller TCJ in *Canada Trustco*, also proceeded by addressing the three basic elements for the GAAR to apply: (1) a tax benefit; (2) an avoidance transaction that could not reasonably be considered to have been entered into primarily for *bona fide* purposes other than to obtain the tax benefit; and (3) a misuse of specific provisions of the ITA or an abuse of the provisions of the ITA read as a whole. Unlike Miller TCJ's decision in *Canada Trustco*, however, Dussault TCJ devoted considerable attention to the concept of a "series of transactions" which enters into the definition of an avoidance transaction.[66]

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[63] *Ibid*. at para. 1.
[64] *Ibid*. at para. 2.
[65] *Ibid*. at para. 3.
[66] See paragraph 245(3)(b) which includes in the definition of an avoidance transaction "any transaction … 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." As explained in *supra* note 44, Miller TCJ appears to have regarded the sale-leaseback arrangement in *Canada Trustco* as a single composite transaction entered into primarily for tax reasons, rather than a series of transactions at least one of which was entered into primarily to obtain a tax benefit.

On the existence of a tax benefit, which Dussault TCJ characterized as "a question of fact,"[67] there was no dispute. Nonetheless, although the taxpayers conceded that the transactions resulted in a tax benefit, they also argued that the benefit from deducting partnership losses was mostly "a tax deferral" since any amount deducted in excess of the adjusted cost base of their partnership interests would ultimately be taxable as a capital gain on the dissolution of the partnership or the disposition of their partnership interests.[68] Since the GAAR provides that "the tax consequences to a person shall be determined as is reasonable in the circumstances in order to deny a tax benefit,"[69] the characterization of the benefit would thus be relevant to the tax consequences if the GAAR were held to apply. Despite the taxpayers' argument, however, the Court relied on the fact that capital gains are only partly taxable and on evidence that the taxpayers planned to never wind up the partnership to conclude that the tax benefit was more than mere tax deferral.[70]

On the question of an avoidance transaction, Dussault TCJ considered the concept of a series of transactions before addressing the primary purpose of specific transactions comprising the series. Since the GAAR applies to a series of transactions only where the series results in a tax benefit and one or more of the transactions comprising the series cannot reasonably be considered to have been undertaken or arranged primarily for *bona fide* purposes other than to obtain the tax benefit,[71] it is necessary to define the series of transactions in order to determine whether the statutory requirements for an avoidance

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[67] *Mathew v. The Queen*, *supra* note 24 at para. 235.
[68] *Ibid*. at para. 236. See subparagraph 53(2)(c)(i) of the ITA which requires taxpayers to deduct their share of the losses of a partnership in computing the adjusted cost base of their interest in the partnership, paragraph 98(1)(c) of the ITA which deems any negative adjusted cost base to be a capital gain when a partnership winds up, and subsection 100(2) of the ITA which deems any negative adjusted cost base to be a capital gain when a taxpayer disposes of a partnership interest.
[69] ITA, subsection 245(2).
[70] *Mathew v. The Queen*, *supra* note 24 at paras. 237-42.
[71] ITA, paragraph 245(3)(b).

transaction are met.[72] For this purpose, Dussault TCJ relied on the Federal Court of Appeal decision in *OSFC Holdings*,[73] the facts of which were essentially the same as those in *Mathew*.[74]

In *OSFC Holdings*, a majority of the Federal Court of Appeal determined that an ordinary series of transactions must be "pre-ordained to produce a final result" – meaning that "when the first transaction in the series is implemented, all essential features of the subsequent transaction or transactions are determined by person who have the firm intention and ability to implement them."[75] Under subsection 248(10) of the ITA, however, this meaning is extended to include "any related transactions or events completed in contemplation of the series" – which the majority in *OSFC Holdings* held to include any transaction having "some connection" with a pre-ordained series, provided that the parties to this transaction "knew of" the pre-ordained series "such that is could be said that they took it into account when deciding to complete the transaction."[76] While the first three transactions in *OSFC Holdings* were sufficiently pre-ordained to comprise an ordinary series of transactions, the sale of Standard's 99 percent partnership interest in STIL II to OSFC, the subsequent sale of this partnership interest to SRMP, and the

[72] The characterization of a series of transactions may also affect the application of subsection 245(4) of the ITA, since it is an individual avoidance transaction that must result in a misuse or abuse for the GAAR to apply. Where a series of transactions results in a tax benefit, therefore, an avoidance transaction that is part of the series must also result in a misuse or abuse.
[73] *Supra* note 31.
[74] OSFC was the company which first acquired Standard's 99 percent partnership interest in STIL II, before selling this interest to SRMP. OSFC acquired a 24 percent interest in SRMP as part of the consideration for the sale of this partnership interest, and also deducted partnership losses when they were realized by SRMP.
[75] *OSFC Holdings*, *supra* note 31 at para. 24, adding that "there must be no practical likelihood that the subsequent transaction or transactions will not take place." This approach is based on the "step transactions doctrine" developed by the House of Lords in several English tax cases. See, e.g., *W. T. Ramsay Ltd. v. Inland Revenue Commissioners*, [1981] 1 All E.R. 865; *Commissioners of Inland Revenue v. Burmah Oil Co. Ltd.* (1981), 54 TC 200 (HL); *Furniss v. Dawson*, [1984] AC 474 (HL); and *Craven v. White*, [1989] A.C. 398 (HL).
[76] *OSCF Holdings*, *supra* note 31 at para. 36.

acquisition of partnership interests in SRMP were not pre-ordained since these were not arranged at the time that Standard carried out the first three transactions. Since OSFC knew about these transactions and "took [them] into account" when it purchased Standard's partnership interest,[77] however, the majority of the Federal Court of Appeal in *OSFC Holdings* held that this transaction was part of series of transactions under the extended statutory meaning in subsection 248(10).[78] It did not, however, determine whether the subsequent sale of this partnership interest to SRMP and the acquisition of units in this partnership were also part of an extended series.

Notwithstanding the Court's failure to specifically address these last two transactions in *OSFC Holdings*, Dussault TCJ concluded in *Mathew* that it could "probably … be inferred" that the majority in that case considered that these transactions were arranged "with full knowledge of the earlier transactions."[79] On this basis, he concluded, all six transactions in the *Mathew* case comprised a series of transactions for the purposes of the GAAR.[80]

Having characterized these transactions as a series, Dussault TCJ proceeded to conclude that each was an avoidance transaction under subsection 245(3) of the ITA. Since the taxpayers themselves acknowledged that the transactions resulted in a tax benefit, the first part of the test in paragraph 245(3)(b) was easily met. In addition, Dussault TCJ observed, the majority in *OSFC Holdings* specifically determined that the

[77] *Ibid*. at para. 38.
[78] *Ibid*. at para. 44.
[79] *Mathew v. The Queen*, *supra* note 24 at para. 254. While this is undoubtedly true of the sale of OSFC's 99 percent partnership interest to SRMP, and OSFC's acquisition of a 24 percent partnership interest in SRMP, it is less obvious that all of the other investors in SRMP had actual knowledge of the first three transactions through which the mortgages were transferred to STIL II. As I have argued elsewhere, however, it is not clear why courts should insist on actual knowledge in order to apply the extended definition of a series of transactions in subsection 248(10). See Duff, "Judicial Application of the General Anti-Avoidance Rule in Canada," *supra* note 31 at 287.

first four transactions were avoidance transactions.[81] Finally, he concluded, it was reasonable to conclude that the final two transactions were undertaken primarily to obtain the tax benefit.[82] As a result, it followed, the only remaining question to determine whether the GAAR applied was whether one or more of these transactions resulted in a misuse of specific provisions of the ITA or an abuse having regard to the provisions of the ITA read as a whole.

Turning to this misuse or abuse analysis, Dussault TCJ also employed the "two-stage analytical process" set out in *OSFC Holdings*, according to which the court should begin by "identifying the relevant policy of the provisions or the Act as a whole" and then "assess … the facts to determine whether the avoidance transaction constituted a misuse or abuse having regard to the identified policy."[83] With respect to the stop-loss rule in subsection 18(13) of the ITA, he maintained, the policy is "to prevent taxpayers who are in the money-lending business from artificially realizing losses on assets which have declined in market value by transferring them to a person with whom they do not deal at arm's length, while maintaining control of the assets through the non-arm's length relationship with the transferee."[84] More generally, he declared, the scheme of the ITA suggests a "general policy" according to which "losses cannot be transferred from one taxpayer to another."[85]

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[80] *Mathew v. The Queen*, *supra* note 24 at para. 257.
[81] *Ibid*. at para. 262.
[82] *Ibid*. at paras. 275-96.
[83] *OSFC Holdings*, *supra* note 31 at para. 67.
[84] *Mathew v. The Queen*, *supra* note 24 at para. 302, citing *OSFC Holdings Ltd. v. The Queen*, [1999] 3 CTC 2649, 99 DTC 1044 (TCC) at para. 54, *per* Bowie TCJ.
[85] *Mathew v. The Queen*, *supra* note 24 at para. 317. In the Federal Court of Appeal decision in *OSFC Holdings*, the majority discerned a general policy against loss trading for tax purposes, but concluded that this policy did not extend to the transfer of losses between partners. See *OSFC Holdings*, *supra* note 32 at paras. 92 and 101.

Based on his interpretation of the policy of subsection 18(13), Dussault TCJ explained that he would have concluded that the use of this stop-loss rule to transfer accrued losses to arm's length persons was a misuse of the provision.[86] In *OSFC Holdings*, however, a majority of the Federal Court of Appeal specifically held that the transactions at issue did not result in a misuse of subsection 18(13).[87] Regardless, he concluded, the transactions resulted in an abuse of the provisions of the ITA read as a whole by transferring "one corporation's losses to other corporations and individuals."[88] As a result, he held, the transactions were subject to the GAAR.[89]

As in *Canada Trustco*, the Federal Court of Appeal upheld the trial decision in *Mathew* in a very short judgment.[90] Noting that the facts at issue were essentially the same as those in *OSFC Holdings*,[91] the Court was content to rely on its prior decision in that case to reject the taxpayer's appeal. According to Rothstein JA:

> In *OSFC*, the Court determined that the general policy of the *Income Tax Act* is against the transfer of non-capital losses between taxpayers. However, this general policy was subject to some exceptions. For example, a partner entering into the partnership may take advantage of losses that were incurred by the partnership in that year before he or she became a partner. On the change of control of a corporation, losses of prior years are deductible in limited circumstances. But the general policy is that every person has independent status for income tax purposes and that losses cannot be transferred between taxpayers dealing with each other at arm's length.[92]

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[86] *Mathew v. The Queen*, *supra* note 24 at para. 304.
[87] *OSFC Holdings*, *supra* note 32 at para. 81. For a critical evaluation of this conclusion, suggesting that the majority's misuse analysis should have be informed by a broader view of the statutory scheme, see Duff, "Judicial Application of the General Anti-Avoidance Rule in Canada," *supra* note 31 at 287.
[88] *Mathew v. The Queen*, *supra* note 24 at para. 316. Whether this statement is consistent with the majority decision in *OSFC Holdings* is unclear, since this decision had generally limited the policy against loss trading to transfers between corporations. See *OSFC Holdings*, *supra* note 31 at para. 98, stating that "the general policy of the *Income Tax Act* is against the trading of non-capital losses *by corporations*, subject to specific limited circumstances." [emphasis added]
[89] *Mathew v. The Queen*, *supra* note 24 at para. 504.
[90] *Mathew v. The Queen*, *supra* note 29.
[91] *Ibid*. at para. 2.
[92] *Ibid*. at para. 12.

Although the taxpayer argued that various stop-loss provisions like subsection 18(13) of the ITA were further exceptions to this general policy,[93] the Court concluded that "[n]one of these provisions detract from the general policy of the *Income Tax Act* against transferring losses between taxpayers,"[94] and were "insufficient to cause the Court to consider overruling its prior decision."[95]

IV. Supreme Court of Canada Decisions

The Supreme Court of Canada dismissed the appeals in *Canada Trustco* and *Mathew*, upholding the trial judgment in each case. The following sections examine both decisions, considering the Court's general approach to tax law and the GAAR and its application of this approach to the facts of each case.

A. General Approach to Tax Law and the GAAR

Of the two decisions, the Court's general approach to tax law and the GAAR appears mostly in *Canada Trustco*. In fact, most of this judgment is devoted to general principles of statutory interpretation,[96] the role of the GAAR in Canadian tax law,[97] and the various requirements that must be satisfied for the GAAR to apply.[98] Before turning to the Court's analysis of the specific transactions in each case, it is useful to review its more general approach to statutory interpretation, tax avoidance and the GAAR, and the statutory requirements for the GAAR to apply.

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[93] *Ibid*. at para. 15.
[94] *Ibid*. at para. 17.
[95] *Ibid*. at para. 18.
[96] *Canada Trustco*, *supra* note 10 at paras. 10-13.
[97] *Ibid*. at paras. 14-16.
[98] *Ibid*. at paras. 17-66.

1. Principles of Statutory Interpretation

Like most Supreme Court of Canada tax cases since *Stubart Investments*,[99] the Court begins its discussion of statutory interpretation by citing E.A. Driedger's "modern rule" according to which "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."[100] Although "Canadian tax legislation received a strict interpretation" under the influence of the English decision in *Commissioners of Inland Revenue v. Duke of Westminster*,[101] the Court explains, "[t]here is no doubt today that all statutes, including the [Income Tax] Act, must be interpreted in a textual, contextual and purposive way."[102] Indeed, although the Court does not make the point, it was its own decision in *Stubart Investments* that signaled "the demise of the strict interpretation rule for the construction of taxing statutes."[103]

Notwithstanding its repeated references to "textual, contextual and purposive" interpretation,[104] however, the Court also emphasizes that the ITA "must be interpreted in order to achieve consistency, predictability and fairness so that taxpayers may manage their affairs intelligently."[105] Thus, it observes, "[w]hen the words of a provision are precise and unequivocal, the ordinary meaning of the words play [sic] a dominant role in

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[99] *Supra* note 2.
[100] *Canada Trustco*, *supra* note 10 at para. 10, citing *65302 British Columbia Ltd. v. Canada*, [1999] 3 SCR 804, at para. 50. The original passage is from E.A. Driedger, *Construction of Statutes*, 2d ed. (Toronto: Butterworths, 1983) at 87, and was cited in *Stubart Investments*, *supra* note 2 at para. 61.
[101] *Supra* note 2 [hereafter *Duke of Westminster*].
[102] *Canada Trustco*, *supra* note 10 at para. 11.
[103] *Stubart Investments*, *supra* note 2 at para. 60, referring to John Willis, "Statute Interpretation in a Nutshell" (1938), 16 *Can. Bar Rev.* 1.
[104] *Canada Trustco*, *supra* note 10 at paras. 10, 11, 40, 41, 42, 43, 44, 47. 59, 62, 64, 65, 66, and 73.
[105] *Ibid*. at para. 12. References to "consistency, predictability and fairness" also appear at paras. 1. 31, 42, 50 and 61.

the interpretive process."[106] Likewise, it declares, repeating the following much-quoted passage from Professors Hogg and Magee's *Principles of Canadian Income Tax Law*:

> It would introduce intolerable uncertainty into the Income Tax Act if clear language in a detailed provision of the Act were to be qualified by unexpressed exceptions derived from a court's view of the object and purpose of the provision.[107]

To the extent that the ITA is "dominated by explicit provisions dictating specific consequences," therefore, the Court concludes that it necessarily "invit[es] a largely textual interpretation."[108]

One might conclude on this basis that the decision reaffirms the "plain meaning" approach to statutory interpretation that has dominated Supreme Court of Canada tax decisions for the past decade.[109] To the extent that the text of a statutory provision cannot be properly understood without some reference to its context or purpose, however, this conclusion is probably mistaken. On the contrary, the Court emphasizes:

> Even where the meaning of particular provisions may not appear to be ambiguous at first glance, statutory context and purpose may reveal or resolve latent ambiguities. "After all, language can never be interpreted independently of its context, and legislative purpose is part of the context. It would seem to follow that consideration of legislative purpose may not only resolve patent ambiguity, but may, on occasion, reveal ambiguity in apparently plain language."[110]

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[106] *Ibid*. at para. 10. On the other hand, the Court continues, "where the words can support more than one reasonable meaning, the ordinary meaning of the words plays a lesser role." *Ibid*.

[107] Peter W. Hogg and Joanne E. Magee, *Principles of Canadian Income Tax Law*, 2d ed. (Scarborough: Carswell, 1997) at 475-76.

[108] *Canada Trustco*, *supra* note 10 at para. 13. See also *ibid*. at para. 11, noting that "the particularity and detail of many tax provisions have often led to an emphasis on textual interpretation."

[109] According to this interpretive approach: "When a provision is couched in specific language that admits of no doubt or ambiguity in its application to the facts, then the provision must be applied regardless of its object and purpose. Only when the statutory language admits of some doubt or ambiguity in its application to the facts is it useful to resort to the object and purpose of the provision." Hogg and Magee, supra note 107 at 454, cited with approval in *Friesen v. Canada*, [1995] 2 CTC 369, 95 DTC 5551 (SCC) at para. 17. For a detailed explanation of this "plain meaning rule" see David G. Duff, "Interpreting the *Income Tax Act* – Part 1: Interpretive Doctrines" (1999), 47 *Can. Tax J*. 464 at 504-17.

[110] *Canada Trustco*, *supra* note 10 at para. 47, citing Peter W. Hogg, Joanne E. Magee, and Jinyan Li, *Principles of Canadian Income Tax Law*, 4th ed. (Scarborough: Carswell, 2002) at 563.

As a result, it seems, the Court has abandoned the plain meaning approach in favour of a more pragmatic approach that combines textual, contextual and purposive considerations in order to "find a meaning that is harmonious with the Act as a whole."[111] Given the deficiencies of the plain meaning approach to statutory interpretation,[112] this is a welcome development.

2. Tax Avoidance and the GAAR

The Court's general approach to tax avoidance and the GAAR also begins like many Supreme Court of Canada tax decisions, by affirming the long-standing principle from the *Duke of Westminster* case that taxpayers may "manage their affairs" to minimize taxes payable.[113] Quoting its earlier decision in *Shell Canada Ltd. v. Canada,*[114] the Court declares:

> [A]bsent a specific provision to the contrary, it is not the courts' role to prevent taxpayers from relying on the sophisticated structure of their transactions, arranged in such a way that the particular provisions of the Act are met, on the basis that it would be inequitable to those taxpayers who have not chosen to structure their transactions that way.[115]

Indeed, it suggests, "[w]here Parliament has specified precisely what conditions must be satisfied to achieve a particular result, it is reasonable to assume that Parliament intended that taxpayers would rely on such provisions to achieve the result they prescribe."[116]

On the other hand, the Court observes, these established principles of Canadian tax law were affected by the enactment of the GAAR in 1988, which "superimposed" on the traditional approach "a prohibition on abusive tax avoidance, with the effect that the

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[111] *Canada Trustco*, *supra* note 10 at para. 10.
[112] For a critical review of this interpretive approach, see David G. Duff, "Interpreting the *Income Tax Act* – Part 2: Toward a Pragmatic Approach" (1999), 47 *Can. Tax J.* 741 at 769-79.
[113] *Ibid*. at para. 12.
[114] [1999] 4 C.T.C. 313, 99 D.T.C. 5669 (SCC) [hereafter *Shell Canada*].
[115] *Ibid*. at para. 45.

literal application of provisions of the Act may be seen as abusive in light of their context and purpose."[117] According to the Court:

> The GAAR was enacted in 1988, principally in response to *Stubart Investments* …, which rejected a literal approach to interpreting the Act. At the same time, the Court rejected the business purpose test, which would have restricted tax reduction to transactions with a real business purpose. Instead of the business purpose test, the Court proposed guidelines to limit unacceptable tax avoidance arrangements. Parliament deemed the decision in *Stubart* an inadequate response to the problem and enacted the GAAR.[118]

To the extent that the GAAR constitutes a "provision to the contrary" as contemplated in *Shell Canada*, therefore, the Court concludes that "the Duke of Westminster principle and the emphasis on textual interpretation may be attenuated."[119]

At the same time, the Court maintains, the GAAR was not intended to repeal the *Duke of Westminster* principle,[120] but rather to "draw … a line between legitimate tax minimization and abusive tax avoidance."[121] In this respect, it suggests, "[d]espite Parliament's intention to address abusive tax avoidance by enacting the GAAR, Parliament nonetheless intended to preserve predictability, certainty and fairness in Canadian tax law."[122] For this reason, it declares, the task for the Court is "to unite" the traditional approach with the GAAR "in a framework that reflects the intention of Parliament in enacting the GAAR and achieves consistent, predictable and fair results."[123]

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[116] *Canada Trustco*, *supra* note 10 at para. 11. See also *ibid*. at para. 31: "Parliament intends taxpayers to take full advantage of the provisions of the *Income Tax Act* that confer tax benefits."
[117] *Ibid*. at para. 1. See also *ibid*. at para. 13, stating that the GAAR was "engrafted" onto the "compendium of detailed stipulations" that dominate the ITA.
[118] *Ibid*. at para. 14.
[119] *Ibid*. at para. 13.
[120] *Ibid*. at para. 1, stating that the ITA "continues to permit legitimate tax minimization."
[121] *Ibid*. at para. 16, adding that "[t]his line is far from bright."
[122] *Ibid*. at para. 31.
[123] *Ibid*. at para. 1.

This conclusion and the Court's general approach to tax avoidance and the GAAR seem entirely reasonable and consistent with legislative intentions and the structure of the GAAR. As the Court itself observes, Explanatory Notes accompanying draft legislation for the GAAR affirmed that "tax planning – arranging one's affairs so as to attract the least amount of tax – is a legitimate and accepted part of Canadian tax law,"[124] and that "the new rule seeks to distinguish between legitimate tax planning and abusive tax avoidance and to establish a reasonable balance between protection of the tax base and the need for certainty for taxpayers in planning their affairs."[125] According to subsection 245(4) of the ITA, moreover, a tax-motivated avoidance transaction is subject to the GAAR only where it results in a misuse of specific provisions of the ITA or another relevant enactment or an abuse having regard to these provisions read as a whole. As a result, the Court's general approach to tax avoidance and the GAAR is as commendable as its approach to statutory interpretation.

3. Application of the GAAR

Turning to the GAAR itself, the Court begins like most other GAAR cases by stating that the application of this rule "involves three steps":

> The first step is to determine whether there is a "tax benefit" arising from a "transaction" under s. 245(1) and (2). The second step is to determine whether the transaction is an avoidance transaction under s. 245(3), in the sense of not being "arranged primarily for *bona fide* purposes other than to obtain the tax benefit". The third step is to determine whether the avoidance transaction is abusive under s. 245(4).[126]

[124] Explanatory Notes, supra note 4 at p. 464, cited in *Canada Trustco*, *supra* note 10 at para. 31.
[125] Explanatory Notes, *supra* note 4 at p. 461, cited in *Canada Trustco*, *supra* note 10 at para. 15
[126] *Canada Trustco*, *supra* note 10 at para. 17.

Observing that "[a]ll three requirements must be fulfilled before the GAAR can be applied to deny a tax benefit,"[127] the Court examines each in turn.

(1) Tax Benefit

The Court's analysis of the concept of a tax benefit is extremely brief, comprising only five paragraphs.[128] In some situations, it states, "it may be that the existence of a tax benefit can only be established by comparison with an alternative arrangement."[129] Where a taxpayer claims a deduction, however, it suggests that "the existence of a tax benefit is clear, since a deduction results in a reduction of tax."[130] More generally, it declares, "[w]hether a tax benefit exists is a factual determination, initially by the Minister and on review by the courts, usually the Tax Court."[131] As such, it explains:

> … the burden of proof is the same as in any tax proceeding where the taxpayer disputes the Minister's assessment and its underlying assumptions of facts. The initial obligation is on the taxpayer to "refute" or challenge the Minister's factual assumptions by contesting the existence of a tax benefit ...[132]

In addition, it concludes, where the Tax Court determines that there is a tax benefit based on a proper construction of the ITA and findings supported by the evidence, "appellate tribunals should not interfere, absent a palpable and overriding error."[133]

Although the Court is undoubtedly right to conclude that the characterization of a tax benefit is ultimately a factual determination, it is also true that this factual inquiry must be governed by a proper understanding of the applicable law. In this respect, the

[127] *Ibid*.
[128] *Ibid*. at paras. 18-20, 63 and 66.
[129] *Ibid*. at para. 20. As examples, the Court mentions "characterization of an amount as an annuity rather than a wage, or as a capital gain rather than business income."
[130] *Ibid*.
[131] *Ibid*. at para. 19.
[132] *Ibid*. at para. 63, citing *Hickman Motors Ltd. v. Canada*, [1997] 2 S.C.R. 336, at para. 92. According to the Court: "It is not unfair to impose this burden, as the taxpayer would presumably have knowledge of the factual background of the transaction." *Canada Trustco*, *supra* note 10 at para. 63.
[133] *Ibid*. at para. 66, subparagraph 7.

Court's brief discussion of this concept is unfortunate. In particular, its statement that a deduction is necessarily a tax benefit because it "results in a reduction of tax" seems incompatible with the structure of the GAAR and its purpose to prevent abusive tax avoidance. As the concept of a tax benefit is central to the definition of an avoidance transaction in subsection 245(3) of the ITA, it seems reasonable, as Miller TCJ suggested in *Canada Trustco*, to determine the meaning of a tax benefit "in the context of the question of whether there is an avoidance transaction."[134] In this respect, as I have argued elsewhere, "one must imagine a notional amount of tax or other amount payable or refundable" that would have existed but for the avoidance transaction or series of transactions of which the avoidance transaction is a part.[135] In some cases, as the Supreme Court of Canada rightly recognizes in *Canada Trustco*, this notional amount may only be determined by comparing the transaction or series of transactions entered into by the taxpayer with an "alternative arrangement" that might reasonably have been carried out but for the existence of the tax benefit.[136] In cases where the taxpayer would not have carried out any transaction but for the tax benefit, on the other hand, this notional amount might reasonably be based on the tax consequences that would have resulted if the transaction or series of transactions had not been carried out.[137] In neither case, however, should a deduction invariably be regarded as a tax benefit.[138]

[134] *Canada Trustco Mortgage Company v. The Queen*, *supra* note 12 at para. 52. See *supra* text accompanying note 36.
[135] David G. Duff, *Canadian Income Tax Law*, (Toronto: Emond-Montgomery, 2003) at 172.
[136] See *ibid*., suggesting that "the finding of a tax benefit may itself depend on the characterization of a 'benchmark transaction' that the taxpayer might reasonably have carried out, but for the existence of the tax benefit."
[137] See, e.g., Brian J. Arnold and James R. Wilson, "The General Anti-Avoidance Rule – Part 2" (1988) 36 *Can. Tax J.* 1123 at 1154-55.
[138] For a similar conclusion, see Daniel Sandler, "The Minister's Burden Under GAAR," Paper presented at University of Toronto Faculty of Law Symposium on The Supreme Court of Canada and the General Anti-Avoidance Rule: Tax Avoidance after *Canada Trustco* and *Mathew*, (November 18, 2005) [hereafter GAAR Symposium], available on the web at http://www.law.utoronto.ca/conferences/taxavoidance.html.

(2) Avoidance Transaction

The Court's discussion of the concept of an avoidance transaction is also relatively brief. Noting that "[t]he function of this requirement is to remove from the ambit of the GAAR transactions or series of transactions that may reasonably be considered to have been undertaken or arranged primarily for a non-tax purpose,"[139] the Court's analysis addresses the concept of a series of transactions and the non-tax purpose test.

(a) Series of Transactions

With respect to the concept of a series of transactions, the Court begins by endorsing the conclusion reached by a majority of the Federal Court of Appeal in *OSFC Holdings* that the ordinary meaning of these words contemplates transactions that are "pre-ordained in order to produce a given result" with "no practical likelihood that the pre-planned events would not take place in the order ordained."[140] Turning to the extended meaning of a series of transactions in subsection 248(10) of the ITA, however, the Court questions the majority's interpretation in *OSFC Holdings*, which included only related transactions carried out by parties who "knew of" the pre-ordained series "such that it could be said that they took it into account when deciding to complete the transaction[s]."[141] On the contrary, it declares, the words "in contemplation" in subsection 248(10) should be read "not in the sense of actual knowledge but in the broader sense of 'because of' or 'in relation to' the series."[142] In addition, it states, the

[139] *Canada Trustco*, *supra* note 10 at para. 21.
[140] *Ibid*. at para. 25, citing *Craven v. White*, *supra* note 75 at 514, *per* Lord Oliver. For the holding in *OSFC Holdings*, see *supra* note 75 and accompanying text.
[141] See *supra* note 76 and accompanying text.
[142] *Canada Trustco*, *supra* note 10 at para. 26.

extended meaning "can be applied to events either before or after the basic avoidance transaction found under s. 245(3)."[143]

The Court's conclusion regarding the ordinary meaning of a series of transactions is welcome and consistent with legislative intent and the language and purpose of subsection 248(10). As the federal government's initial announcement that it intended to enact a GAAR stated that this rule would introduce a "step-transactions" doctrine,[144] it seems reasonable to infer that the ordinary meaning of a series of transactions in subsection 245(3) should correspond to the pre-ordination concept that the English House of Lords had developed in this doctrine.[145] This interpretation is also compatible with the language and purpose of subsection 248(10), which adds to an ordinary series of transactions "related transactions or events completed in contemplation of the [ordinary] series."

With respect to the extended meaning of a series of transactions, however, the Court's interpretation is less persuasive. Although the conclusion that related transactions can occur "either before or after" an avoidance transaction is likely to accord with legislative intent,[146] it is not obvious that this interpretation is consistent with the text of

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[143] *Ibid*.

[144] Government of Canada, *White Paper: Tax Reform 1987* (18 June 1987), reproduced in *White Paper on Tax Reform*, *supra* note 3 at 70.

[145] See *supra* note 75. In its decision in *OSFC Holdings*, *supra* note 31, the majority of the Federal Court of Appeal relied on statements to this effect from senior government officials that were published around the time that the GAAR came into effect. See David A. Dodge, "A New and More Coherent Approach to Tax Avoidance" (1988), 36 *Can. Tax J.* 1 at 15 (suggesting that the step transactions doctrine "as suggested in *Burmah* and *Furniss v. Dawson*, … has been included in proposed section 245 in the form suggested by these cases"); and Michael Hiltz, "Section 245 of the *Income Tax Act*," in *Report of the Proceedings of the Fortieth Tax Conference*, 1988 Conference Report (Toronto: Canadian Tax Foundation, 1989), at 7:7 (explaining that a series of transactions "would include a preliminary and subsequent transaction only if, at the time the preliminary transaction is carried out, all important elements of the subsequent transaction are settled, and the subsequent transaction is eventually carried out").

[146] See Duff, "Judicial Application of the General Anti-Avoidance Rule in Canada," *supra* note 31 at 287: "It is highly unlikely that Parliament could have intended to include in the statutory definition of 'series of transactions' related transactions completed in contemplation of a subsequent series of transactions, but not

subsection 248(10), which might more reasonably be interpreted to include only related transactions completed prior to an ordinary series of transactions but not related transactions completed after the series.[147] Likewise, while the Court is undoubtedly right to reject an "actual knowledge" requirement for a related transaction to be completed "in contemplation" of an ordinary series, the suggested words "because of" or "in relation to" seem no more appropriate. Neither corresponds to dictionary definitions of the word "contemplation" and the latter is redundant given that subsection 248(10) already requires the additional transaction to be "related" to the ordinary series. Given the Court's own emphasis on the ordinary meaning of statutory language,[148] it would have been more appropriate to have interpreted the words "in contemplation of" to have required the series to have been "intended", "regarded as possible", or "considered" when the related transaction was carried out.[149]

(b) Purpose of Transaction

With respect to the non-tax purpose test in subsection 245(3) of the ITA, the Court makes four key observations. First, it declares, this requirement involves a "factual inquiry" in which "[t]he Tax Court judge must weigh the evidence to determine whether it is reasonable to conclude that the transaction was not undertaken or arranged primarily

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related transactions in the contemplation of which taxpayers completed a prior series of transactions." This passage is cited in *Canada Trustco*, *supra* note 10 at para. 26.

[147] See Duff, "Judicial Application of the General Anti-Avoidance Rule in Canada," *supra* note 31 at 286-87, suggesting that subsection 248(10) should be amended "to include, in addition to related transactions completed in contemplation of a series of transactions, related transactions in the contemplation of which a series of transactions is completed."

[148] *Canada Trustco*, *supra* note 10 at para. 10. See *supra* text accompanying note 106.

[149] See the definition of "contemplation" in Katherine Barber, ed., *The Canadian Oxford Dictionary*, (Toronto: Oxford University Press, 1998) at 304.

for a non-tax purpose."[150] Second, it explains, the use of the words "reasonably" and "primarily" in subsection 245(3) dictates "an objective assessment of the relative importance of the driving forces of the transaction."[151] For this purpose, however, the Court notes that it "will not suffice" that "some alternative transaction that might have achieved an equivalent result would have resulted in higher taxes."[152] Finally, it maintains, the burden of proof and standard for appellate review are the same for this purpose test as they are for the characterization of a tax benefit: "[t]he initial obligation is on the taxpayer to 'refute' or challenge the Minister's factual assumptions … by showing that a *bona fide* non-tax purpose primarily drove the transaction,"[153] and "appellate tribunals should not interfere, absent a palpable and overriding error."[154]\

These remarks seem entirely reasonable and consistent with the structure and purpose of the non-tax purpose test in subsection 245(3) of the ITA. Of particular importance, the Court's statement that it "will not suffice" for this test that "some alternative transaction that might have achieved an equivalent result would have resulted in higher taxes" suggests that the existence of a higher taxed alternative transaction might be relevant. Indeed, where an alternative transaction would have resulted in higher taxes, the text of subsection 245(3) states that the transaction at issue is an avoidance transaction if it or a series of transactions of which it is a part results in a tax benefit and

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[150] *Canada Trustco*, *supra* note 10 at para. 29. See also *ibid*. at para. 30, explaining that: "The courts must examine the relationships between the parties and the actual transactions that were executed between them. The facts of the transactions are central to determining whether there was an avoidance transaction."

[151] *Ibid*. at para. 28. See also *ibid*. at para. 29, explaining that "[t]he determination invokes reasonableness, suggesting that the possibility of different interpretations of events must be objectively considered." Although the Court also declares that "[i]t is not helpful to speak of the threshold imposed by s. 245(3) as high or low," the language of the provision – which requires the taxpayer to make a reasonable case that the transaction was undertaken or arranged primarily for *bona fide* purposes other than to obtain the tax benefit" – suggests that the threshold is more likely to be low than high.

[152] *Ibid*., citing the Explanatory Notes, *supra* note 4 at p. 464.

[153] *Canada Trustco*, *supra* note 10 at para. 63.

[154] *Ibid*. at para. 66, subparagraph 7.

if it is carried out primarily to obtain the tax benefit. This does not mean that the transaction is "recharacterized" to determine if it is an avoidance transaction,[155] but that it is assessed against an alternative arrangement that might reasonably have been carried out but for the existence of the tax benefit.[156]

(3) Misuse or Abuse

In contrast to its analysis of the concepts of a tax benefit and an avoidance transaction, the Supreme Court of Canada devotes considerable attention in *Canada Trustco* to the requirement in subsection 245(4) of the ITA, as it read prior to its amendment, that the GAAR "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." Observing that "this requirement … has given rise to the most difficulty in the interpretation and application of the GAAR,"[157] the Court's analysis addresses three central issues: (1) the distinction, if any, between a misuse of specific provisions and an abuse of the provisions of the ITA read as a whole[158]; (2) the process for determining whether a transaction is abusive[159]; and (3) the burden of proof for this inquiry.[160] As an initial matter, the Court also addresses the retroactive amendment to subsection 245(4) of the ITA.[161]

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[155] See the Explanatory Notes, *supra* note 4 at p. 464: "Subsection 245(3) does not permit the 'recharacterization' of a transaction for the purposes of determining whether or not it is an avoidance transaction."
[156] See the related discussion of the concept of a tax benefit at *supra*, notes 135-38 and accompanying text.
[157] *Canada Trustco*, *supra* note 10 at para. 37.
[158] *Ibid*. at paras. 38-43.
[159] *Ibid*. at paras. 44-62.
[160] *Ibid*. at paras. 64-65.
[161] *Ibid*. at para. 7. See *supra* note 6.

(a) Amendment to Subsection 245(4)

As originally enacted, subsection 245(4) stipulated that the GAAR "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." In response to two Tax Court decisions concluding that this language precluded the rule's application to the Regulations,[162] the provision was amended in 2005,[163] with retroactive application to the date when the GAAR came into effect, to stipulate that the GAAR:

> … applies to a transaction only if it may reasonably be considered that the transaction
>
> (a) would, if this Act were read without reference to this section, result directly or indirectly in a misuse of the provisions of any one or more of
>
> (i) this Act,
>
> (ii) the *Income Tax Regulations*,
>
> (iii) the *Income Tax Application Rules*,
>
> (iv) a tax treaty, or
>
> (v) any other enactment that is relevant in computing tax or any other amount payable by or refundable to a person under this Act or in determining any amount that is relevant for the purposes of that computation; or
>
> (b) would result directly or indirectly in an abuse having regard to those provisions, other than this section, read as a whole.

First announced in the Federal Budget on March 23, 2004,[164] draft legislation implementing this amendment was tabled on December 8 2004,[165] and received Royal

[162] See, e.g., *Rousseau-Houle*, *supra* note 45, and *Fredette*, *supra* note 45.
[163] S.C. 2005, c. 19, s. 52(2).
[164] Department of Finance Canada, *New Agenda for Achievement: The Budget Plan 2004*, (Ottawa: Her Majesty in Right of Canada, 2004) at pp. 345 and 386 [hereafter 2004 Budget].
[165] Bill C-33, *A second Act to implement certain provisions of the budget tabled in Parliament on March 23, 2004*, s. 52(2).

Assent on May 13, 2005. Although originally intended "to clarify that the Act's general anti-avoidance rule applies to a misuse or abuse of the provisions of the *Income Tax Regulations*, the *Income Tax Application Rules* (ITARs), and any enactments amending the Act, Regulations or ITARs, as well as to a misuse or abuse of a tax treaty,"[166] the draft legislation also converted the double negative language of the initial provision to an affirmative test stipulating that the GAAR "applies to a transaction only if it may reasonably be considered that the transaction … would … result … in a misuse … or … an abuse …." The Supreme Court of Canada heard the appeals in *Canada Trustco* and *Mathew* on March 8, 2005 and released the decisions on October 19, 2005. As a result, the appeals were heard after the draft legislation was released but before it was enacted, and the decisions were released after the new provision had become law.

Although recognizing that the amendment was enacted to apply retroactively, the Court nonetheless concludes that it "has no application to the judgments under appeal" on the basis that "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."[167] Furthermore, it adds, "even if this amendment were to apply, it would not warrant a different approach to the issues on appeal," since the amendment "make[s] it clear that the GAAR applies to tax benefits conferred by Regulations enacted under the *Income Tax Act*" and the Tax Court judge in *Canada Trustco* "proceeded on this assumption, which was not challenged in submissions" to the Court.[168]

[166] 2004 Budget, *supra* note 164 at p. 345.
[167] *Canada Trustco*, *supra* note 10 at para. 7.
[168] *Ibid*.

While the first conclusion that a retroactive amendment cannot apply to pending appeals appears to be consistent with established judicial presumptions against retroactive legislation,[169] the second conclusion that the amendment "would not warrant a different approach to the issues on appeal" ignores the fact that new subsection 245(4) not only extends the application of the GAAR to the Regulations and other relevant enactments, but also replaces the double negative language of the former provision with a positive requirement that the avoidance transaction may reasonably be considered to result in a misuse or abuse. To the extent that the Court's analysis of subsection 245(4) depends on the double negative language of the former provision, therefore, it has questionable relevance to future GAAR cases for which the new language will apply. As explained later in this comment, this may affect the burden of persuasion that the Minister must satisfy to establish that a transaction has resulted in a misuse or abuse.[170]

(b) Misuse and Abuse

With respect to the interpretation of subsection 245(4), the Court begins by asking whether the statutory concepts of a misuse and an abuse are different or alike. Although the French version of the ITA uses the same word "*abus*" to refer to specific provisions and provisions read together, the majority of the Federal Court of Appeal in *OSFC Holdings* relied on the use of different words in the English version of the ITA to conclude that the misuse analysis looks to specific provisions in isolation from the

[169] See, e.g., *Hornby Island Trust Committee v. Stormwell* (1988), 53 DLR (4th) 435 (BCCA) at 442, where the Court refused to apply retroactive legislation to the validity of an otherwise invalid municipal by-law on the grounds that "a retroactive 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." For a more thorough examination of this issue of retroactivity, see Benjamin Alarie, "Retroactivity and the General Anti-Avoidance Rule" (to be presented at the GAAR Symposium on November 18, 2005).

broader scheme of the ITA, while the abuse analysis looks to the purpose, scheme or policy reflected in the provisions of the ITA as a whole.[171] On this basis, it concluded that the taxpayer had not misused subsection 18(13) of the ITA, but had abused a more general policy against transferring losses between corporate taxpayers.[172]

In *Canada Trustco*, the Supreme Court of Canada rejects the bifurcated approach adopted by the majority in *OSFC Holdings*, and instead affirms Miller TCJ's statement in the trial decision that "the analysis of the misuse of the provisions and the analysis of the abuse having regard to the provisions of the *Act* read as a whole are inseparable."[173] With respect to specific provisions, the Court suggests, interpretation "cannot be separated from contextual considerations arising from other provisions."[174] At the same time, it emphasizes, courts should not "search for an overriding policy of the Act that is not based on a unified, textual, contextual and purposive interpretation of the specific provisions in issue."[175] As a result, it concludes, subsection 245(4) "requires a single, unified approach to the textual, contextual and purposive interpretation of the specific provisions of the *Income Tax Act* that are relied upon by the taxpayer in order to determine whether there was abusive tax avoidance."[176]

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[170] See the discussion at *infra* notes 197-98 and accompanying text. The expression "burden of persuasion" was used by Chief Justice Donald Bowman of the Tax Court of Canada, speaking at the University of Toronto Faculty of Law GAAR Symposium, *supra* note 138.

[171] *OSFC Holdings*, *supra* note 31 at paras. 59-66.

[172] *Ibid*. at paras. 71-114.

[173] *Canada Trustco*, *supra* note 10 at para. 39, citing *Canada Trustco Mortgage Company v. The Queen*, *supra* note 12 at para. 90. See *supra* note 55.

[174] *Canada Trustco*, *supra* note 10 at para. 39.

[175] *Ibid*. at para. 41, explaining that such an approach would "inappropriately place the formulation of taxation policy in the hands of the judiciary, requiring judges to perform a task to which they are unaccustomed and for which they are not equipped" and "run counter to the overall policy of Parliament that tax law be certain, predictable and fair, so that taxpayers can intelligently order their affairs."

[176] *Ibid*. at para. 43. See also *ibid*. at para. 40, suggesting that "[t]he policy analysis proposed as a second step by the Federal Court of Appeal in *OSFC* is properly incorporated into a unified, textual, contextual, and purposive approach to interpreting the specific provisions that give rise to the tax benefit."

That the concept of a misuse of specific provisions of the ITA "cannot be separated from contextual considerations arising from other provisions" is undoubtedly correct as a matter of statutory interpretation. The Court also rightly concludes that the concept of an abuse having regard to the provisions of the ITA read as a whole should be rooted in these provisions rather than "an overriding policy."[177] To combine the analysis of a misuse and abuse into a "single, unified approach," however, ignores the statutory language of subsection 245(4) which refers to a misuse of "provisions" of the ITA and other relevant enactments and an abuse "having regard to those provisions" other than the GAAR "read as a whole." More seriously, to limit this "single unified approach" to the interpretation of "the specific provisions" of the ITA that "are relied upon by the taxpayer" to obtain a tax benefit seems to impede the more wide-ranging inquiry that is suggested by the concept of an abuse having regard to provisions of the ITA and other relevant enactments read as a whole. As the Court's ultimate decision in *Canada Trustco* suggests,[178] the absence of this more wide-ranging inquiry may impede the effective operation of the GAAR.

(c) Abusive Transactions

With respect to the process for determining whether a transaction is abusive under subsection 245(4) of the ITA, the Court adopts the same "two-stage" approach that the majority of the Federal Court of Appeal affirmed in *OSFC Holdings*.[179] Thus, it states:

> The first task is to interpret the provisions giving rise to the tax benefit to determine their object, spirit and purpose. The next task is to determine whether the transaction falls within or frustrates that purpose.[180]

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[177] For a persuasive argument to this effect, see Brian Arnold, "The Long, Slow, Steady Demise of the General Anti-Avoidance Rule" (2004), 52 *Can. Tax J.* 488.
[178] See the discussion at *infra*, section IV.B.1.
[179] See *supra* notes 46-47 and accompanying text.

In addition, it explains, although the "overall inquiry" involves "a mixed question of fact and law", the interpretation of specific provisions of the ITA is "essentially a question of law" while the assessment of specific transactions in reference to this interpretation is "necessarily fact-intensive."[181]

In order to determine the object, spirit and purpose of provisions giving rise to the tax benefit, the Court suggests, the first part of the inquiry under subsection 245(4) "requires the court to look beyond the mere text of the provisions and undertake a contextual and purposive approach to interpretation."[182] For this purpose, it states, courts should not search for "an overriding policy" that is not based on the specific provisions in issue,[183] but should interpret these provisions "in their legislative context, together with other related and relevant provisions, in light of the purposes that are promoted by those provisions and their statutory schemes."[184] In this respect, it emphasizes, "it should not be forgotten that the GAAR is part of the Act."[185]

Once the object, spirit and purpose of the provisions giving rise to the tax benefit are properly interpreted, the Court continues, the second task under subsection 245(4) is to determine "whether the transaction frustrates or defeats the object, spirit or purpose of those provisions."[186] This determination, it declares, is "a question of fact for the Tax Court judge" with which "appellate tribunals should not interfere, absent palpable

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[180] *Canada Trustco*, *supra* note 10 at para. 44. See also *ibid*. at para. 55, explaining that subsection 245(4) "imposes a two-part inquiry. The first step is to determine the object, spirit or purpose of the provisions of the *Income Tax Act* that are relied on for the tax benefit, having regard to the scheme of the Act, the relevant provisions and permissible extrinsic aids. The second step is to examine the factual context of a case in order to determine whether the avoidance transaction defeated or frustrated the object, spirit or purpose of the provisions in issue."
[181] *Ibid*. at para. 44.
[182] *Ibid*. at para. 47.
[183] *Ibid*. at para. 41.
[184] *Ibid*. at para. 51.

error."[187] In general, however, it suggests that abusive tax avoidance will occur when taxpayers rely on specific provisions of the ITA to achieve results that these provisions seek to prevent, when transactions frustrate or defeat "the underlying rationale of the provisions that are relied upon" to obtain tax benefits, and when arrangements "circumvent … the application of certain provisions, such as specific anti-avoidance rules, in a manner that frustrates or defeats the object, spirit or purpose of those provisions."[188] Conversely, it states, abusive tax avoidance does not exist where an avoidance transaction is determined to be within the object, spirit or purpose of the provisions that confer the tax benefit.[189] Nor does the Court consider it appropriate to characterize an avoidance transaction as abusive solely because it lacks real economic substance,[190] emphasizing that this consideration is relevant only where the object, spirit and purpose of the statutory provisions at issue limit tax benefits to transactions with economic substance.[191]

Finally, the Court concludes, "the GAAR can only be applied to deny a tax benefit when the abusive nature of the transaction is clear,"[192] so that "[i]f the existence

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[185] *Ibid*.
[186] *Ibid*. at para. 49.
[187] *Ibid*. at para. 46. See also *ibid*. at para. 66, subparagraph 7.
[188] *Ibid*. at para. 47.
[189] *Ibid*.
[190] *Ibid*. at para. 57.
[191] *Ibid*. at para. 58, suggesting that the absence of this element "may then become a relevant factor towards the inference that the transactions abused the provisions at issue, but there is no golden rule in this respect." For a more detailed examination of the relationship between the concept of economic substance and the GAAR, see Jinyan Li, "The Economic Substance Doctrine and Abusive Tax Avoidance: A Critical and Comparative Perspective," Paper presented at the GAAR Symposium, *supra* note 138, available on the web at http://www.law.utoronto.ca/conferences/taxavoidance.html.
[192] *Ibid*. at para. 50.

of abusive tax avoidance is unclear, the benefit of the doubt goes to the taxpayer."[193] Specifically, it explains:

> The GAAR may be applied to deny a tax benefit only after it is determined that it was not reasonable to consider the tax benefit to be within the object, spirit or purpose of the provisions relied upon by the taxpayer. The negative language in which s. 245(4) is cast indicates that the starting point for the analysis is the assumption that a tax benefit that would be conferred by the plain words of the Act is not abusive. This means that a finding of abuse is only warranted where the opposite conclusion – that the avoidance transaction was consistent with the object, spirit or purpose of the provisions of the Act that are relied on by the taxpayer – cannot be reasonably entertained. In other words, the abusive nature of the transaction must be clear. The GAAR will not apply to deny a tax benefit where it may reasonably be considered that the transactions were carried out in a manner consistent with the object, spirit or purpose of the provisions of the Act, as interpreted textually, contextually and purposively.[194]

In this respect, therefore, the Court appears to agree with the conclusion reached by the majority of the Federal Court of Appeal in *OSFC Holdings* that the relevant policy against which an abusive transaction is assessed must be "clear and unambiguous".[195]

The Court's suggestion that subsection 245(4) demands a "two-step inquiry" involving the initial interpretation of the ITA and the subsequent assessment of specific transactions in light of this interpretation seems workable and reasonable, as does its conclusion that the first of these inquiries is a question of law while the second is a factual determination. The Court is also right to emphasize that the first inquiry "requires the court to look beyond the mere text" of the ITA "and undertake a contextual and purposive approach to interpretation." As explained earlier, however, while an analysis directed at the specific provisions on which a taxpayer has relied to obtain a tax benefit is

[193] *Ibid*. at para. 66, subparagraph 3. See also *ibid*. at para. 69, repeating that "[t]he abuse of the Act must be clear, with the result that doubts must be resolved in favour of the taxpayer."
[194] *Ibid*. at para. 62.
[195] *OSFC Holdings*, *supra* note 31 at para. 69. See *supra*, text accompanying note 51. Although the clarity that the majority insisted upon in *OSFC Holdings* addressed the interpretation of the relevant provisions, while the clarity that the Court demands in *Canada Trustco* concerns "the abusive nature of the transaction," it is difficult to imagine how the latter can exist without the former.

consistent with the concept of a misuse of specific provisions, this seems inappropriate for the more wide-ranging inquiry suggested by the concept of an abuse having regard to provisions of the ITA and other relevant enactments read as a whole. To the extent that this language suggests a more general inquiry into the purposes of the statutory scheme, therefore, the Court's approach is unduly restrictive. For this reason, moreover, the Court's conclusion in *Canada Trustco* that an avoidance transaction is not abusive solely because it lacks economic substance may also be questioned. As the Explanatory Notes accompanying draft legislation explained:

> Subsection 245(4) recognizes that the provisions of the Act are intended to apply to transactions with real economic substance, not to transactions intended to exploit, misuse or frustrate the Act to avoid tax.[196]

As a result, it follows, transactions that lack economic substance might reasonably be considered to result in an abuse having regard to the provisions of the ITA read as a whole.

Finally, it is important to comment on the Court's conclusion in *Canada Trustco* that the GAAR should apply only where the abusive nature of an avoidance transaction is clear, with any doubts resolved in favour of the taxpayer. As the Court rightly notes, and I have argued elsewhere,[197] this conclusion flows logically from the double negative language in subsection 245(4) as it formerly read, which stipulated that the GAAR would not apply to transactions that could reasonably be considered not to result in a misuse or

[196] Explanatory Notes, *supra* note 4 at p. 464, cited in *Canada Trustco*, *supra* note 10 at para. 48.

[197] Duff, "Judicial Application of the Anti-Avoidance Rule in Canada," *supra* note 80 at 286, explaining (at footnote 105) that "[s]ince the taxpayer may avoid the application of the GAAR by presenting a 'reasonable' argument that the transaction at issue does not result in a misuse or abuse, it seems to follow that the revenue authorities must establish a clear and unambiguous misuse or abuse for the GAAR to apply."

abuse.[198] As the amended version of subsection 245(4) has replaced this double negative language with a positive requirement that the GAAR "applies to a transaction only if it may reasonably be considered that the transaction … would … result … in a misuse … or … an abuse," it follows that the burden of persuasion to establish that a transaction results in a misuse or abuse has been reversed. Under the retroactively amended provision, therefore, it is only necessary that the abusive nature of the transaction is reasonably established, and doubts are resolved in favour of the Crown.

(d) Burden of Proof

With respect to the burden of proof under subsection 245(4) of the ITA,[199] the majority of the Federal Court of Appeal in *OSFC Holdings* held that neither party has a formal onus to establish the relevant policy of the provisions but that the Minister has a "practical" burden to explain this policy, while the taxpayer has "the onus … to prove the necessary facts to refute the Minister's assumptions of fact that the avoidance transaction in question results in a misuse or abuse."[200] In *Canada Trustco*, the Supreme Court of Canada, rejects this distinction between a formal and a practical burden of proof, insisting that "[t[he taxpayer, once he or she has shown compliance with the wording of a

[198] See also *Imperial Oil Ltd. v. The Queen* [2004] 2 CTC 190, 2004 DTC 6044 (FCA) at paras. 39-40: "While the Act does not expressly provide that the policy must be 'clear and unambiguous', this is implicit in the language of subsection 254(4), which permits the exemption for a tax avoidance scheme 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 ... read as a whole.' Thus, if the scheme may reasonably be considered *not* to result directly or indirectly in a misuse or an abuse, GAAR does not apply: in effect, the taxpayer is given the benefit of any doubt. Consequently, for GAAR to apply it must be clear that the provisions of the Act are being misused or the Act as a whole is being abused. It is not enough that a court might reasonably consider them to be misused or abused." [emphasis in original]

[199] For a more detailed examination of this issue, see Sandler, *supra* note 138.

[200] *OSFC Holdings*, *supra* note 31 at para. 68. See *supra* notes 46-49 and accompanying text.

provision, should not be required to disprove that he or she has thereby violated the object, spirit or purpose of the provision."[201] According to the Court:

> It is for the Minister who seeks to rely on the GAAR to identify the object, spirit or purpose of the provisions that are claimed to have been frustrated or defeated, when the provisions of the Act are interpreted in a textual, contextual and purposive manner.[202]

As a result, it seems, the Court places the burden on the Minister not only to establish the object, spirit and purpose of the relevant provisions, but also to establish the abusive nature of the avoidance transaction at issue.

Under the former version of subsection 245(4), which excluded transactions that could reasonably be considered not to result in a misuse or abuse, one might reasonably have thought that the taxpayer might bear an initial burden to advance a reasonable argument that an avoidance transaction was not abusive, whereupon the burden would shift to the Minister to establish that this argument was unreasonable. Under the amended version, however, which stipulates that the GAAR applies to transactions that may reasonably be considered to result in a misuse or abuse, it seems that the Minister has an explicit burden to advance a reasonable argument that the transaction is abusive, while the taxpayer must establish that this argument is unreasonable.[203] As a result, although it is unclear whether the Court's interpretation of the burden in subsection 245(4) is

[201] *Canada Trustco*, *supra* note 10 at para. 65.

[202] *Ibid*., suggesting that "[t]he Minister is in a better position than the taxpayer to make submissions on legislative intent with a view to interpreting the provisions harmoniously within the broader statutory scheme that is relevant to the transaction at issue." Whether the Minister is always in a better position than the taxpayer to make submissions on legislative intent may be doubted where the taxpayer well advised and well-represented, as was undoubtedly the case in *Canada Trustco* and *Mathew*. For a similar point, see Sandler, *supra* note 138.

[203] In this respect, see Duff, "Judicial Application of the General Anti-Avoidance Rule in Canada," *supra* note 31 at 288, arguing that the burden in subsection 245(4) as it then read should be "explicitly shifted to the revenue authorities and relaxed by amending the provision to state that the GAAR does not apply unless it may reasonably be considered that the transaction results in a misuse or abuse." In effect, this is what was accomplished by the amendments to subsection 245(4).

compatible with the language of the former provision, it is entirely consistent with the amended version.

B. Application to the Facts

Based on its general approach to tax law and the GAAR, the Supreme Court of Canada dismissed the Crown's appeal in *Canada Trustco* and the taxpayer's appeal in *Mathew*. In each case, the key issue on appeal was whether the transaction resulted in a misuse or abuse under subsection 245(4) of the ITA.

1. *Canada Trustco*

On appeal to the Supreme Court of Canada, the Crown's main argument in *Canada Trustco* was that "the manner in which the respondent structured and financed the purchase, lease and sublease of the trailers contravened the object, spirit or purpose of the CCA regime and resulted in abusive tax avoidance under s. 245(4) of the *Income Tax Act*."[204] More specifically, it argued, because the transactions allowed the taxpayer to acquire the trailers without incurring any economic risk, their "real economic cost" was nil, contradicting the object and spirit of the CCA provisions "to provide for the recognition of money spent to acquire qualifying assets to the extent that they are consumed in the income-earning process."[205] In response, the taxpayer argued that the CCA deductions were consistent with the text and scheme of the leasing property and specified leasing property rules,[206] and with the general policy of the ITA that cost means

[204] *Canada Trustco*, *supra* note 10 at para. 68.
[205] *Ibid*. at para. 70, citing *Water's Edge*, *supra* note 31 at para. 44.
[206] *Canada Trustco*, *supra* note 10 at para. 71.

"the price that the taxpayer gave up in order to get the asset, except in specific and precisely prescribed circumstances" that did not apply.[207]

Rejecting the Crown's arguments, the Court relies on textual, contextual, purposive, and consequential considerations to favour the taxpayer's interpretation of the relevant statutory provisions.[208] Textually, it states, the CCA provisions refer only to the cost of depreciable property "in the well-established legal sense of the amount paid to acquire the assets,"[209] not amounts at "economic risk".[210] Contextually, it adds, the conclusion that cost of depreciable property generally means the amount paid for the property is supported by other provisions of the ITA that make adjustments to the cost of this property in specific circumstances.[211] Furthermore, it suggests, the Tax Court judge held that the purpose of the CCA provisions "as applied to sale-leaseback transactions" is "to permit deduction of CCA based on the cost of the assets acquired."[212] Finally, it maintains, to "rewrite" the CCA provisions to interpret cost to mean amounts economically at risk "would be to invite inconsistent results" which would "vary with the degree of risk in each case" and "offend the goal of the Act to provide sufficient certainty and predictability to permit taxpayers to intelligently order their affairs."[213]

[207] *Ibid*. See also *ibid*. at para. 72: "The respondent argues that the transaction was consistent with the object and spirit of the legislation. The Act's inclusion of specific provisions that take 'cost' to mean the amount 'at risk' in limited circumstances illustrates the general policy of the Act that the term 'cost' outside of those specific provisions means cost as understood at law, namely the amount paid. A cost is not reduced to reflect a mitigation of economic risk."

[208] *Ibid*. at para. 73. Although the Court does not explicitly identify consequential considerations as a factor, its decision relies upon these. See *infra*, text accompanying note 213.

[209] *Ibid*. at para. 74.

[210] *Ibid*. at para. 75.

[211] *Ibid*. at paras. 74 and 75, referring specifically to subsections 13(7.1) and (7.2) of the ITA, which adjust the cost of depreciable property in respect of which a taxpayer has received government assistance.

[212] *Ibid*. at para. 74. See also *ibid*. at para. 78: "The Tax Court judge, after considering all the circumstances, found that the transaction was not so dissimilar from an ordinary sale-leaseback to take it outside the object, spirit or purpose of the relevant CCA provisions of the Act and Regulations."

[213] *Ibid*. at para. 75.

More generally, the Court continues, the Crown's argument that the meaning of cost for the purpose of the CCA provisions should be understood as economic cost or amounts economically at risk reflects an improper interpretation of the GAAR by reading into the ITA an "external" concept of "economic substance" without regard to "the specific provisions that are relied upon for the tax benefit."[214] On the contrary, the Court emphasizes, although consideration of the economic substance of transactions may be relevant to the application of the GAAR, this is so only where the object, spirit and purpose of the relevant statutory provisions limit tax benefits to transactions with real economic substance.[215]

Finally, the Court declares, the conclusions of the Tax Court judge "were based on a correct view of the law and were grounded on evidence."[216] Specifically, it explains:

> The Tax Court judge's analysis on the issue of abuse under s. 245(4) is largely consistent with the approach to the application of the GAAR we have adopted. He rejected the two-stage overriding-policy approach to abuse and misuse. He went on to inquire into the policy or purpose underlying the CCA treatment in sale-leaseback arrangements. Construing the CCA provisions as a whole, he rejected the submission that "cost" in the relevant provisions of the Act should be reread as "money at risk", and he also rejected the argument that the "economic substance" of the transaction determined that there was abusive tax avoidance. He conducted a detailed analysis of the transactions to determine whether they fell within the object, spirit or purpose of the CCA provisions. In the end, he concluded that a tax benefit was consistent with the object, spirit and purpose of the CCA provisions and held that the GAAR could not apply to disallow the tax benefit.[217]

Consequently, it concludes, the trial judgment should be confirmed and the appeal dismissed.[218]

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[214] *Ibid*. at paras. 73, 74 and 76.
[215] *Ibid*. at para. 76. See also *ibid*. at para. 60: "A transaction may be considered to be 'artificial' or to 'lack substance' *with respect to specific provisions* of the *Income Tax Act*, if allowing a tax benefit would not be consistent with the object, spirit or purpose of these provisions." [emphasis in original]
[216] *Ibid*. at para. 80.
[217] *Ibid*.
[218] *Ibid*. at paras. 80 and 81.

Given the Court's general approach to the application of the GAAR and the main argument that the Crown advanced on appeal, the conclusion in *Canada Trustco* seems inescapable. If the GAAR does not generally prohibit transactions that are lacking in real economic substance, the Crown's argument that cost means amounts economically at risk could not succeed unless it could point to a general statutory scheme to this effect. While the Crown might have made more of the tax shelter rules in section 143.2 of the ITA and the partnership at-risk rules in subsections 96(2.1) to (2.7) to suggest the development of a general policy to this effect in response to judicial decisions defining cost for tax purposes as the amount paid for property,[219] the Crown appears to have eschewed this litigation strategy in favour of a more general emphasis on economic substance. While the Court dismisses this argument on the grounds that the Crown misconstrued the GAAR by importing an "external" concept without regard to "the specific provisions that are relied upon for the tax benefit", this conclusion depends on the Court's own narrow interpretation of the abuse analysis in subsection 245(4). On the contrary, as I have argued earlier, to the extent that transactions lacking real economic substance constitute an abuse having regard to the provisions of the ITA read as a whole, the transactions in *Canada Trustco* might reasonably have been subject to the GAAR notwithstanding the absence of a clear statutory scheme suggesting that cost generally means real economic cost. More specifically, the production of CCA deductions through a circular flow of

[219] Where a taxpayer acquires a "tax shelter investment" within the meaning of subsection 143.2(1) of the ITA, subsection 143.2(6) reduces the cost of the investment by any "limited-recourse amounts" and an "at-risk adjustment" for any amount or benefit that reduces the impact of any loss that the taxpayer may sustain in respect of the expenditure. Subsections 96(2.1) to (2.7) limit the amount of limited partnership losses that may be deducted by a partner to the partner's at-risk amount in the partnership. The latter provisions were enacted to reverse the results in decisions such as *The Queen v. Gelber*, [1983] CTC 381, 83 DTC 5385 (FCA) and *Signum Communications Inc. v. The Queen*, [1991] 2 CTC 31, 91 DTC 5360 (FCA), in which the Federal Court of Appeal rejected the judicial development of an "at-risk" concept to limit the amount that taxpayers might deduct as partnership losses.

funds which left the taxpayer at little or no economic risk with respect to the trailers in respect of which it claimed CCA could legitimately be regarded as an abuse having regard to the provisions of the ITA read as a whole.

2. *Mathew*

As in *Canada Trustco*, the key point at issue in the appeal to the Supreme Court of Canada in *Mathew* was whether the transactions resulted in a misuse or abuse under subsection 245(4) of the ITA.[220] More specifically, the Court asks, would permitting the taxpayers to deduct the partnership losses "frustrate the object, spirit or purpose" of the specific provisions of the ITA that give rise to the tax benefit, namely the stop-loss rule in subsection 18(13) and the flow-through rule for partnership income and losses in subsection 96(1).[221] Consistent with the "two-part inquiry" that it affirms in *Canada Trustco*,[222] the Court first interprets these provisions to determine their object, spirit and purpose,[223] and then considers the transactions themselves to determine whether they defeat or frustrate these purposes.[224]

With respect to the interpretation of subsections 18(13) and 96(1), the Court employs the "unified textual, contextual and purposive approach" that it affirms in *Canada Trustco*.[225] Textually, it observes, "[i]t is clear that the preservation of the loss under s. 18(13) is for the benefit of a person or partnership who does not deal at arm's

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[220] *Mathew*, *supra* note 11 at para. 35.
[221] *Ibid*.
[222] See *supra* note 160 and accompanying text.
[223] *Mathew*, *supra* note 11 at paras. 40-55.
[224] *Ibid*. at paras. 56-63.
[225] *Ibid*. at para. 42, explaining in this context that it rejects the "narrow textual" approach to these provisions that the majority of the Federal Court of Appeal adopted in its misuse analysis in *OSFC Holdings*. For references to the "unified textual, contextual and purposive approach" in *Canada Trustco* see *supra* note 158 and accompanying text.

length with the transferor."[226] On the other hand, it notes, the text of the partnership provisions in section 96 of the ITA contains "no restrictions on loss sharing between partners, except for foreign partnerships under s. 96(8)."[227] Nonetheless, the Court continues, a broader contextual analysis of other provisions of the ITA supports the opinion of the Federal Court of Appeal in *Canada Trustco* that "the general policy of the *Income Tax Act* is to prohibit the transfer of losses between taxpayers, subject to specific exceptions."[228] At the same time, it maintains, "it cannot be automatically inferred from the general policy against the transfer of losses between taxpayers" that the taxpayers cannot deduct the losses that they obtained through the combined operation of subsections 18(13) and 96(1) of the ITA.[229] Finally, however, the Court resolves the issue through a purposive analysis of these provisions, explaining that the purpose of the stop-loss rule in subsection 18(13) is to deny the loss to the transferor "because it originated and remains in the transferor's control before and after the transfer,"[230] while the purpose of the loss sharing rule in subsection 96(1) is "to promote an organizational structure that allows partners to carry on a business in common, in a non-arm's length relationship."[231] As a result, it concludes, "the combined effect of s. 18(13) and the partnership provisions

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[226] *Mathew*, *supra* note 11 at para. 44.
[227] *Ibid*. at para. 45, adding that "[a]ccumulated losses are available to all partners, provided that they entered the partnership before the end of the year." Where a partnership has no Canadian residents and a person resident in Canada becomes a member of a partnership or a person who is a member of a partnership becomes resident in Canada, subsection 96(8) deems property to be acquired at the lesser of its cost or fair market value at that time and deems losses to be nil, making it impossible to transfer accrued losses.
[228] *Ibid*. at para. 49. See *supra* text accompanying note 92.
[229] *Ibid*. at para. 49, emphasizing that "[t]his policy is but one consideration to be taken into account in determining Parliament's intent with respect to s. 18(13) and s. 96." To the extent that there are deliberate exceptions to the general policy against loss trading, it seems reasonable for the Court to insist that something more than a reference to this general policy is required.
[230] *Ibid*. at para. 54, adding that subsection 18(13) "allows the preservation and transfer of a loss because of the non-arm's length relationship between the transferor and transferee. Absent that relationship, there is no reason for the provision to apply."

do not allow taxpayers to preserve and transfer unrealized losses to arm's length parties."[232]

Having determined the object, spirit and purpose of the provisions on which the taxpayers relied in order to obtain the tax benefit, the Court had no difficulty concluding that the series of transactions resulted in abusive tax avoidance under subsection 245(4) of the ITA.[233] According to the Court

> We are of the view that to allow the appellants to claim the losses in the present appeal would defeat the purposes of s. 18(13) and the partnership provisions, and that the Minister properly denied the appellants the losses under the GAAR.[234]

Furthermore, it adds:

> The abusive nature of the transactions is confirmed by the vacuity and artificiality of the non-arm's length aspect of the initial relationship between [STIL II] and [Standard]. A purposive interpretation of the interplay between s. 18(13) and s. 96(1) indicates that they allow the preservation and sharing of losses on the basis of shared control of the assets in a common business activity. In this case, the absence of such a basis leads to an inference of abuse. Neither [STIL II] nor [SRMP] ever dealt with real property, apart from [Standard]'s original mortgage portfolio. Nor was [Standard] ever in a partnership relation with either OSFC or any of the appellants, having sold its entire interest to OSFC. The only reasonable conclusion is that the series of transactions frustrated Parliament's purpose of confining the transfer of losses such as these to a non-arm's length partnership.[235]

As a result, the Court concludes, the taxpayer's appeal should be dismissed.[236]

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[231] *Ibid*. at para. 52. See also *ibid*. at para. 51, suggesting that "[t]he partnership rules under s. 96 are predicated on the requirement that partners in a partnership pursue a common interest in the business activities of the partnership in a non-arm's length relationship."

[232] *Ibid*. at para. 55, adding that subsection 18(13) "relies on the premise that the partners in the transferee partnership pursue a business activity in common other than to transfer the loss and that the partnership and the transferor deal in a non-arm's length relationship with respect to the property." See also *Ibid*. at para. 54: "To allow a new arm's length partner to buy into the transferee partnership and thus to benefit from the loss would violate the fundamental premise underlying s. 18(13) that the loss is preserved because it essentially remains in the transferor's control. It would contradict the main purpose of s. 18(13) and the premise on which it operates."

[233] *Ibid*. at para. 58.

[234] *Ibid*.

[235] *Ibid*. at para. 62.

[236] *Ibid*. at para. 64.

It is difficult to disagree with the Court's conclusion in *Mathew* that the transactions at issue were properly subject to the GAAR. To the extent that the general policy of the ITA is to disallow the transfer of losses between taxpayers, the use of a stop-loss rule designed to prevent superficial losses on non-arm's length transfers in order to preserve accrued losses to be transferred to arm's length investors surely constitutes a misuse or abuse. What is less clear, however, is why the Court considered it necessary to speculate on the purpose of the partnership rules as part of its analysis under subsection 245(4) of the ITA. Having rejected the idea of separate misuse and abuse analyses, it seems, the Court considered it insufficient to conclude that the transaction resulted in a misuse of subsection 18(13) alone. As a result, unfortunately, it adopted a questionable interpretation of subsection 96(1) that could have significant and unexpected implications for the allocation of partnership losses in subsequent cases. Although partners have various mutual obligations by virtue of this legal relationship, it does not follow that they no not deal with each other at arm's length. As a result, to limit the sharing of partnership losses to partners who are not at arm's length is contrary to ordinary business practice and to the general operation of subsection 96(1) of the ITA.

V. Conclusion

In evaluating the decisions in *Canada Trustco* and *Mathew,* it is important to remember that the Supreme Court of Canada is a court of general jurisdiction with a heavy workload. As a result, one should not have unrealistic expectations about how well it is able to address complex tax avoidance transactions like those in these appeals. Indeed, the Court seems acutely aware of its own limitations in the deference that it accords to the trial decisions in each case, and in its repeated emphasis on the factual nature of most GAAR inquiries and on the limited role for appellate tribunals. Under the circumstances, therefore, the Court has performed a generally reasonable job interpreting the GAAR and setting out a coherent structure to govern the rule's application.

Affirming a "textual, contextual and purposive" approach to the interpretation of the GAAR and the ITA more generally, the Court's general conclusion that the GAAR draws "a line between legitimate tax minimization and abusive tax avoidance" is sensible and in keeping with legislative intentions and the structure of this statutory provision.[237] So also should one endorse its general approach to the application of the GAAR, involving the "three steps" of a tax benefit, an avoidance transaction, and an abuse under subsection 245(4) of the ITA,[238] its emphasis on the factual nature of the first two requirements,[239] and the two-step approach that it adopts to determine the abusive nature of a transaction according to which courts should first interpret the object, spirit and purpose of the ITA and then assess specific transactions in light of this interpretation.[240]

On the other hand, as this comment has attempted to demonstrate, the decisions also reach several conclusions that are difficult to reconcile with the text and purpose of the GAAR and with the extended definition of a series of transactions in subsection 248(10) of the ITA. With respect to the concept of a tax benefit, for example, the Court's statement that a deduction is always a tax benefit is incompatible with the structure of the GAAR and its purpose to prevent abusive tax avoidance.[241] Although the Court's understanding of an ordinary series of transactions is consistent with legislative intent and

[237] See *supra*, text accompanying notes 120-23.
[238] See *supra*, text accompanying notes 126-27.
[239] See *supra*, text accompanying notes 131 and 150.
[240] See *supra*, text accompanying notes 179-81.
[241] See *supra*, text accompanying notes 134-38.

the text of subsection 248(10),[242] its interpretation of the extended definition of a series of transactions bears little relationship to the text of subsection 248(10).[243] More seriously, the Court's "single, unified approach" to the concepts of a misuse or abuse ignores the text of subsection 245(4) of the ITA,[244] limiting the analysis to an inquiry into the object, spirit and purpose of the specific provisions relied upon by the taxpayer to obtain a tax benefit, and precluding a more wide-ranging inquiry into an abuse having regard to the provisions of the ITA and other relevant enactments read as a whole.[245] Since transactions lacking economic substance might reasonably be regarded as an abuse having regard to these provisions read as a whole,[246] one might also question the Court's conclusion that economic substance is only relevant where the object, spirit and purpose of the specific provisions at issue limit tax benefits to transactions with economic substance.[247] On this basis, moreover, one might challenge the specific outcome in *Canada Trustco*.

As a final matter, it is important to qualify the Court's statement that the GAAR should apply only where the abusive nature of an avoidance transaction is clear, with doubts resolves in favour of the taxpayer.[248] Since that this conclusion depends on the double negative language of subsection 245(4) as it formerly read,[249] it has little relevance for future GAAR decisions that will be decided under the amended language. Indeed, although the amended language confirms the Court's view that the burden of

[242] See *supra*, text accompanying notes 144-45.
[243] See *supra*, text accompanying notes 146-47.
[244] See *supra*, section IV.A.3(3)(b).
[245] See *supra* sections IV.A.3(3)(b) and (c).
[246] See *supra*, text accompanying note 196.
[247] See *supra*, text accompanying note 191.
[248] See *supra*, text accompanying note 192-95.
[249] See *supra*, notes 194 and 197-98 and accompanying text.

establishing a misuse or abuse rests with the revenue authorities,[250] the elimination of the double negative language suggests that it is sufficient for the Minister to establish a reasonable case that the transaction results in a misuse or abuse, with any doubt resolved in favour of the Crown. Given the Court's apparent reluctance to hear future GAAR appeals, its failure to address this issue more clearly is particularly unfortunate.

[250] See *supra*, notes 201-03 and accompanying text.