A Modern Overview of Specific Anti-Avoidance Rules

H. Michael Dolson, Kenneth Keung, and Josh Kumar

H. Michael Dolson. Felesky Flynn LLP, Edmonton. LLB (2009) University of Western Ontario; LLM (2014) New York University. Lecturer, Faculty of Law, University of Alberta. Frequent speaker and writer on taxation issues.

Kenneth Keung. Moodys Gartner Tax Law LLP, Calgary. BComm (2002) University of British Columbia; MTax (2004) University of Waterloo; LLB (2009) University of London. CPA, CA, CFP, TEP. Frequent writer and speaker on tax matters for numerous professional seminars and conferences.

Josh Kumar. Thorsteinssons LLP, Toronto. BComm, Queen's University; JD, Western University. CPA, CA. Speaker and writer on tax matters.

Abstract

The application of, and circumvention of, specific anti-avoidance rules (SAARs) are significant matters for tax practitioners, tax administrators, and the courts. This paper reviews how SAARs are drafted and interpreted, and examines the framework for the application of the general anti-avoidance rule in matters involving SAARs. The paper then considers the state of the law and best practices relating to SAARs, including subsections 75(2), 55(2), and 84.1(1).

Keywords GAAR; anti-avoidance rules; statutory interpretation; surplus stripping.

Introduction

Although it was once believed that the general anti-avoidance rule (GAAR)[1] would reduce the need for specific anti-avoidance rules (SAARs), this has not proven to be the case. SAARs have continued to proliferate and have become increasingly complicated and difficult to apply or interpret. Moreover, SAARs and GAAR could apply to the same transactions, or GAAR may apply where SAARs have been circumvented or used in a manner that was not intended.

This paper examines various issues relating to the drafting and interpretation of SAARs, as well as their interaction with GAAR. Recent case law and administrative developments concerning some important SAARs (or provisions that are not SAARs but are often thought of as SAARs) are reviewed, and comments are offered on how these SAARs may or ought to apply in certain circumstances.

The Drafting and Interpretation of SAARs

What Is or Is Not a SAAR?

Although the term "specific anti-avoidance rule" has been used dozens of times in reported cases, and is used by tax academics around the world, few attempts have been made to comprehensively define what is or is not a SAAR.

Finances Québec defines a SAAR as a special rule that modifies the result obtained from the application of generic provisions of the Act in order to ensure compliance with the objective of the generic provisions.[2] These special provisions are intended to frustrate transactions that would otherwise achieve an outcome desirable to taxpayers that is contrary to Parliament's intentions.[3] Under this definition, an obvious example of a SAAR would be subsection 69(11), which can prevent the operation of generic rollover provisions in some instances if the transferor ceases to have an economic interest in the transferred property.

Jinyan Li et al.[4] define SAARs as provisions that are designed to counter specific types of avoidance transactions. This definition is substantially the same as the Finances Québec definition: the avoidance transactions targeted by the SAARs are transactions that would achieve an outcome not intended by Parliament were only the generic provisions of the Act to apply.

Other authors, while not defining what a SAAR is, have attempted to classify SAARs in a way that allows them to be identified. According to Thomas McDonnell,[5] SAARs are generally intended to do one of four things:

1) counter transactions entered into for the purpose of reducing or avoiding tax otherwise payable under the Act;
2) identify and include in income the value of tax benefits (including value shifts) that might otherwise escape tax;
3) reclassify receipts that would otherwise be taxed as capital gains as dividends, and vice versa; or
4) modify relationships between taxpayers or prescribe one or more tax consequences of a particular transaction.

The first category of SAARs identified by McDonnell comprises SAARs that are clearly within the definition proposed by Finances Québec, including provisions such as subsections 69(11) and 103(1). The same is true of the third category, which includes subsection 55(2). McDonnell's second category is more problematic because it includes both provisions that are clearly SAARs, such as subsections 15(1.1) and 56(2), and provisions that are not SAARs, such as subsection 15(1).[6] It is not clear that the fourth category is a separate category at all: prescriptive provisions, such as sections 84.1 and 212.1, could fit into either the first or third category, as would a relationship-modifying provision, such as subsection 55(4).

Like McDonnell, David Duff et al.[7] and others have also adopted a categorical approach to SAARs. Duff et al. likewise separated the Act's various SAARs into four categories on the basis of their purpose:

1) provisions that require the inclusion of precise amounts;
2) provisions that disallow or restrict the deduction of certain amounts;
3) provisions that govern the timing of inclusions and deductions; and
4) rules that provide for deemed consequences or that recharacterize certain amounts or certain recipients.

Unfortunately, the classification of SAARs on the basis of their effect offers little guidance as to whether or not a provision is a SAAR. For example, generic provisions such as paragraph 12(1)(x), paragraph 18(1)(b), and section 142.5 require the inclusion of precise amounts, disallow the deduction of certain amounts, or govern the timing of income inclusions or deductions.

We believe that it is difficult to improve upon Finances Québec's definition of a SAAR. In addition to being concise, it allows for SAARs to be identified on the basis of their legislative rationale and intended effect. This definition is also sufficiently broad to encompass most of the provisions of the Act that have been identified by the courts as a SAAR or described as a SAAR by the Department of Finance, including

- stop-loss rules, including the superficial and suspended loss rules;[8]
- the income attribution rules,[9] including subsection 74.5(11);[10]
- sections 84.1[11] and 212.1;[12]
- subsection 55(2);[13] and
- subsection 75(2).[14]

Conspicuously absent from this list is subsection 84(2). Like Hershfield J in *MacDonald v. The Queen*, we do not believe that subsection 84(2) is properly described as an anti-avoidance provision.[15] Under the Finances Québec definition or the Li et al. definition of a SAAR, subsection 84(2) is not a SAAR because it does not modify the tax consequences that would otherwise arise from the application of the generic provisions of the Act. Rather, subsection 84(2), subsection 15(1), subsections 69(4) and (5), and subsections 88(1) and (2) set out the basic tax consequences that arise on the appropriation or distribution of corporate property to a shareholder other than by way of a dividend, whether on the winding up, discontinuance, or reorganization of a business or otherwise.

Drafting Choices and SAARs

Many academic commentators have identified a shift in the drafting style used by the Department of Finance in creating SAARs. According to these commentators, older SAARs were drafted in a narrow fashion and required either mechanical tests or a tax-avoidance motive, or both, in order to apply; newer SAARs apply by default to broad categories of transactions, subject to the application of specific exceptions.[16]

In our view, the shift in Finance's drafting style is likely a reflection of the department's longstanding concerns relating to SAARs, which date back at least to the time of the Carter commission. In particular:

1) Finance cannot foresee all possible avoidance techniques, so the mechanical tests used in older SAARs may be avoided through creativity; and
2) SAARs with mechanical tests create a road map for tax avoidance, since tax planners will understand which steps cannot be taken to achieve a desired result, and will identify an alternative route to the same destination.[17]

These were some of the concerns (but not the only ones) that resulted in the enactment of GAAR. However, part of the rationale for GAAR was that it would avoid the need for overbroad SAARs that could apply to innocuous, commercially motivated transactions and that account for much of the complexity in the Act.[18] By enacting increasingly broad and complex SAARs that function as "mini-GAARs," the Department of Finance has created considerable uncertainty both for tax planners and for taxpayers who are undertaking bona fide commercial transactions and has eliminated GAAR's potential benefits for non-aggressive taxpayers.

A good example of the older drafting style can be found in paragraph 95(6)(b), which was intended to prevent the misuse or circumvention of the foreign affiliate rules and which has been in effect in some form since 1972. That paragraph reads as follows:

> **Where rights or shares issued, acquired or disposed of to avoid tax**
> (6) For the purposes of this subdivision (other than section 90), . . .
> (b) where a person or partnership acquires or disposes of shares of the capital stock of a corporation or interests in a partnership, either directly or indirectly, and it can reasonably be considered that the principal purpose for the acquisition or disposition is to permit a person to avoid, reduce or defer the payment of tax or any other amount that would otherwise be payable under this Act, that acquisition or disposition is deemed not to have taken place, and where the shares or partnership interests were unissued by the corporation or partnership immediately before the acquisition, those shares or partnership interests, as the case may be, are deemed not to have been issued.

Paragraph 95(6)(b) has all of the identified features of a classical SAAR: a mechanical requirement that a person acquire or dispose of shares of a corporation, whether directly or indirectly; a motive requirement that the principal purpose of the acquisition or disposition be the avoidance or deferral of tax; and a narrow, certain consequence if the SAAR applies. Although paragraph 95(6)(b) could apply in an abundantly broad set of circumstances—taxpayers frequently acquire or dispose of shares of corporations or interests in partnerships, whether directly or indirectly—the principal purpose test and the confinement of the application of paragraph 95(6)(b) to subdivision i, division B, part I of the Act reduce uncertainty to a tolerable level.

Another good example of the older SAAR drafting style is subsection 69(11), which was first enacted in 1987 and was intended to prevent the use of tax-deferred transactions to access the tax attributes of non-affiliated persons. Subsection 69(11) is newer than paragraph 95(6)(b), but it is easy to detect the building blocks of a classical SAAR:

- There are two mechanical requirements that must be satisfied: (1) the taxpayer must dispose of property for proceeds of disposition that are less than the fair market value (FMV) of the property; and (2) a subsequent disposition of the transferred property, or property substituted for the transferred property, must be made or arranged within three years of the date of the tax-deferred disposition.
- There is a necessary tax-avoidance motive: one of the main reasons for the series of transactions that includes the tax-deferred disposition must be to obtain the benefit of a deduction, credit, undeducted expense, or other amount available to a non-affiliated person, or to obtain the benefit of any exemption available to another person on the subsequent disposition.
- There is a reasonable, clear consequence if the conditions of application are met: the taxpayer will be deemed to have disposed of the property that was the subject of the previously tax-deferred transaction for proceeds of disposition equal to the FMV of the property.

The combination of the tax-avoidance motive requirement, the three-year disposition window, and the exclusion for transactions that use tax attributes of a person affiliated with the taxpayer at the commencement of the series of transactions means that it is possible for tax professionals to be reasonably confident about when subsection 69(11) will or will not apply. Even so, subsection 69(11) is broader than paragraph 95(6)(b) because the principal purpose test of the latter provision has been replaced with the more expansive "one of the main reasons" requirement.

Paragraph 95(6)(b) and subsection 69(11) stand in contrast to some newer SAARs, such as the revised tax on split income (TOSI) rules in section 120.4, the deferred plan advantage rules in part XI.01, the restrictive covenant rules in section 56.4, or the foreign affiliate dumping rules in section 212.3. Each of these SAARs is several thousand words in length—far too long to reproduce in this paper—and contains numerous definitions and several subsections. As noted by the academic commentators, the common feature of these SAARs, other than their length, is their breadth: before the application of various potential exclusions, they could apply to nearly every dividend paid by a private corporation, the surrender of many types of rights in commercial agreements, or most investments in foreign affiliates by non-resident-controlled Canadian corporations. While the Department of Finance has made real efforts to ensure that the available exclusions are sufficient, most practitioners know that these SAARs may potentially apply in unanticipated, inappropriate circumstances.

The breadth of anti-avoidance rules has also increased as a result of Finance's weakening of the requirement for a tax-avoidance motive, particularly through the shift to the very low standard embodied by "one of the reasons" language. A good example of this very low standard for intent can be found in the recently enacted subsection 125(5.2).

There is some doubt as to how "a reason" for a transaction can be distinguished from "a main reason" for the transaction.[19] Regardless of how permissive an approach is taken to identifying a main reason, a SAAR that applies if *any* reason for a transaction is a reduction of tax will be far broader in scope. A SAAR such as subsection 125(5.2) could apply in any situation where the mechanical requirements of the SAAR are satisfied unless the taxpayer can demonstrate that it did not have any knowledge of the potential tax benefit at the time that the transaction was undertaken or can prove that it was completely indifferent to the existence of the tax benefit. The requirement for a tax-avoidance motive thus borders on superfluous, and most taxpayers will approach the SAAR as applying or not applying on the basis of the mechanical conditions.

We believe that both the current overbroad drafting style and the use of the "one of the reasons" standard are inappropriate, and that the Department of Finance should reconsider its approach to drafting SAARs. Although the use of the older SAAR drafting style will undoubtedly lead to circumstances where a SAAR will not apply to a transaction that accomplishes a tax outcome that the SAAR was intended to prevent, one of the reasons that GAAR exists is to preclude tax benefits that arise when SAARs are circumvented. Even if some tax-motivated transactions avoid both the potentially applicable SAARs and GAAR, the revenue loss may be justified by the fact that increased certainty and simplicity will not prevent or delay bona fide commercial transactions.

We suspect that the Department of Finance has returned to the overbroad, overly complex drafting style it intended to abandon in 1988 because officials are skeptical about whether GAAR could apply in some circumstances in which SAARs such as the restrictive covenant rules already apply. If this is the case, it may be time for the Department of Finance to consider amending subsection 245(4) to clarify the standard for a misuse or abuse of the Act or any of its provisions. Although a change to the misuse or abuse standard would create uncertainty for taxpayers, that uncertainty should be confined to taxpayers who undertake transactions that are primarily tax-motivated; the priority should be to reduce uncertainty faced by taxpayers undertaking commercially motivated transactions.

Interpretation of SAARs

The general rules for interpreting SAARs have been the subject of lengthy discussion in other papers published by the Canadian Tax Foundation (CTF).[20] Rather than reviewing the general rules of interpretation applicable to SAARs, we will examine the extent to which the courts in recent cases have adopted different interpretive methods in applying SAARs that are drafted in different styles.

As with every other provision of the Act, the interpretation of a SAAR requires a textual, contextual, and purposive analysis of the provision in order to find a meaning that is harmonious with the Act as a whole.[21] However, with SAARs, greater emphasis is placed on textual interpretation: if a provision is drafted clearly and its application to the facts before the court is apparent, then the precise and unequivocal words will play a dominant role, so that the provision applies as written.[22]

There have been obvious examples, in recent cases, of courts favouring a textual or literal interpretation in applying SAARs. For example:

- In considering whether an agreement to waive a right under a unanimous shareholders' agreement to veto a disposition of shares was a restrictive covenant, the Tax Court of Canada did not consider whether it was appropriate for section 56.4 to apply to the payment.[23] Although the court did reproduce the Crown's argument with respect to why section 56.4 was enacted and did discuss the pre-section 56.4 case law,[24] the court's analysis consisted of applying the words of the definition of the term "restrictive covenant"[25] to the agreement entered into by the taxpayer.[26] On the basis of this literal interpretation, the payment received by the taxpayer to induce it to execute a share purchase agreement was included in the taxpayer's income and was subject to part XIII tax;[27] the payment did not form part of the proceeds of disposition of the taxpayer's shares of the corporation.
- When the Tax Court was required to decide whether subsection 55(2) could result in capital gains for both corporations that completed a cross-redemption of shares giving rise to deemed dividends not excluded from subsection 55(2) and in excess of safe income on hand, the court rejected the appellant's argument that subsection 55(2) should be read down so that only the "right" amount of capital gain would be realized.[28] Even though courts in prior cases have taken a purposive approach to applying subsection 55(2) in situations where its interpretation was ambiguous,[29] the court concluded that a plain and ordinary reading of subsection 55(2) called for the provision to apply to both dividends. The court was also not inclined to read down subsection 55(2) on the basis that a literal application would result in economic (but not juridical) double taxation.[30]
- In deciding whether paragraph 110.6(14)(f) applied to preclude the appellant from claiming his capital gains deduction in respect of a capital gain

allocated to him by a partnership following the partnership's disposition of qualified small business corporation (QSBC) shares, the Tax Court did not consider the context or purpose of paragraph 110.6(14)(f).[31] Instead, it simply applied the words of subparagraph 110.6(14)(f)(ii) on the basis of its findings of fact. In doing so, the court concluded that the shares sold by the partnership were not QSBC shares, because the partnership had not acquired the shares in consideration for assets used in the partnership's business.
- In considering whether subsection 74.5(11) applied to a transfer of shares between spouses that was intended to be subject to the attribution rules in subsection 74.1(1), the Tax Court did not consider the context or purpose of subsection 74.5(11) beyond reciting the Supreme Court of Canada's earlier comments on the provision's purpose.[32] Instead, the Tax Court identified the rationale for the transfer by the donor spouse and, on the basis of this purpose, held that subsection 74.5(11) applied.

However, strict textual interpretation has not been a universal approach in recent cases:

- In considering whether the at-risk rules would apply to a top-tier partnership in a tiered partnership structure, the Federal Court of Appeal took great care to ensure that its interpretation of subsection 96(2.1) accorded with the legislative scheme in sections 3, 96, and 111, as well as with the purpose of section 96.[33] The court not only identified why particular words were used in subsection 96(2.1) in order to assist with textual interpretation, but also used contextual and purposive interpretation in order to justify its decision as the outcome most consistent with the legislative scheme. On the basis of this holistic interpretation, the at-risk rules did not apply to the top-tier partnership, which was permitted to allocate its share of the lower-tier partnership's losses to its partners. The Department of Finance has proposed draft legislation that would overrule this decision.[34]
- When required to decide what types of investments were "portfolio investments" for the purposes of section 94.1, the Tax Court relied on the purpose of section 94.1 to support its conclusion that the term had a broader meaning than that suggested by the appellant.[35] The text of section 94.1 was the determining factor: the court's conclusion followed from the ordinary use of the term "portfolio investment" in the investment industry, but the purpose of section 94.1 reinforced the conclusion that the ordinary meaning ought to be used. The court also relied on the purpose of section 94.1 in rejecting the appellant's argument that a property could not be a portfolio investment if the property was an interest in a fund that carried on an active investing business; the court held that a purposive interpretation required the examination of the underlying assets of the fund.

- In considering whether subsection 16(1) applied to recharacterize an amount paid by the appellant as interest, the Tax Court relied on textual interpretation to determine that the provision required the court to consider all of the relevant circumstances and economic substance, and that symmetrical treatment of the debtor and creditor was required.[36] However, the court also undertook a comprehensive review of the statutory and historical context of subsection 16(1)—which revealed that it was intended to be a SAAR—as well as a review of its purpose, in order to reinforce the conclusions flowing from the textual analysis.[37]
- When required to decide whether regulation 6204(1)(b) applied to stock options in circumstances where a right described in regulation 6204(2)(c) existed in relation to the share, the Federal Court of Appeal relied on a textual interpretation of both provisions in deciding that rights described in regulation 6204(2)(c) could not form the basis of a reasonable expectation in the application of regulation 6204(1)(b).[38] The court relied on a contextual and purposive interpretation of the relevant provisions to confirm that this was the proper result: regulation 6204(1)(b) was intended to be an anti-avoidance rule, and the type of avoidance contemplated by Parliament had not occurred where the only basis for a reasonable expectation was a right specifically ignored under regulation 6204(2)(c).[39] As a result, the appellants were entitled to a paragraph 110(1)(d) deduction.

It is difficult to discern any pattern from these recent cases. Most have concerned the application of more targeted SAARs with mechanical and motive-based conditions precedent (paragraph 110.6(14)(f), subsection 75.4(11), subsection 96(2.1), section 94.1, subsection 16(1), and regulation 6204(1)(b)). Only two cases concerned broader SAARs that might apply in the absence of narrow exclusions (section 56.4 and subsection 55(2)); although contextual and purposive interpretation would prove most useful in determining the scope of broad, new-style SAARs, these two cases were decided on the basis of textual interpretation alone. What is apparent is that the Federal Court of Appeal takes contextual and purposive analysis seriously, and will devote time and attention to identifying the context and purpose of provisions even where textual analysis alone could dispose of an appeal.

The Federal Court of Appeal has suggested twice in the last half-decade that SAARs should be interpreted using a purposive approach, and that broad SAARs can be read down in order to ensure that they apply only where Parliament intended.[40] Although it is not obvious that the courts routinely rely on purposive analysis to read down broad SAARs, we believe that a purposive approach is useful in interpreting newer SAARs that are drafted in an overbroad style and that can apply to bona fide commercial transactions unless the transactions fit within narrow exclusions. This purposive approach seems especially appropriate when a court has to interpret the TOSI or restrictive covenant rules, which could otherwise apply to small transactions that taxpayers complete without obtaining any tax advice.

SAARs and GAAR

In most instances where it is necessary to consider the interaction of a SAAR and GAAR, the existence of a tax benefit and one or more avoidance transactions will not be seriously contested. Instead, the question will be whether the taxpayer's reliance on the SAAR to obtain the tax benefit, or the taxpayer's exploitation of a gap in the application of a potentially relevant SAAR, has resulted in a misuse or abuse of the SAAR or of the Act as a whole.

The Supreme Court has made it very clear that a SAAR can be misused or abused when it is relied on in order to achieve an outcome that the SAAR was intended to prevent, or when the SAAR is circumvented in a manner that frustrates or defeats its object, spirit, or purpose.[41] What the Supreme Court did not make clear, however, is the distinction between the circumvention of a SAAR in a manner that is compatible with the object, spirit, and purpose of the provision and the circumvention of a SAAR in a manner that is abusive. It has largely been left to the lower courts to distinguish between creative tax plans that avoid traps created by SAARs on the one hand and, on the other, abusive tax avoidance that exploits the gaps left by SAARs in a manner that defeats the purpose of one or more SAARs.

Circumvention of SAARs

Writing in 2014, Brian Studniberg reviewed the case law as it then existed, and he concluded that the Supreme Court and the lower courts had done little to resolve the competing approaches to finding a misuse or abuse where a SAAR was circumvented.[42] In the most difficult cases where there has been an allegedly abusive circumvention of a SAAR, the text of the SAAR, its context as part of the Act as a whole, the purpose of the SAAR as discerned from its text, and the accompanying technical notes will not clearly establish both the purpose and the scope of the SAAR. When the intended scope of a SAAR is unclear, the courts (and the trial judge in particular) will have considerable latitude to decide whether the application of GAAR would constitute an impermissible attempt to fill gaps or a permissible attempt to preserve the integrity of the Act.

Broadly speaking, there are two possible post-*Canada Trustco* approaches to identifying abuse when SAARs are inapplicable. The first is the approach adopted by the Tax Court of Canada and the Federal Court of Appeal in cases such as *Landrus*[43] and *Canada v. Collins & Aikman Canada Inc.*[44] This approach is grounded in the assumption that the specificity of most SAARs means that a SAAR is intended to apply only in the circumstances where the conditions of application are satisfied; Parliament has carefully articulated its intention and there is no general unexpressed policy.[45] As a result, one can infer that Parliament intended the existence of most alleged gaps in the legislative scheme, so it is usually not a misuse or abuse of either the SAAR or the Act as a whole if a taxpayer takes advantage of those gaps.

The second analytical approach was adopted by the Supreme Court in *Lipson*,[46] although that case also involved reliance on a SAAR to achieve an outcome that the SAAR sought to prevent.[47] In this approach, GAAR was intended by Parliament to address complex tax-avoidance transactions that fall outside the scope of SAARs.[48] Once the object, spirit, and purpose of the circumvented SAAR have been identified, the court can consider the overall result of the series of transactions as a whole to assist in identifying whether the SAAR has been circumvented in a manner that defeats or frustrates its legislative rationale.[49] If the series of transactions accomplishes something very similar to what the SAAR would have prevented had its conditions of application been satisfied, then there has likely been an abuse of the SAAR or of the Act as a whole.

In 2016, Julie D'Avignon and Curtis Stewart attempted to reconcile these competing approaches on the basis of the manner in which the SAAR is circumvented.[50] If the SAAR has limitations or thresholds and is inapplicable because those limitations or thresholds have not been exceeded by the taxpayer, then the *Landrus* approach should be adopted. In contrast, if the SAAR does not apply, or if it applies in a manner that does not produce an adverse result, because of an apparent loophole, then the *Lipson* approach should be adopted. However, if the taxpayer did not exceed limitations or thresholds of the circumvented SAAR because of artificial or non-commercial transactions, then the *Lipson* approach may nevertheless be appropriate.[51]

This attempt at reconciliation strikes us as an eminently reasonable approach that could be adopted by courts. Recent decisions of the Federal Court of Appeal concerning the potential circumvention of SAARs demonstrate that there may not, however, be any need for such a reconciliation in order to allow for a more consistent application of GAAR.

First, in *Canada v. 594710 British Columbia Ltd.*,[52] one of the issues before the court was whether subsection 103(1) had been circumvented in a manner that frustrated its purpose. The interpretation adopted by the litigants was that subsection 103(1) did not apply to a tax-motivated income allocation by a partnership since the taxpayer was not a partner at the end of the partnership's fiscal period. As a result, the issue for the Federal Court of Appeal was whether the non-application of subsection 103(1) was the outcome of an abusive circumvention.

Woods JA held that the purpose of subsection 103(1) was to counter tax-avoidance arrangements in which partners share income principally for tax reasons and the resulting income allocation is commercially unreasonable.[53] Since income must be allocated at the end of a particular fiscal period, it was necessarily intended that subsection 103(1) should potentially apply to all persons who were partners during a fiscal period.[54] Assuming that subsection 103(1) did not apply for the reasons adopted by the litigants, the allocation of 100 percent of the partnership's income to its remaining partners at the end of the subject fiscal period was abusive.[55] In arriving at this conclusion, Woods JA relied heavily on the overall result of the transactions: the incoming partner was a partner for four weeks during which time little activity was conducted, and the profit-making functions of the partnership had ceased before the taxpayer had ceased to be a partner.[56] In the absence of any commercial substance, this was a commercially unreasonable arrangement that frustrated the purpose of subsection 103(1).

Second, in *Canada v. Oxford Properties Group Inc.*,[57] the court characterized the issue before it as whether subsection 100(1), or provisions relied on in order to preclude the avoidance of subsection 100(1), had been circumvented in a manner that frustrated the purpose of the provision.[58] In that case, in greatly simplified terms, depreciable property had been transferred to partnerships and the adjusted cost base (ACB) of the interests in the partnerships was increased through sequential "bump" transactions. After the expiration of the three-year period in subsection 69(11), the interests in the partnership were sold to tax-exempt buyers. The effect of the bumps was to eliminate any capital gain that could have been subject to subsection 100(1) on the sale to the tax-exempt purchasers.

Noël CJ adopted the Crown's position that the object, spirit, and purpose of subsection 100(1) were to ensure that tax would be paid on latent recapture from depreciable property owned by a partnership when the partnership interest was sold to a tax-exempt person.[59] Relying on the overall result of the transactions, Noël CJ held that subsection 100(1) had been circumvented in a manner that frustrated its purpose, since the outcome was exactly what Parliament had intended to prevent.[60] Although this finding probably would have been sufficient to dispose of the appeal, Noël CJ also found that, given the overall result of the transactions, various non-SAAR provisions that the partnership relied on in circumventing subsection 100(1), most notably subsection 97(2), had also been misused or abused.[61] Noël CJ disagreed with the trial judge that subsection 97(2) could not be misused or abused because the SAAR in subsection 69(11) did not apply since the partnership satisfied the three-year hold condition.

Third, in *Univar Holdco Canada ULC v. Canada*,[62] the Federal Court of Appeal framed the issue before it as whether subsection 212.1(1) had been circumvented in a manner that frustrated its purpose. In that case, the taxpayer undertook a post-acquisition of control reorganization that resulted in the creation of significant cross-border paid-up capital (PUC) and a $589 million note owing to the taxpayer's non-resident parent. The transactions undertaken would have resulted in the application of subsection 212.1(1) but for the relieving rule in subsection 212.1(4) (as it then read).

In allowing the taxpayer's appeal, Webb JA relied on the overall result of the series of transactions to confirm that there had not been a misuse or abuse: the taxpayer could have undertaken an alternative (and admittedly more complex) series of transactions that would have resulted in the tax benefit and to which GAAR could not reasonably have applied.[63] The purpose of subsection 212.1(1) in the context of an arm's-length acquisition was not to prevent the extraction of pre-acquisition of control surplus, which was substantially the result of the series of transactions.[64] Given this conclusion, the subsequent amendments to subsection 212.1(4) were not supportive of the trial judge's finding that the transactions were abusive.[65]

What all three of these decisions have in common is a strong reliance on the overall result of the transactions in determining whether a SAAR has been circumvented in a manner that frustrates its purpose. In all three cases, the preferred method of the Federal Court of Appeal was to identify the object, spirit, and purpose of the SAAR that the minister believed had been circumvented, and to then use the economic result of the series of transactions to determine whether or not the circumvention of the SAAR was abusive.

The fact that the Federal Court of Appeal adopted the *Lipson*-style approach in *Oxford* and *Univar Holdco Canada ULC* is particularly interesting. Both of those cases directly or indirectly involved SAARs with thresholds that were not met, meaning that the Federal Court of Appeal could have relied on the *Landrus*-style analysis in order to arrive at the same result (because of either a misuse of subsection 212.1(4) in *Univar Holdco Canada ULC* or an abuse of paragraph 88(1)(d) in *Oxford*). Although three decisions is too small a sample size to arrive at any definitive conclusion, it may be reasonable to hypothesize that the Federal Court of Appeal has attempted to reconcile the law going forward by determining that GAAR will apply where the overall result of a series of transactions does not accord with the object, spirit, and purpose of a SAAR that was deliberately avoided.

Reliance on SAARs

As noted by D'Avignon and Stewart, relatively few cases have been characterized by the courts as involving a taxpayer's reliance on a SAAR to obtain a tax benefit. All of these cases have resulted in a finding of abusive tax avoidance based on the purpose of the SAAR identified by the courts, even though there may not have been a clear expression of legislative intent.[66] At the same time, none of these cases has articulated an approach to determining when reliance on a SAAR frustrates the object, spirit, and purpose of the SAAR that could be consistently adopted in other cases.

The most recent such case, the decision of the Federal Court of Appeal in *Satoma*,[67] is not especially helpful in this regard. In *Satoma*, the taxpayer was a trust that had been settled in such a manner that the SAAR in subsection 75(2) applied to attribute the trust's dividend income to a corporation. The corporation claimed a subsection 112(1) deduction in respect of the attributed income, while the cash remained in the trust and was available for future capital distributions to the trust's individual beneficiaries.

Noël CJ found that the purpose of subsection 75(2) was to prevent income splitting and that, in isolation, the taxpayer had relied on subsection 75(2) in a manner that was consistent with its purpose. However, relying on the analysis of overall results from *Lipson*, Noël CJ held that the combined effect of subsection 75(2) and subsection 112(1) produced an abuse of subsection 112(1).[68] The remainder of Noël CJ's analysis focused on the object, spirit, and purpose of subsection 112(1) and the manner in which the overall result of the series of transactions frustrated that purpose.

The one potential lesson that can be drawn from *Satoma* is that a taxpayer's reliance on a SAAR to achieve a tax benefit will not necessarily result in a misuse or abuse of the SAAR. One cannot extend this lesson too far, though. Given the conclusion in *Lipson* that a taxpayer's reliance on a SAAR to further a tax-avoidance scheme can result in an abuse of the SAAR even where there is no identifiable legislative purpose that has been frustrated,[69] it remains theoretically possible that any reliance on a SAAR that produces a tax benefit could be abusive. Further guidance from the courts is clearly necessary.

Surplus-Stripping SAARs

This section of the paper reviews the SAARs dealing with surplus stripping and some of the relevant jurisprudence, and examines how they fit into the SAAR interpretation scheme discussed above.

Surplus stripping generally describes the realization or extraction of a Canadian corporation's corporate surplus by an individual or trust in a manner that does not result in a taxable dividend. The tax motivations for surplus splitting include

- avoiding income tax, such as where the distribution is in the form of a return of PUC, a capital dividend, or the realization of a capital gain that is sheltered by the lifetime capital gains exemption (LCGE);
- reducing income tax by converting a surplus extraction from a taxable dividend to a taxable capital gain, since the effective tax rate on either eligible or non-eligible dividends is significantly higher than that on capital gains; and
- avoiding part XIII withholding tax since part XIII does not apply to a return of PUC or capital gains.

Surplus-stripping planning and navigating the provisions in sections 84, 84.1, and 212.1 have long been a staple in tax planning and an unending source of disputes between taxpayers and the CRA. The government's attempt on July 18, 2017 to completely do away with surplus stripping by amending section 84.1 and introducing section 246.1, and the government's subsequent abandonment of these two proposals, have shone a stronger light on this topic than ever before. In the discussion that follows, we review these surplus-stripping SAARs and explore whether surplus stripping through tax-paid "hard" basis or through capital gains triggered at the corporate level should be freely permitted under the Act.

Provisions Dealing with the Distribution of Corporate Surplus

We begin by reviewing several key provisions that deal with the removal of surplus—or, more generally, corporate assets—from a corporation resident in Canada to a shareholder. We also examine which of these provisions are SAARs.

Section 82, Paragraph 12(1)(j), and Subsection 83(2)

A corporation may transfer value to a shareholder through the declaration of a dividend in accordance with the relevant corporate statutes. A dividend from a Canadian-resident corporation is includible in the income of the shareholder under the rules of section 82 and paragraph 12(1)(j). If a private corporation has a capital dividend account (CDA), it may elect under subsection 83(2) to make the dividend into a capital dividend that its shareholder receives free of tax. These provisions are not SAARs and are part of the generic provisions of the Act.

Section 84

Where a Canadian-resident corporation transfers corporate funds or property to a shareholder without declaring a dividend (or indirectly, through an increase in legal stated capital and hence the PUC of the shares), section 84 may deem a dividend to have arisen nonetheless in various circumstances. These include:

- a net increase of PUC without a corresponding equity injection from the shareholder (subsection 84(1));
- a distribution or appropriation of corporate funds or property to the shareholder in any manner whatever on the winding up, discontinuance, or reorganization of the corporation's business, to the extent that such distribution or appropriation exceeds the amount of PUC reduced on the distribution or appropriation (subsection 84(2));
- a payment by the corporation on the redemption, acquisition, or cancellation of its shares, to the extent that such payment exceeds the PUC of the redeemed, acquired, or cancelled shares (subsection 84(3)); and
- a payment by the corporation on a reduction of PUC other than by way of a redemption, acquisition, or cancellation of any share, to the extent that such payment exceeds the amount of the PUC reduced (subsection 84(4)).

All of these provisions are similar in that they describe specific ways of removing funds or property from a corporation (or of increasing PUC, which in turn offers the ability to return funds or property tax-free to a shareholder), and trigger the realization of a deemed dividend to the extent that the removal exceeds the PUC given up (or exceeds the net assets contributed by the shareholder). This dividend is includible in the shareholder's income, unless a capital dividend election is made under subsection 83(2). However, as discussed earlier, we do not believe that subsection 84(2) and section 84 in general are SAARs. In *Collins & Aikman Canada Inc.*, Boyle J described subsection 84(4) as a starting point for determining how corporate distributions are to be included in income.[70] We believe this description similarly applies to other provisions within section 84, which describe various taxing mechanisms for different corporate distribution actions and are part of the generic provisions of the Act.

Subsection 15(1)

Subsection 15(1) can be viewed as a catchall provision for any corporate actions that benefit an existing or contemplated shareholder that are not a dividend, a deemed dividend under section 84, a return of capital, or a transaction described in paragraphs 15(1)(a) through (d). If an action falls into this catchall provision, the result is punitive. Subsection 15(1) deems the benefit conferral to be income, which does not entitle the Canadian shareholder to the gross-up and dividend tax credit regimes in sections 82 and 121, respectively. As a result, the outcome for the Canadian shareholder is worse than it would be if an actual dividend or deemed dividend had been received,[71] while the corporation is not entitled to any corresponding deduction. Although subsection 15(1) is a catchall provision and carries a punitive result, we do not believe it is a SAAR because it is merely prescribing a system to tax the conferral of benefits that do not fit into more specific provisions. It is not a rule that modifies the result from the application of the generic provisions of the Act; rather, it is part of the generic provisions of the Act.

Section 84.1

The provisions discussed above cover situations where the stripping of corporate value is initiated by corporate actions. A shareholder may also realize the value of its shareholding through a sale on which the accrued gain or loss will be treated by the Act as a capital gain or loss (unless the shareholder is holding those shares as inventory). To the extent that the shares qualify as QSBC shares[72] and certain criteria are met,[73] the shareholder may claim a capital gains deduction under subsection 110.6(2.1), also known as the LCGE, to shelter the capital gain from tax.

Where both the purchaser and the corporation whose shares are being sold (the subject corporation) are taxable Canadian corporations, the purchaser may be able to extract funds from the subject corporation on a fully tax-deferred basis (either through a winding up under subsection 88(1) or through an intercorporate dividend that entitles the purchaser to an offsetting subsection 112(1) deduction) and use those extracted funds to satisfy the purchase price payable to the seller. In a way, this is an indirect extraction of the subject corporation's funds by the seller, which the seller could otherwise have accessed only through a dividend or deemed dividend, and may be viewed as artificial where the purchaser and the seller are not dealing at arm's length. This type of planning is often known as the "pipeline." If the seller was able to shelter the capital gain on the sale of the shares with the LCGE (or if the capital gain was reduced because of a tax-free increment to ACB on January 1, 1972 valuation day [V-day]), then the extraction of the subject corporation surplus could be achieved without tax being triggered on the sale or historically.

The Act recognizes this and uses subsection 84.1(1) to prevent a completely tax-free corporate surplus extraction. Subsection 84.1(1) applies where

- a taxpayer resident in Canada (other than a corporation) disposes of shares ("the subject shares");
- the shares are of a corporation resident in Canada ("the subject corporation");
- the subject shares are capital property of the taxpayer;
- the taxpayer disposed of subject shares to another corporation ("the purchaser corporation") with which the taxpayer does not deal at arm's length; and
- immediately after the disposition, the subject corporation and the purchaser corporation are "connected" (as defined in section 186—generally two corporations are connected if one owns shares representing more than 10 percent of votes and value in the other).

Where subsection 84.1(1) applies, the consequences are twofold:

1) with respect to purchaser corporation shares received by the taxpayer as consideration, the PUC thereon is reduced to the amount that is the greater of the "hard ACB" and the PUC of the subject shares immediately prior to the disposition; and
2) where any non-share consideration is received by the taxpayer, the taxpayer is generally deemed to have received a dividend to the extent that the non-share consideration exceeds the greater of the "hard ACB" and the PUC of the subject shares immediately prior to the disposition.

The terms "hard ACB" and "soft ACB" are not used in subsection 84.1(1) or the Act—they are colloquial references used by tax practitioners; the ACB that subsection 84.1(1) actually refers to is an amount of ACB that is modified by paragraphs 84.1(2)(a) and (a.1). Generally speaking, these two paragraphs require that, for the purpose of applying section 84.1, the subject shares' ACB be reduced by (1) any V-day increment if the subject shares or substituted shares were held by the taxpayer or a non-arm's-length person at the end of 1971, and (2) any historical capital gains from a previous disposition of the subject shares or substituted shares by the taxpayer or a non-arm's-length individual that were sheltered by an LCGE claim.[74] The ACB of the subject corporation shares after such reductions is known as "hard ACB" (that is, ACB not derived from a tax-free ACB increment on V-day or from a capital gain that was sheltered from tax by a historical LCGE claim). Therefore, unless the taxpayer disposing of the subject shares has PUC or hard ACB in the subject shares immediately before the disposition, the PUC of any share consideration received by the taxpayer will be ground down; and to the extent that non-share consideration is received, the taxpayer will be deemed to have received a taxable dividend instead of a capital gain on which the LCGE could be claimed. In other words, without PUC or hard ACB, a taxpayer is not able to strip out corporate assets by entering into a pipeline transaction with a non-arm's-length purchaser.

There is no question that subsection 84.1(1) is a SAAR. The Supreme Court in *Copthorne Holdings Ltd. v. Canada*[75] described section 84.1 as a SAAR for surplus stripping:

> For example, ss. 84.1 and 212.1 both grind PUC in non-arm's length transactions. These sections have been described as "anti-avoidance" provisions aimed at "dividend stripping" (*Collins & Aikman Products Co. v. The Queen*, 2009 TCC 299, 2009 D.T.C. 1179, at paras. 55 and 105, aff'd 2010 FCA 251, [2011] 1 C.T.C. 250), because such non-arm's length transactions may provide an opportunity for corporations to return funds in excess of the initial investment made with tax-paid funds to a shareholder as a non-taxable return of capital, rather than as a taxable dividend.[76]

In *Descarries v. The Queen*,[77] Hogan J described the object, spirit, and purpose of section 84.1 as being "to prevent taxpayers from performing transactions whose goal is to strip a corporation of its surpluses tax-free through the use of a tax-exempt margin or a capital gain exemption."[78] More recently, in *1245989 Alberta Ltd.*, the Federal Court of Appeal quoted with approval the Crown's explanation of the object, spirit, and purpose of section 84.1 as being "to prevent the inappropriate increase of PUC and the tax free distribution of a corporation's retained earnings or surplus through non-arm's length transactions designed to artificially or unduly increase or preserve the PUC of shares."[79]

In the first section of this paper, we distinguished between classical SAARs (more targeted, with mechanical and motive-based conditions) and newer SAARs (overly broad, like subsection 55(2)). Section 84.1 is a relatively old provision, but while it is not as broad as subsection 55(2), it has the characteristics of a modern SAAR. An obvious feature of section 84.1 that distinguishes it from a classical SAAR is that it does not have a motive-based condition. There is a reason for this. The original section 84.1 was enacted in 1974, and at that time the Act already included a broad anti-surplus-stripping provision in the form of subsection 247(1) (which itself came from the former Act as section 138A(1), enacted in 1963). At that time, subsection 247(1) gave the minister discretion to recharacterize proceeds from the sale of shares as a dividend in the case of individuals and as ordinary income in the case of corporate recipients if one of the purposes of the transaction or series could reasonably be considered to be the extraction of corporate assets in a way that avoided tax.

In a 1975 journal article, McDonnell and Richardson reviewed the context of the legislative landscape into which section 84.1 had been enacted:

> Although [former section 138A(1)] went a long way towards eliminating many of the then current stripping schemes, it became apparent that resort to a discretionary rule was not the complete answer. Not only did it appear that some cases were beyond the reach of the section but it was sometimes difficult to say when one of the purposes for the interposition of a holding company was the avoidance of tax.[80]

Section 84.1 was therefore enacted in 1974 as a SAAR with purely mechanical conditions, to supplement the former subsection 247(1), which in contrast did have a tax-avoidance motive condition. Even after the repeal of subsection 247(1) in 1988, section 84.1 remained a SAAR without a motive condition. The absence of a motive condition inevitably causes subsection 84.1(1) to apply sometimes to bona fide commercial transactions. However, this may have been seen by the drafter of the legislation as justifiable collateral damage, given the substantial amount of tax that could be avoided by taxpayers seeking to strip surplus with tax-exempt margin or the LCGE. Later, we will briefly examine how the courts have applied section 84.1.

Section 212.1

A non-resident shareholder of a Canadian-resident corporation may attempt a similar "pipeline" strategy to avoid part XIII tax that would otherwise apply to a dividend declaration by the Canadian corporation. Section 212.1(1) is the non-resident counterpart to section 84.1, and it generally applies if

- a non-resident person disposes of shares ("the subject shares");
- the shares are of a corporation resident of Canada ("the subject corporation");
- the non-resident person disposes of the subject shares to another corporation resident in Canada ("the purchaser corporation") with which the non-resident person does not deal at arm's length; and
- immediately after the disposition, the subject corporation and the purchaser corporation are connected.

If these conditions are met, the consequences under subsection 212.1(1.1) are twofold:

1) To the extent that the non-share consideration received by the non-resident seller exceeds the PUC of the subject shares immediately before the

disposition, the excess is deemed to be a dividend to the non-resident. The deemed dividend is subject to part XIII tax.

2) With respect to purchaser corporation shares received by the non-resident seller as consideration, the PUC is generally reduced to the PUC of the subject shares immediately before the disposition.

The Supreme Court's comment in *Copthorne* made it clear that section 212.1 is a SAAR.[81] In the *Univar Holdco Canada ULC* decision, the Federal Court of Appeal described section 212.1 and the tax avoidance it prevents as follows:

> Section 212.1 of the ITA was introduced to prevent a non-resident person from indirectly extracting from Canada accumulated surplus in a Canadian corporation (Targetco) in a non-arm's length transaction. Accumulated surplus in this context would mean net assets (assets minus liabilities) in excess of the PUC of the shares. Without section 212.1 of the ITA, a non-resident person could sell the shares of Targetco to another Canadian corporation (with which the vendor does not deal at arm's length) for non-share consideration and realize a capital gain that would not be taxable in Canada as a result of an applicable tax convention. Section 212.1 of the ITA would, however, convert what would otherwise have been a capital gain into a deemed dividend to the extent that the amount paid exceeds the PUC of the shares that are transferred.[82]

Is There a General Policy in the Act Against Surplus Stripping?

At first glance, it may be tempting to point to sections 84, 84.1, 212.1, and 15 as support for the argument that the Act contains a general policy against surplus stripping, and the Crown has repeatedly attempted to make this claim. Proponents of this view could also point to former subsection 247(1), which gave the minister discretion to recharacterize proceeds as dividends if one of the purposes was the extraction of corporate assets in a way that avoided tax. Former subsection 247(1) was repealed in 1988 when GAAR was introduced, and the Department of Finance's technical notes explained that the repeal was "because the scope of that general anti-avoidance rule is broad enough to cover the transactions to which subsection 247(1) was intended to apply."[83]

According to the view that the Act contains a general policy against surplus stripping, the Act intends that any extraction of corporate value be included in the recipient's income as a dividend, unless it is done in a manner permitted specifically in the provisions (for example, extraction up to the amount of PUC, or a sale of shares to an arm's-length purchaser). If such a general policy exists, then it may be argued that any corporate distribution that does not fall within a specifically permitted method and does not result in a dividend income inclusion is potentially a misuse or abuse of the Act and therefore attracts the application of GAAR.

The courts initially agreed with this view. For example, in *RMM Canadian Enterprises Inc. v. The Queen*, Bowman J (as he then was) wrote that

> the Income Tax Act, read as a whole, envisages that a distribution of corporate surplus to shareholders is to be taxed as a payment of dividends. A form of transaction that is otherwise devoid of any commercial objective, and that has as its real purpose the extraction of corporate surplus and the avoidance of the ordinary consequences of such a distribution, is an abuse of the Act as a whole.[84]

However, these rulings were made before the Supreme Court laid out the modern approach of interpreting GAAR in *Canada Trustco.* One of the principles espoused in *Canada Trustco* is that in applying GAAR, "the courts cannot search for an overriding policy of the Act that is not based on a unified, textual, contextual and purposive interpretation of the specific provisions in issue."[85] Viewed from this perspective, it is not difficult to conclude that there is actually no general policy in the Act against surplus stripping.

Using the *Canada Trustco* approach, we must use the specific provisions of the Act as a starting point. Section 82 taxes dividends, section 84 sets out various ways an extraction of corporate surplus may be deemed to be a dividend, and section 15 taxes other ways a corporation may confer a benefit to its shareholders. Subsections 84.1(1) and 212.1(1) are SAARs that recognize that an individual, trust, or non-resident of Canada may extract a Canadian-resident corporation's corporate surplus indirectly via a sale to a purchaser corporation but that disallow such extraction in a non-arm's-length context in the absence of PUC or, in the case of subsection 84.1(1), hard ACB.

There are gaps between these provisions, and as long as the gaps do not go beyond the provisions' object, spirit, and purpose, the *Canada Trustco* principle disallows the filling of those gaps by a search for an overriding policy. Also, although subsections 84.1 and 212.1(1) do not contain a motive requirement and therefore could potentially be broad enough to catch non-tax-motivated transactions, the mechanical requirements of both provisions are narrow enough to indicate that Parliament was targeting a specific set of circumstances rather than setting out a general policy against surplus stripping. For example, as will be discussed later in the paper, a non-arm's-length pipeline transaction by which the capital gain triggered was not sheltered by the LCGE or reduced by the V-day increment should not be considered a misuse or abuse of the Act merely because the taxpayer realizes a capital gain instead of receiving a dividend.

Indeed, subsequent to *Canada Trustco*, the courts have overwhelmingly agreed that no general policy against surplus stripping exists in the Act. For example, when another surplus-stripping case came before Bowman CJ in *Evans v. The Queen*,[86] he deviated from his prior conclusion in *RMM Canadian Enterprises Inc.*:

> The only basis upon which I could uphold the Minister's application of section 245 would be to find that there is some overarching principle of Canadian tax law that requires that corporate distributions to shareholders must be taxed as dividends, and where they are not the Minister is permitted to ignore half a dozen specific sections of the *Act*. This is precisely what the Supreme Court of Canada has said we cannot do.[87]

Former subsection 247(1) is no longer an existing provision of the Act, and arguably should not form part of the GAAR analysis under the *Canada Trustco* principle. Former subsection 247(1) was referred to recently in the Tax Court's decision of *Pomerleau*, and it seemed to have helped inform the court's view of the object of section 84.1, but it did not appear to have any significance beyond that.[88]

A recent confirmation that the Act as it stands does not contain a general policy against surplus stripping came in the form of legislative proposals that were subsequently abandoned. As part of a controversial attempt at a mini tax reform, the government announced on July 18, 2017[89] its intention

1) to amend the existing SAAR of section 84.1 to expand its scope to hard ACB, so that shareholders would be precluded from extracting corporate surplus through non-arm's-length transactions even where the taxpayer had ACB generated from tax-paid capital gains; and
2) to introduce a new SAAR as section 246.1, which (if it had been enacted) would have deemed an individual to have received a taxable dividend on amounts received or receivable from a non-arm's-length person where, as part of the transaction or series of transactions, there was a disposition of property or an increase or decrease in PUC of the corporation and one of the purposes of the transaction or series was to effect a reduction or elimination of assets of a private corporation in a manner that would avoid tax otherwise payable by the individual.

The amendment to section 84.1 would have eliminated planning that involves the creation of pipelines through tax-paid capital gains, including the typical post mortem pipeline, where the hard ACB arises on a deemed disposition on the date of death (the objective being to enable the estate to extract corporate surplus at an effective tax rate applicable to capital gains). Proposed section 246.1 would have eliminated other manners of surplus stripping such as the triggering of a capital gain inside a corporation in order to generate a CDA balance (so that the fully distributed effective tax rate resembles the capital gains rate). If the existing Act already contained a general policy against removing corporate assets in a manner that attracts less tax than a taxable dividend such that doing so would have attracted application of GAAR, Parliament would not have had to propose these changes to the Act. The fact that the proposals were considered was further confirmation that the Act does not contain such a general policy.

The proposed amendment to section 84.1 and the proposed addition of section 246.1 were subsequently abandoned by the government and never became law. The Department of Finance explained the abandonment as follows:

> the Government will not be moving forward with measures relating to the conversion of income into capital gains. During the consultation period, the Government heard from business owners, including many farmers and fishers that the measures could result in several unintended consequences, such as in respect of taxation upon death and potential challenges with intergenerational transfers of businesses.[90]

This explanation is further confirmation that the government believed that the proposals would have created tax consequences that would not otherwise occur without these proposals; that is, the proposals would have prevented what the pre-existing Act, including GAAR, could not prevent. Therefore, given the withdrawal of these proposals, taxpayers should be free to undertake surplus-stripping planning that complies with and does not misuse or abuse the spirit, object, or purpose of sections 84, 84.1, 15, and 212.1.

Application of Anti-Surplus-Stripping SAARs in Respect of Tax-Free Strips

There is no shortage of case law on surplus stripping, particularly in respect of section 84.1. This is because a surplus strip using the LCGE is extremely profitable if it succeeds: zero tax on the extraction of $848,252 corporate surplus per shareholder (based on the 2018 exemption limit) versus 28.33 percent to 47.33 percent tax on a taxable dividend, depending on the province or territory and depending on whether the dividend is an eligible dividend. As a result, many attempts have been made to circumvent section 84.1.

Since subsection 84.1(1) does not apply to prevent surplus-stripping transactions between arm's-length parties, one category of section 84.1 cases involves the question of whether a taxpayer that disposes of shares of a subject corporation deals at arm's length with the purchaser corporation. The answer often comes down to the elusive determination of factual arm's length. The 2016 Tax Court of Canada cases of *Poulin v. The Queen*[91] and *Turgeon v. Canada*[92] (heard on common evidence) were particularly illuminating because they involved two unrelated shareholders, both of whom attempted to extract corporate surplus as a capital gain on which they could claim the LCGE, but one shareholder was exiting the company while the other remained with the company. The *Turgeon* case was appealed to the Federal Court of Appeal, which affirmed the Tax Court's decision.

In *Poulin*, the individual (Poulin) entered into a bona fide sale of the shares of a subject corporation to a purchasing corporation, which triggered a capital gain that was offset by the LCGE. The payment of the sale price by the purchasing corporation was funded by the surplus of the subject corporation. The Tax Court concluded that Poulin factually dealt at arm's length with the purchaser corporation, because both parties were guided by their own objectives. The transaction was entered into as part of an arrangement whereby Poulin exited the underlying business. The fact that the parties worked together to structure the transaction to make the LCGE available did not mean that the parties were not dealing at arm's length. Therefore, subsection 84.1(1) was found not to apply.[93]

In contrast, in *Turgeon*, the individual (Turgeon) entered into a similar sale arrangement, but there was no substance of a bona fide sale. As a result, the Federal Court of Appeal affirmed the Tax Court's finding that Turgeon and the purchaser corporation did not factually deal at arm's length. A primary reason for this was that Turgeon remained a controlling party of the subject corporation after the transaction, and the court found that Turgeon entered into the transaction for the purpose of using the LCGE to extract corporate surplus. As a result, all of the conditions were met for subsection 84.1(1) to apply to Turgeon.[94]

Another category of section 84.1 cases involves taxpayers who cleverly structure non-arm's-length transactions to circumvent the conditions in subsection 84.1(1), and the court must determine whether GAAR applies. The approach taken by the court in dealing with these cases is largely consistent with the approach recently taken by the Federal Court of Appeal and discussed earlier, which was to determine whether the circumvention of a SAAR was abusive by comparing the object, spirit, and purpose of the SAAR with the economic results achieved by the transactions in question. A comprehensive review of the body of GAAR cases involving section 84.1 is beyond the scope of this paper, but the following are some examples for illustrative purposes.

- *Desmarais v. MNR*:[95] An individual triggered a capital gain that was sheltered by the LCGE by disposing of 9.76 percent of the shares of a corporation in which the individual owned 14.28 percent but had no significant influence to a non-arm's-length purchaser corporation. Since the purchaser corporation and the subject corporation were not connected immediately after the disposition, subsection 84.1(1) did not apply to grind the PUC of the purchaser corporation shares issued to the individual, which the individual subsequently used to strip the surplus of another corporation that the individual and his brother together controlled.

  Decision: Subsection 84.1(1) technically did not apply because the 10 percent ownership threshold required for the purchaser corporation and the subject corporation to be connected was not met. In determining whether GAAR applied, the Tax Court stated that Parliament intended section 84.1 to prevent the tax-free stripping of surpluses, but not in every circumstance. In particular, by setting the threshold at the 10 percent "connected" test, Parliament tolerates tax-free surplus stripping when the individual does not have sufficient influence over a subject corporation to cause it to pay a dividend. Therefore, while the intentional transfer of less than 10 percent of the subject corporation to create PUC was not in itself abusive (because the individual, with only 14.28 percent ownership, had no significant influence over the subject corporation), the leveraging of this PUC to achieve a strip of another corporation that the individual and his brother controlled was an abusive circumvention of subsection 84.1(1). The result achieved was contrary to the purpose and spirit of section 84.1, and GAAR was therefore found to apply.[96]

- *1245989 Alberta Ltd. v. The Queen*:[97] An individual created soft ACB in shares of a non-arm's-length purchaser corporation by transferring to it shares of a subject corporation and realizing a capital gain that was sheltered by the LCGE. Subsequently, the subject corporation transferred assets with high tax cost amounts to the purchaser corporation under subsection 85(1), taking back as consideration the same class of shares in the purchaser corporation as those held by the individual. By the operation of subsections 85(1) and 85(2.1), the transfer was elected at the transferred assets' cost amount, which allowed the share consideration issued by the purchaser corporation to have the same elected amount as the ACB and PUC. However, as a result of the share class averaging mechanism within the definition of PUC, the second transfer effectively shifted a portion of the PUC from the hands of the subject corporation to the hands of the individual. As a result, the individual now had both soft ACB and PUC in its shares of the purchaser corporation, which would permit a future strip of the subject corporation's assets without adverse consequences under subsection 84.1(1), since the application of that subsection looks to the greater of PUC and hard ACB.

  Decision: The Tax Court analyzed the text, context, and purpose of section 84.1 and the PUC definition in subsection 89(1). The court concluded that the object, spirit, and purpose of the two provisions were that (1) PUC should represent the amount invested in the company shares by its shareholders, and (2) individual taxpayers should not be allowed to use the LCGE to strip corporate surpluses by entering into non-arm's-length transactions or to obtain excess PUC tax-free. The Tax Court found that the taxpayer, by misusing the PUC averaging mechanism to artificially inflate the PUC of his shares without any new capital contribution, achieved a result (the extraction of corporate surplus indirectly using tax basis created by an LCGE-sheltered capital gain) that section 84.1 was intended to prevent and defeated the provision's underlying rationale. This led the Tax Court to conclude that GAAR applied.[98] However, the Tax Court's judgment was subsequently set aside by the Federal Court of Appeal, which noted that no corporate retained earnings had in fact been distributed. Thus, while the increased PUC created the potential for a tax-free strip of corporate retained earnings, that potential had not, to date, been realized. Given that the result that section 84.1 was intended to prevent had not occurred, the court found that section 84.1 had not, to date, been misused or abused.[99]

However, the court also noted that its judgment was without prejudice to the entitlement of the minister to reassess the taxpayer in the event that the taxpayer does eventually remove the subject corporation's corporate surplus as a tax-free return of capital.[100]

- *Pomerleau v. Canada*:[101] An individual held class A and G shares of a subject corporation. The individual's ACB in the class G shares was soft ACB that arose from a historical LCGE claim by the individual and his family members, whereas his ACB in the class A shares was hard ACB created by a tax-paid capital gain triggered under subsection 69(1) in the hands of a family member upon the gifting of the class A shares to him. The subject corporation then redeemed the class G shares for their full redemption value (which essentially is an amount equal to the soft ACB). Since the class G shares had nominal PUC, their redemption resulted in a subsection 84(3) deemed dividend (equal to the soft ACB) and a corresponding capital loss due to the reduction in paragraph (j) of the definition of "proceeds of disposition" in section 54. This loss was deemed nil by paragraph 40(3.6)(a), but the denied loss was added to the individual's ACB in respect of his class A shares of the subject corporation by the operation of paragraphs 40(3.6)(b) and 53(1)(f.2). Since the ACB addition reflected the said deemed capital loss rather than a gain in respect of which the LCGE was claimed, the individual's soft ACB in the class G shares was effectively converted into part of the hard ACB of the class A shares. Then, the individual transferred those class A shares to a non-arm's-length purchaser corporation for shares of the purchaser corporation with PUC equal to the increased ACB of the class A shares transferred. The purchaser corporation shares were subsequently redeemed so that the PUC was returned to the individual free of tax. The result of this series of transactions was that an amount of corporate surplus equal to the soft ACB was received twice by the individual, but the individual was taxed (at the dividend tax rate) only on the first extraction.

  Decision: The Federal Court of Appeal analyzed section 84.1 and concluded that the scope of the object, spirit, and purpose of section 84.1 is greater than the words of the provision, which is to prevent amounts that have not been taxed from being used to remove corporate surplus on a tax-free basis. In analyzing the provision, a court must look beyond the ACB of the subject shares (or substituted shares) and ask whether it is made up of amounts on which tax has not been paid. Since the series of transactions resulted in the tax-free extraction of surplus using an ACB that was connected to an amount not previously subject to tax, the object, spirit, and purpose of section 84.1 were frustrated, and GAAR was applicable.[102]

As is evident from this sampling of cases, the court interprets the object, spirit, and purpose of section 84.1 broadly when determining whether a taxpayer's circumvention of the provision is subject to GAAR. Therefore, any surplus-stripping planning involving the sale of shares to a non-arm's-length purchaser corporation that results in an extraction of corporate surplus using tax basis that was created directly or indirectly with the LCGE or V-day increments is likely to be challenged under GAAR.

On the other hand, similar surplus-stripping transactions involving a sale to an arm's-length purchaser corporation should not attract the application of section 84.1 or GAAR, even if there is a degree of accommodation by the purchaser, as was the case in *Poulin*. That said, the determination of whether a factual arm's-length relationship exists will continue to be difficult in practice in many situations. This may be the case, for example, with "employee buyco" arrangements, in which an Opco funds a Buyco to purchase shares from its shareholder-employees to provide liquidity or an exit. For the shareholder-employees, such an arrangement allows the realization of a capital gain in respect of which the LCGE may potentially be claimable, and is therefore preferable to having the operating company simply repurchase or redeem their shares, which would result in a subsection 84(3) deemed dividend.

However, if Buyco is found not to be dealing at arm's length with the selling shareholder-employee and Buyco is connected with Opco immediately after, then subsection 84.1(1) would apply to cause the seller to have realized a dividend instead of a capital gain. At the 2012 CTF annual tax conference round table, the CRA expressed its view that Buyco and the selling shareholder-employee are generally not dealing at arm's length with each other given the degree of accommodation and the parties' lack of separate interest.[103] However, as illustrated in the cases of *Poulin* and *Turgeon*, it is certainly possible for a shareholder-employee and a Buyco to have a factual arm's-length relationship, especially where there is bona fide commercial rationale for the Buyco and the shareholder-employee to enter into the transaction.[104]

An interesting comment from the Federal Court of Appeal in its judgment in *Pomerleau* was its observation that section 84.1 could have a punitive effect in the context of an intergenerational transfer of a family business, since it could make selling the business to the next generation more expensive from a tax perspective than selling to someone outside the family—

> for instance, where a corporation is sold by way of a share transfer at their FMV to a corporation controlled by the family member inheriting the business. In such a case, the transferor would pay tax on a deemed dividend whereas he or she would have realized a capital gain had the transferee been at arm's length.
>
> This particular situation, if it arose in the context of an analysis under the GAAR, could possibly give rise to a construction of section 84.1 which would prevent this punitive result. However, this is not the situation before us.[105]

This comment was obiter and has no binding or precedential effect. However, obiter from the Federal Court of Appeal could be persuasive in future cases in which a court must determine whether the circumvention of section 84.1 should escape GAAR when a transaction was done to facilitate a bona fide intergenerational transfer. An argument can certainly be made along those lines. Nevertheless, it may be overly optimistic to rely on this obiter at this point, because we believe that it may be difficult to find an intent to exclude intergenerational transfers when section 84.1 is interpreted in a contextual or purposive manner. The silver lining is that such comments from the judiciary could potentially nudge the government to consider modifying section 84.1 so that intergenerational transfers are exempted from its scope. The challenge in drafting such an exception to section 84.1 would be in distinguishing between a true intergenerational transfer and a transfer the main purpose of which is to strip surplus with the LCGE.

Surplus Stripping with Hard ACB

Given that the jurisprudence strongly indicates that (1) the Act does not contain a general policy against surplus stripping and (2) the object, spirit, and purpose of section 84.1 are to prevent corporate stripping of untaxed amounts (that is, the LCGE and V-day increment), surplus stripping with hard ACB should not attract the application of GAAR since the hard ACB would have previously been subject to tax. Although the creation of hard ACB is a taxable transaction, the significant gap between the effective tax rate on a dividend (with a top rate of between 28.33 and 47.33 percent, depending on the province or territory and whether the dividend is eligible) and the effective tax rate on a capital gain (with a top rate of between 22.5 and 27 percent, depending on the province or territory) provides a strong incentive to undertake this type of planning when there is a need for a significant repatriation of corporate surplus to an individual or trust shareholder. For smaller distributions to individual shareholders with little to no income, remuneration by dividend is typically preferable to capital gains treatment because of the mechanics of the dividend tax credit. For example, in British Columbia, $51,809 in eligible dividends can be received tax-free by an individual with no other income in 2018.

Post mortem pipeline planning for a deceased shareholder of a private corporation is a commonly practised form of hard ACB surplus stripping. Upon the shareholder's death, shares of the private corporation (Opco) are subject to a deemed disposition at FMV unless they are transferred to the shareholder's spouse or common-law partner or vested indefeasibly in a spousal or common-law partner trust.[106] To the extent that the LCGE has not been claimed either on the terminal capital gain or previously, the estate would hold the Opco shares with hard ACB equal to their FMV. To create the pipeline, the estate would then transfer these shares to a non-arm's-length purchaser corporation in exchange for either a promissory note or high-PUC shares. Subsequently, the purchaser corporation would repay the promissory note or return the PUC on a tax-free basis to the estate or the heir using funds from the Opco (either by way of an intercorporate dividend—subject to subsection 55(2)—or through a merger of the two corporations). Section 84.1 does not apply to the extent that all of the estate's ACB in the Opco shares represents hard ACB immediately before the transaction. The net result is that the surplus of Opco is stripped at capital gains rates rather than at dividend tax rates.

Similar planning can be deployed in an inter vivos context. For example, an individual or trust shareholder who holds shares in a Canadian private corporation (Opco) with nominal ACB and PUC may create hard ACB and strip corporate surplus at capital gains rates by undertaking the following series of steps:

1) The shareholder and Opco enter into an internal share exchange whereby the shareholder's existing Opco shares are exchanged for new Opco shares. The shareholder and Opco jointly elect subsection 85(1) so that the shareholder elects to realize a capital gain of a desired amount. The shareholder either pays tax on the capital gain or shelters the capital gain with other capital losses. Either way, the shareholder now has hard ACB in its new Opco shares equal to the elected amount.
2) The shareholder transfers the new Opco shares to a non-arm's-length purchaser corporation, Holdco, in exchange for a promissory note with a face amount equal to the transferred Opco shares' hard ACB. Section 84.1 does not apply because the promissory note does not exceed the greater of the transferred shares' PUC and hard ACB. Alternatively, instead of issuing a promissory note, Holdco could issue share consideration with PUC equal to the transferred Opco shares' hard ACB.
3) Holdco repays the note (or returns PUC) with funds from Opco, which Opco transfers to Holdco by way of either intercorporate dividends (subject to subsection 55(2)) or an amalgamation with Holdco.

The plan described above uses an internal share exchange to create the hard ACB, but similar results can be achieved through other means. In *Pomerleau*, the taxpayer stripped surplus using shares with both soft ACB and hard ACB. The hard ACB was created when a family member of the taxpayer gifted shares to the taxpayer as part of the same series of transactions (which would have triggered capital gains in the family member's hands). GAAR was applied to the portion of the strip relating to the soft ACB, but the Crown did not challenge the strip using the hard ACB created by the series of transactions.[107]

An additional benefit of a hard ACB pipeline after 2017 is that the TOSI regime in section 120.4 does not apply to capital gains, provided that (1) the gain arises from the disposition of qualified farm or fishing property or QSBC shares, and (2) the gain is not recharacterized as a dividend under subsection 120.4(4) or (5).[108] Dividend recharacterization occurs only where the shareholder or the beneficiary who realizes the capital gain has not attained the age of 17 before the year, and the disposition is of unlisted shares to a non-arm's-length purchaser.[109] Therefore, a pipeline transaction that triggers a capital gain in the hands of adults will avoid the application of TOSI provided that the shares are QSBC shares at the time.

In *Gwartz v. Queen*,[110] a family trust disposed of shares of a private corporation to a family member, triggering capital gains that were distributed to various beneficiaries including minor individuals. This disposition created hard ACB that was then used in a pipeline transaction to strip corporate surplus. The transactions occurred prior to the enactment of subsections 120.4(4) and (5), so the capital gains allocated to the minor beneficiaries were taxed at their marginal tax rates. The primary issue before the court was whether the transaction frustrated the kiddie tax provisions at that time, and the case was decided in the taxpayer's favour. Hogan J stated:

> The fact that specific anti-avoidance provisions were enacted long before the introduction of section 120.4 leads me to infer that Parliament was well aware of the fact that taxpayers could arrange to distribute corporate surpluses in the form of taxable dividends or of capital gains subject to the application of those specific anti-avoidance provisions. The fact that those provisions were not amended and that a specific rule was not included in section 120.4 to curtail well-known techniques leads me to infer that Parliament preferred simplicity over complexity when it enacted section 120.4.[111]

Similar reasoning can be applied to the TOSI rules today. Parliament specifically excluded capital gains on QSBC shares from TOSI for adults, while being clearly aware of corporate surplus-stripping transactions. (The government announced its proposal to amend the TOSI rules at the same time as it announced the subsequently abandoned proposals to eliminate surplus stripping.) Also, although the Crown did not challenge the surplus-stripping premise behind the series of transactions in *Gwartz*, the court still noted that surplus stripping is not abusive tax avoidance.[112]

Besides assessing the capital gains rate, pipeline planning may also be useful in an emigration scenario. A Canadian departing Canada is subject to a deemed disposition of most property at FMV under paragraph 128.1(4)(b). If the person holds shares in a Canadian private corporation, the person would be required to recognize all capital gains accrued on those shares up to the date of emigration. However, since PUC of the shares remain low, post-emigration repatriation from Canada would attract part XIII withholding tax even though it may relate to the same value that was already taxed as a capital gain on emigration (section 119 may provide relief, but only in respect of shares that are taxable Canadian property). To avoid this result, the departing individual may trigger the accrued gain prior to departure by entering into a pipeline transaction similar to that described above. A repayment of a promissory note or a return of PUC post-emigration does not attract part XIII tax. Also, subsection 212.1(1) would not apply as long as the transaction takes place before the individual departs Canada, since the person disposing of subject shares is not a non-resident of Canada at the time.

Where a hard ACB pipeline transaction may go off the rails, in either a post mortem or an inter vivos context, is in the potential application of subsection 84(2). Subsection 84(2) deems a corporate distribution to be a dividend to the extent that it exceeds PUC if corporate funds or property is "distributed or otherwise appropriated in any manner whatever to or for the benefit of the shareholders . . . on the winding-up, discontinuance or reorganization of its business." The leading authority on this matter is the Federal Court of Appeal decision in *MacDonald v. The Queen*,[113] which applied a broad textual, contextual, and purposive interpretation to subsection 84(2) and the words "in any manner whatever." Essentially, a court will ignore the legal character of the transactions and will "look to (i) who initiated the winding-up, discontinuance or reorganization of the business; (ii) who received the funds or property of the corporation at the end of that winding-up, discontinuance or reorganization; and (iii) the circumstances in which the purported distributions took place."[114]

Since the eventual repayment of the promissory note (or the return of PUC) by the purchaser corporation is funded by Opco's funds or property, this repayment or return of PUC is likely considered to be a distribution or appropriation by Opco "in any manner whatever" under the approach adopted by the Federal Court of Appeal. If this distribution occurred on the winding up, discontinuance, or reorganization of Opco's business, then subsection 84(2) would apply to deem the otherwise tax-free repayment or return of PUC to be a taxable dividend to the extent that it exceeds the PUC of Opco's shares, even though the equivalent value has already been taxed previously as a capital gain on the creation of the hard ACB. Therefore, a pipeline transaction should be structured to avoid having the ultimate strip be connected to a winding up, discontinuance, or reorganization of the underlying business. This topic has been discussed in detail in many other papers and articles and will not be addressed here.[115] Also, as discussed earlier, the July 18, 2017 amendment proposed to section 84.1 would have shut down hard ACB pipelines, but this amendment was subsequently abandoned by the government. There is no telling when the government may make another attempt to attack these types of arrangements, but any legislative change is unlikely to be retroactive.

Surplus Stripping with Capital Gains Triggered Inside a Corporation

The tax savings of a hard ACB pipeline can also be achieved through capital gains triggered inside a private corporation. A private corporation that realizes a capital gain is able to pay out the 50 percent non-taxable portion of the capital gain to a shareholder tax-free as a capital dividend under subsection 83(2). Although the taxable portion of the capital gain will eventually have to be distributed to the shareholder as a non-eligible dividend (per the new non-eligible refundable dividend tax on hand regime effective for taxation years beginning after 2018), the overall tax rate on a fully distributed basis generally approximates the tax rate applicable to capital gains for an individual.

To illustrate, assume that a BC-resident individual, Ms. A, is in the top tax bracket and has shares in an Opco with $5 million FMV, $0 ACB, and $0 PUC. Opco is a Canadian-controlled private corporation that operates a successful business and has internally generated goodwill valued at $4 million. Ms. A needs $1,000,000 for a home purchase. Since the top effective tax rate for dividends in British Columbia is either 34.2 percent or 43.7 percent, depending on whether the dividend is an eligible dividend, Opco will have to pay a dividend of between $1,519,757 and $1,776,199 for Ms. A to have $1,000,000 of after-tax cash. Alternatively, the following series of transactions may be considered:

1) Opco incorporates an internal partnership or corporate subsidiary ("Subsidiary").
2) Opco transfers its entire business to Subsidiary under either subsection 97(2) or 85(1), depending on whether Subsidiary is a partnership or a corporation. The parties jointly elect to recognize a $1,378,930 capital gain on the internal goodwill (a class 14.1 asset). Opco adds the non-taxable portion of the capital gain, that is, $689,465, to its CDA. On the taxable portion, Opco is liable for corporate tax of $137,893 after the dividend refund (subsection 129(1) provides for a full refund of the non-eligible refundable dividend tax on hand as a result of the non-eligible dividend payment).[116]
3) Subsidiary is wound up in a tax-deferred manner, under subsection 98(3), 98(5), or 88(1), with the result that the assets are returned to Opco.
4) Opco declares and pays two dividends: a $689,465 dividend in respect of which a subsection 83(2) capital dividend election is made, and a $551,572 non-eligible taxable dividend. Ms. A pays personal tax of $241,037 on the non-eligible taxable dividend, and ends up with $1,000,000 after-tax cash available to purchase the home. As an added benefit, Opco now has undepreciated capital cost in a class 14.1 asset equal to $689,465, on which it could claim capital cost allowance deductions going forward.[117]

The overall tax burden of this series of transactions is $378,930, which is significantly lower than a burden of between $519,757 and $776,199 that would have resulted had no planning been undertaken. It may also be possible to achieve a similar result by triggering a corporate-level capital gain under subsection 55(2). This latter method will be discussed in the next section of this paper.

An additional benefit of surplus stripping by way of a corporate-level capital gain compared with a traditional pipeline is that the former may avoid the subsection 84(2) issue. As illustrated in the example above, the entire distribution received by the individual shareholder was two dividends. Even though one of the dividends is treated as a tax-free capital dividend under subsection 83(2), that election does not alter the fact that the distribution is a dividend. Since the entire corporate distribution to the shareholder is already in the form of dividends, there is no further amount for subsection 84(2) to deem as a dividend. This may be an important consideration when choosing the appropriate planning option for a surplus strip.

Section 246.1, which was proposed by the government on July 18, 2017, would likely have prevented this type of surplus-stripping transaction, but it was subsequently abandoned. As we noted previously with respect to hard ACB pipelines, there may be only a short window of time before this type of planning is eliminated or at least curtailed.

Capital-Gains-Stripping SAAR—Subsection 55(2)

Numerous papers have been written about the recent changes to subsection 55(2).[118] We will not repeat such commentary but instead provide an overview and analysis of subsection 55(2) as a SAAR. In 2015, subsection 55(2) underwent significant changes, but the amendments did not fundamentally alter the purpose test. That test, outlined below, forms a critical component of this provision.

Subsection 55(2) is designed to combat certain types of capital gains stripping. "Capital gains stripping" generally refers to the conversion of taxable capital gains into tax-free intercorporate dividends.[119] Where subsection 55(2) applies, a dividend received by a corporation is recharacterized as a capital gain.

Subsection 55(2.1) outlines the situations where the provision applies. We focus here on the language in paragraph (b), or what are known as the purpose test and the results test. Subsection 55(2) applies to a taxable dividend received by a Canadian-resident corporation ("the dividend recipient") as part of a transaction or event or a series of transactions or events if, in part,

> (b) it is the case that
>
> (i) *one of the purposes* of the payment or receipt of the dividend (or, in the case of a dividend under subsection 84(3), *one of the results of which*) is to effect a significant reduction in the portion of the capital gain that, but for the dividend, would have been realized on a disposition at fair market value of any share of capital stock immediately before the dividend, or
>
> (ii) the dividend (other than a dividend that is received on a redemption, acquisition or cancellation of a share, by the corporation that issued the share, to which subsection 84(2) or (3) applies) is received on a share that is held as capital property by the dividend recipient and *one of the purposes* of the payment or receipt of the dividend is to effect
>
> (A) a significant reduction in the fair market value of any share, or
>
> (B) a significant increase in the cost of property, such that the amount that is the total of the cost amounts of all properties of the dividend recipient immediately after the dividend is significantly greater than the amount that is the total of the cost amounts of all properties of the dividend recipient immediately before the dividend.[120]

The amendments[121] added two new purpose tests in subparagraph (ii). The 2015 amendments[122] were added primarily to overrule the result in *D & D Livestock Ltd. v. The Queen*.[123] However, the amendments went far beyond simply addressing the mischief from *D & D*.[124]

Purpose Tests

There is some debate whether the purpose tests in subsection 55(2) are evaluated on an objective or a subjective standard. At the 2017 CTF round table, the CRA provided its views on the purpose test in subsection 55(2). The CRA reiterated its 2015 position that the correct test to determine purpose in the context of this provision is the test outlined in *Ludco*.[125]

Quoting *Ludco*,[126] the CRA said that "where purpose or intention behind actions is to be ascertained, courts should objectively determine the nature of the purpose, guided by both subjective and objective manifestations of purpose."[127] The CRA also quoted *Symes*,[128] which stated that courts will "look for objective manifestations of purpose, and purpose is ultimately a question of fact to be decided with due regard for all of the circumstances."[129]

When asked about the competing view of the purpose test from *Placer*,[130] which dealt directly with the prior version of subsection 55(2), the CRA said that the court in *Placer* did not contradict *Ludco*. Interestingly, the CRA said that *Placer* resulted from the Crown's argument, based on Australian case law, that the purpose test in subsection 55(2) was to be evaluated only on an objective standard.

Since the CRA's view is that *Ludco* governs, it stated that "the Crown and the CRA will ensure that all relevant facts and evidence are brought to the court to help it to establish the objective manifestations of purpose and the credibility of the testimony of the taxpayers."[131]

In addition, the CRA commented on paying a dividend for the purpose of maintaining QSBC share status. The CRA's view is that whether a dividend can be viewed as having only the purpose of maintaining QSBC share status, and therefore not one of the purposes in paragraph 55(2.1)(b), must be made in light of all the relevant facts and circumstances.

The CRA then went on to state that where the dividend is paid with assets other than surplus assets, it may be a sign that the dividend payment could have a purpose referred to in paragraph 55(2.1)(b). Further, if the removal of the surplus assets from the corporation through the payment of a dividend is made in contemplation of a possible share disposition, it may also indicate that the purpose test is met. The CRA also questioned why the payment of a dividend to remove surplus assets would not be covered by safe income.

At a meeting of the Tax Executives Institute in 2015, the CRA outlined the criteria to consider when evaluating the purpose (and motivation behind the purpose) in the context of subsection 55(2) when paying a dividend: "(i) What does the taxpayer intend to accomplish with a reduction in value or increase in cost?

(ii) How would such reduction in value or increase in cost be beneficial to the taxpayer? (iii) What actions did the taxpayer take in connection with the reduction in value or increase in cost?"[132]

The CRA's comments warrant a closer look at the case law. The leading case on the purpose test under the previous version of subsection 55(2) is *Placer*. The issue in the case was whether one of the purposes of the transactions undertaken by the taxpayer was to cause a significant reduction in the capital gain that, but for the dividend, would have been realized on a sale of the shares at issue at FMV.

In outlining the purpose test, the court said that the principal difference between a subjective and an objective appreciation of the term "purposes" is that the former extends a personal invitation to the taxpayer to testify as to his or her state of mind at the time the transactions were implemented.[133]

The court then outlined how the subjective test operates:

> First, the onus or burden rests on the taxpayer to establish the inapplicability of subsection 55(2) of the Act. Second, mere denial (without explanation or elaboration) by a taxpayer that his or her purpose was to effect a significant reduction in capital gain is not by itself a sufficient basis on which to discharge that burden. Third, it is not necessary that the taxpayer adduce corroborative or additional evidence which shows or tends to show that his or her testimony is true.[134]

The court said that, practically speaking, it is proper for the minister to infer that a taxpayer met the purpose test once it is established that the transaction had the effect of significantly reducing a capital gain. The taxpayer can then rebut that inference by offering an explanation that reveals the purpose of the transaction. The explanation must be neither improbable nor unreasonable. The taxpayer must provide "a persuasive explanation that establishes that *none* of the purposes was to effect a significant reduction in capital gain. It is in this sense that uncorroborated but credible testimony can be sufficient proof of taxpayer intention."[135]

Placer also provided an explanation from a statutory interpretation perspective as to why there is a subjective analysis in the purpose test and an objective analysis in the results test:

> No one can doubt that the term "result" invites an objective appreciation of the factual circumstances. In this context I do not see how one can argue persuasively that both the words "purpose" and "result" are to be interpreted as embracing an objective criterion. In my opinion, it is clear that the use of the term "purpose" in one context and "result" in another requires that a different meaning be attributed to each that is consistent with their use and context within subsection 55(2).[136]

Similarly, the court in *C.P.L. Holdings Ltd. v. The Queen*[137] acknowledged that subsection 55(2) drew a distinction between the terms "purpose" and "result":

> The taxpayer has provided convincing evidence that the purpose of the rollover was to make [the taxpayer] a secured creditor of the corporation. *I do not find that the purpose of the transaction was to reduce the fair market value of the shares, although I agree that it was one of the effects of the transaction.*[138]

In *Meager Creek Holdings Ltd. v. R*,[139] the court endorsed the subjective test from *Placer*[140] and also commented on the respondent's argument that any possible future sale can trigger the application of subsection 55(2):

> I cannot accept Respondent's argument that any possible future sale can suffice to bring subsection 55(2) into play. There must be a series of transactions or events contemplated. To accept Respondent's argument could open the door to the subsection being applied to almost any declaration of inter-corporate dividends.[141]

The only recent case to deal with subsection 55(2) was *101139810 Saskatchewan Ltd.*[142] Although the case dealt with the pre-2015 version of the provision, the Tax Court endorsed the interpretation of the purpose test from *Placer*.

At issue in *101139810 Saskatchewan* was whether subsection 55(2) applied to recharacterize deemed dividends received by the taxpayers on a redemption of shares as a capital gain. The court said that it was clear that the taxpayers had "walked right into a situation" caught by subsection 55(2).

With regard to the purpose test, the court endorsed *Placer*, saying that "it is clear that the 'purpose' test in subsection 55(2) requires a subjective understanding whereas an objective approach is required for the 'results' test."[143]

With regard to the results test, the taxpayer argued that the gains were not significantly reduced when one examined the totality of the capital gains claimed by the ultimate shareholder as well. The court rejected this argument, stating that "it is clear from a plain and ordinary reading of subsection 55(2) that this provision is meant to apply to a corporation and not to an individual shareholder and thus, the capital gains realized by [the shareholder] has no relevance in the analysis."[144]

At issue in *Ludco* was the purpose test under the paragraph 20(1)(c) interest deductibility provision. In the context of that provision, the Supreme Court focused on the reasonable expectation of the taxpayer:

> In the result, the requisite test to determine the purpose for interest deductibility under s. 20(1)(c)(i) is whether, considering all the circumstances, *the taxpayer had a reasonable expectation of income at the time the investment was made*.
>
> Reasonable expectation accords with the language of purpose in the section and provides an objective standard, apart from the taxpayer's subjective intention, which by itself is relevant but not conclusive. It also avoids many of the pitfalls of the other tests advanced and furthers the policy objective

> of the interest deductibility provision aimed at capital accumulation and investment.[145]

Framing the test in this manner for paragraph 20(1)(c) accords with the language of that provision. Not only does the paragraph contain a purpose test, it also ends with the qualifier "or a reasonable amount in respect thereof, whichever is the lesser." Therefore, it is clear that the *Ludco* purpose test was interpreted in the context of the interest deductibility paragraph. The specific wording and context of that provision led to the court's comments about objectivity.

Similarly, in *Symes v. Canada*,[146] the court analyzed the purpose test in the context of the deductibility of a certain expense pursuant to sections 9 and 18. In that case, the expense had to be incurred for the purpose of gaining or producing income from the business in order to be deductible. The court's framing of the purpose test in sections 9 and 18 in *Symes* was driven by the analysis of personal versus business expenses. In advocating for an objective approach in this context, the court said:

> In other words, there are a great many expenses which are never alleged to be "personal expenses" at all. With respect to these, *the approach is ordinarily much more objective*, and the analysis is generally confined to s. 9 of the *Act*. It is only when an expense is alleged to be a "personal expense" that one must go further and ask what is meant by the concept of "business need."[147]

There is recent authority that a purpose test must be analyzed in the context of the provision in which it is found. In *Gerbro Holdings Co. v. Canada*,[148] the provision at issue used a "one of the main reasons" test. The Tax Court framed the section 94.1 inquiry as an evaluation of whether one of the taxpayer's main reasons for investing in the funds at issue was to pay less tax than would have been payable under part I of the Act if the portfolio investment had been held directly.[149]

The court commented on the differing legislative language in various SAARs and provided guidance on how the courts should apply such tests:

> The Act is replete with specific anti-avoidance provisions, and the criteria for their application can be more or less difficult to satisfy depending on the wording used. Clearly a "one of the reasons" test is less difficult to meet than a "one of the *main* reasons" or a "one of the *main* purposes" test.[150]
>
> The line between a main reason and a secondary reason is difficult to draw, especially if the reason is undeclared, since it must then be inferred from the relevant circumstances that a particular reason could perhaps be elevated to "main reason" status. Once it has been determined what the requisite benefit is for the purpose of the Motive Test, the determination of whether tax deferral was one of Gerbro's main reasons is entirely factual.[151]

At issue in *Groupe Honco Inc.*[152] was the capital dividend anti-avoidance provision in subsection 83(2.1). The provision employs a "one of the main purposes" test, and the court noted that simply providing two or three credible "main purposes" does not prevent a finding that an undisclosed, tax-motivated purpose is present:

> The phrase "one of the main purposes" is unambiguous and implies that a taxpayer may have more than one main motive in acquiring shares. With respect, it seems to me that counsel for the appellants is ignoring the purpose and spirit of subsection 83(2.1) of the Act in attempting to persuade us that the word "main" does not leave open the possibility of having two or three motivations that explain a transaction or series of transactions. According to this interpretation, a taxpayer would merely have to present two or three plausible and credible main purposes for a transaction or series of transactions to shield himself or herself from the anti-avoidance rule. . . . The fact that the taxpayer has provided reasons for getting involved in a transaction or series of transactions in no way excludes a finding that one of the main purposes—one generally not disclosed by the taxpayer—is to obtain a tax advantage.[153]

It is therefore clear that a purpose test must be analyzed in the context of the provision where it is found. On the basis of the case law examined above, the test from *Placer* should still apply to amended subsection 55(2), for a number of reasons.

First, the amendments did not change the overall purpose of the provision. The revisions simply expanded the situations in which an intercorporate dividend could be recharacterized as a capital gain.

Second, the amendments preserved the use of both "purpose" and "result." The comments in *Placer* still apply, and as a matter of interpretation, when both "purpose" and "result" are used in the same subsection, the first implies a subjective test and the second an objective one.

Third, as has been previously pointed out, an objective test cannot be supported by the purpose and text of subsection 55(2), which is aimed at preventing capital gains stripping. An objective test would substitute a reasonable person's intention for the purpose test, which would likely result in every dividend being caught by the purpose test, since all taxpayers desire to reduce their tax burden.[154]

Fourth, the interpretation of the purpose tests from *Ludco* and *Symes* cannot be applied in the context of subsection 55(2). In *Ludco*, the court emphasized the "reasonable expectation" aspect of the provision. When the issue is framed in that light, it is easy to see how an objective element was inserted into the purpose test. The same can be said about *Symes*, where the court was attempting to differentiate between personal and business expenses. Again, an objective element in that context is the only way to reasonably make such determination.

In advocating for an objective-subjective hybrid test, the CRA appears to be confusing statutory interpretation with evidentiary issues. It seems clear that the interpretation in *Placer* should continue to apply to subsection 55(2): the purpose tests are subjective. Whether or not a subjective explanation by a taxpayer is a credible one is a completely separate issue.

If the Crown has documentary or other evidence that would call the taxpayer's explanation into question, the issue then becomes one of credibility. However, that does not change the subjective nature, based on principles of statutory interpretation, of the purpose test in subsection 55(2). When a taxpayer is not credible, the court will reject the taxpayer's subjective explanation and instead rely on the minister's assumptions of fact.

Related-Party Butterfly Exception

Generally, paragraph 55(3)(a) permits a butterfly transaction (and excludes the application of subsection 55(2)) where, as part of the series of transactions that includes the receipt of the dividend to which subsection 84(2) or (3) applies,

1) either there is no transfer of property to an unrelated person or, if property is transferred to an unrelated person, that property is not shares of the dividend recipient or the dividend payer[155] and is transferred for FMV proceeds; and
2) there is no significant increase in interest in any corporation by an unrelated person otherwise than as a result of a disposition of shares (other than shares of the dividend recipient or dividend payer[156]) for proceeds of disposition not less than FMV.[157]

Since a typical related-party butterfly includes share redemptions (and/or purchases for cancellation), subsection 84(3) will deem the corporation to have paid a dividend equal to the amount by which the redemption price exceeds the PUC of the share. But for paragraph 55(3)(a), subsection 55(2) would apply to recharacterize the dividend, thus deeming it not to be a dividend, and the subsection 112(1) dividend deduction would therefore not apply.

The CRA has said that it would apply GAAR to a series of transactions that rely on paragraph 55(3)(a) to artificially create or unduly preserve ACB.[158]

A recent situation that the CRA commented on was a reorganization that relied on the paragraph 55(3)(a) exemption.[159] In the example, Parentco owned 100 percent of Holdco, which owned 100 percent of Opco. The corporate group intended to transfer one of Opco's existing business lines to Newco, a new subsidiary of Holdco, by way of an internal spinoff reorganization that fell under paragraph 55(3)(a).

Two alternative transactions were outlined in the CRA's technical interpretation:

Alternative 1:

1) Holdco forms Newco.
2) Holdco transfers shares of Opco (with a value equal to the value of the Opco assets transferred to Newco in step 3) to Newco in exchange for shares of Newco on a tax deferred basis pursuant to subsection 85(1).
3) Opco transfers the relevant assets to Newco in exchange for preferred shares of Newco on a tax deferred basis pursuant to subsection 85(1).
4) Newco redeems the shares that it issued to Opco in step 3 and issues a note to Opco (the "Newco note") as a redemption payment for the redeemed shares.
5) Opco redeems the shares that Newco received in step 2, and issues a note to Newco (the "Opco note") as a redemption payment for the redeemed shares.
6) The Newco note and the Opco note issued in steps 4 and 5 are offset and cancelled.

Alternative 2:

1) Holdco forms Newco.
2) Opco transfers the relevant assets to Newco in exchange for preferred shares of Newco on a tax deferred basis pursuant to subsection 85(1).
3) Newco redeems the shares transferred to Opco in step 2 in exchange for a note (the "Newco note").
4) Opco redeems a portion of its shares (with a value equal to the value of the Opco assets transferred to Newco in step 2) and transfers the Newco note to Holdco as a redemption payment.
5) Holdco transfers the Newco note to Newco in exchange for shares or as a capital contribution (thereby cancelling the note).[160]

The CRA did not take issue with alternative 1 because it said that Holdco did not seek to increase the ACB of property that it held. The CRA noted that the aggregate ACB of the shares of Newco and Opco that are owned by Holdco after the transfer at step 2 was equal to the aggregate ACB of shares of Opco that were owned by Holdco before the transfer.

The CRA said that when Newco received the Opco note on the redemption of shares held in Opco, the receipt of such note may have resulted in an increase in the ACB of property held by Newco. In addition, Opco received the Newco note on the redemption of shares held in Newco, and the receipt of such note may have resulted in an increase in the ACB of property held by Opco. However, because both notes were offset and cancelled, the CRA did not find the transactions offensive since they eliminated any increase in the ACB of property held by either Newco or Opco.

With regard to alternative 2, since the amount of the promissory note in step 4 was higher than the ACB of the redeemed shares, and the amount of the promissory note in step 5 increased Holdco's ACB of the shares of Newco, the CRA viewed these transactions as having artificially increased the ACB in the hands of Holdco.

The CRA indicated that it would seek to apply GAAR on Holdco's reliance on paragraph 55(3)(a). It specifically stated that the Department of Finance's technical notes accompanying the July 31, 2015 legislative proposals to paragraph 55(3)(a) support its view that paragraph 55(3)(a) "is restricted in its application to subsection 84(3) dividends in order to facilitate *bona fide* internal corporate reorganizations and it is not intended to provide taxpayers with a tool to create or multiply ACB as in the present case."[161]

In addition to applying GAAR, the CRA said that it would consider arguing that the transactions were part of a series that includes an eventual disposition of shares of Newco to a person unrelated to either Opco or Newco, such that the paragraph 55(3)(a) exemption would not apply.

In a later interpretation, the CRA was asked to confirm whether a subsequent transaction to "use" the note or other property received as consideration for a share redemption, such as the transfer of the note to Newco in the example above, was a necessary trigger for the application of GAAR. In other words, could the receipt of a note or other property with ACB higher than the ACB of the redeemed shares in itself cause GAAR to apply?

The CRA said that where there exists a purpose to increase the cost amount of property of the dividend recipient, GAAR would be triggered. It was irrelevant whether such cost amount had been used in the series of transactions that includes the dividend. As support for its view of the abuse, the CRA stated that the scheme of subsection 55(2) "is to prevent, amongst other things, the creation or multiplication of ACB with the use of tax-free inter-corporate dividends."[162]

We believe it is possible to argue that the overall purpose of subsection 55(2) has not changed as a result of the amendments (that is, to prevent the conversion of taxable capital gains into tax-free intercorporate dividends). The amendments directed at paragraph 55(3)(a) simply limit the circumstances in which taxpayers can take advantage of a related-party butterfly transaction. The anti-avoidance rule in subsection 55(4) makes it clear that abusing the relatedness of various parties would be contrary to the purpose of the paragraph 55(3)(a) exemption.

As stated in the first section of this paper, subsection 55(2) and its associated rules are SAAR provisions that are drafted very technically. Where a provision is drafted clearly, the precise and unequivocal words will play a dominant role in its interpretation. Paragraph 55(3)(a) provides a clear exception for share redemptions that meet a very narrow and mechanical set of circumstances. One would think that if a taxpayer has managed to comply with those narrow and precise circumstances, GAAR could not apply because of the common occurrence of redeeming shares with a promissory note higher than the redeemed shares' ACB (or redeeming shares with property with ACB higher than the redeemed shares' ACB).

The point was also made in the first section that where a SAAR (such as subsection 55(2)) is extremely broad, the correct interpretive approach is not to expand the rule's already broad reach. This is precisely what the CRA is doing with its comments.

The Act has a general policy of allowing transfers to occur in a tax-deferred manner within corporate groups, which paragraph 55(3)(a) assists with. Examples include transfers done with rollovers or through intercorporate dividends or intercorporate share redemptions. Share redemptions generally provide less opportunity for ongoing capital gains stripping because the share is eliminated on redemption. Contrast that with a dividend where the share and its corresponding ACB remain outstanding.

It should also be noted that the test for an increase in cost amount (which the CRA claims was abused) is contained in subparagraph 55(2.1)(b)(ii), which explicitly does *not* apply to a share redemption to which subsection 84(3) applies. Therefore, Parliament intended that a subsection 84(3) share redemption is not subject to the cost amount increase test. It is then difficult to understand how reliance on a subsection 84(3) share redemption to increase the cost amount to the dividend recipient is somehow abusive to the scheme in subsection 55(2).

The Department of Finance used broad language in its technical notes to the recent amendments: "[Paragraph 55(3)(a)] is not intended to be used to accommodate the payment or receipt of dividends or transactions or events that seek to increase, manipulate, manufacture or stream cost base."[163] Taken to the extreme, this could mean that GAAR potentially applies to every share redemption where the cost base of any significant assets transferred on the share redemption is not eliminated as part of the series.

Our view is that if the share redemptions occur where nothing is effectively disposed of to an unrelated person as part of the series, Parliament was satisfied that no mischief exists. Redeeming shares with a note or property that has higher ACB than the ACB of the redeemed shares does not change this conclusion. One can argue that the comments in the technical notes were made merely to facilitate the application of GAAR where a share redemption is used to circumvent the ultimate purpose of subsection 55(2), which, as stated earlier, is still to prevent the conversion of taxable capital gains into tax-free intercorporate dividends, not to impede bona fide corporate reorganizations and the everyday movement of corporate property by related persons.

In addition, the comments by the Federal Court of Appeal in *1245989 Alberta Ltd.*, discussed above, further support the argument that the CRA's view of GAAR in this context may not be correct.

"Relatedness" in a Related-Party Butterfly

GAAR should not be a concern when a related-party butterfly is implemented in a manner similar to alternative 1 above. The purpose of the paragraph 55(3)(a) exemption is to allow reorganizations of related corporate groups, that include deemed dividends, to occur on a tax-deferred basis.[164] However, complications may arise when a trust is involved in the structure.

Consider a typical situation where a trust owns all of the common shares of a corporation (Opco), but an individual (B) controls Opco through voting preferred shares. The beneficiaries of the trust are brother and sister (the children of B). The parties want to split the assets of Opco between Opco and a new corporation, Newco, using the related-party butterfly rules. The share structure of Newco will be the same as Opco. In order to implement the butterfly transactions, the parties will undertake transactions similar to the CRA's alternative 1 discussed above. After the splitting of the assets, the trust will transfer certain shares of Opco and/or Newco to the brother and sister.

The redemptions at steps 4 and 5 will result in deemed dividends to Newco and Opco, and these deemed dividends are potentially subject to subsection 55(2) unless paragraph 55(3)(a) applies. The requirements for paragraph 55(3)(a) are outlined earlier in the paper. Here, the dividend recipients are Newco and Opco, and as part of the series the trust, the brother, and the sister would have acquired an interest or received a distribution of property that falls into one of the triggering events in paragraph 55(3)(a) if any of them is an unrelated person. "Unrelated person" has a specific meaning in the context of paragraph 55(3)(a) and means a person to whom the dividend recipient is not related or a partnership any member of which is not related to the dividend recipient.[165]

Section 251 sets out the rules for establishing whether parties are related. For example, a person who controls a corporation is related to it, as are any persons related to the person who has control.[166] Consequently, B is related to Opco and Newco because he has control.[167] Any person related to B will also be related to Opco and Newco.

Additional rules and modifications for relatedness are provided in paragraph 55(5)(e). Overall, the paragraph 55(3)(a) related-party butterfly exemption is subject to the anti-avoidance provision in subsection 55(4), which applies "where it can reasonably be considered that one of the main purposes of one or more transactions or events was to cause 2 or more persons to be related to each other or to cause a corporation to control another corporation."

Subparagraph 55(5)(e)(i) states that for the purposes of section 55, brothers and sisters are deemed to be dealing with each other at arm's length and not to be related. This deeming provision is also relevant in determining the relationship between other persons who might otherwise have been related because of the relationship between siblings. Paragraph 55(5)(e) also contains deeming-related rules with respect to trusts in the context of section 55, and generally deems a person to be related to a trust where he or she is related to every beneficiary who is or may be entitled to share in the income or capital of the trust.

Therefore, B's relationship with each beneficiary of the trust must be examined. The legislation requires an examination of the relatedness to the beneficiaries rather than the trustees of a trust.[168] Because the beneficiaries are B's children, B is deemed to be related to the trust since he is related to each beneficiary.[169] Opco and Newco are also related to the trust since they are deemed to be related to each beneficiary through their relationship to B, who controls and is related to both corporations.[170]

Since B is required to be related to each beneficiary of the trust, the trust deed must be carefully examined to ensure that all beneficiaries are accounted for. The CRA applies a broad meaning to the term "beneficiary" in a related-party butterfly involving a trust. It has stated:

> The CRA will apply the broad meaning of beneficiary adopted by the Federal Court of Appeal in the *Queen v. Propep Inc.* (2009 CAF 274) for the purpose of subparagraph 55(5)(e)(ii). Therefore, the CRA will take into account for that purpose, the definition of "beneficially interested" in subsection 248(25). To determine whether a person is a "beneficiary" or has a "right as a beneficiary" in a particular situation requires the analysis of the common law or the civil law, as the case may be.[171]

Assuming that the brother and sister are the only beneficiaries of the trust, the trust should not be an unrelated person. What about the brother and sister? They are also not unrelated to the dividend recipients because both of them are children of and thus related to B, and B is related to both Opco and Newco. The brother and sister are thus related to both Opco and Newco, the dividend recipients.[172] Therefore, the reorganization should qualify under paragraph 55(3)(a) provided that the trust does not gain control of Opco or Newco as part of the series. This could occur, for example, if the plan was to redeem all of B's preferred shares (that is, to effectively cash out B) such that the trust gained control. The analysis below may then apply in that situation.

However, what if B's preferred shares in Opco and Newco were non-voting, so that the trust rather than B controlled Opco and Newco? Newco and Opco are corporations controlled by the trust and would for the purposes of section 55 be related to the trust pursuant to subparagraph 55(5)(e)(iii). Since the brother and sister are deemed not to be related to the trust for the purposes of section 55 (that is, because each of them is deemed not to be related to his or her sibling who is the other beneficiary of the trust), they would not be related to Newco or Opco, which are controlled by the trust.[173] Therefore, to the extent that the trust's distributions to the brother or sister are part of the same series of transactions or events as the deemed dividends to Newco and Opco, paragraph 55(3)(a) will not apply and subsection 55(2) will apply to Newco and Opco.

The phrase "series of transactions" has been interpreted quite broadly and includes any related transactions or events completed in contemplation of the series.[174] The courts have said that "in contemplation of" may refer to transactions occurring either before or after a series of transactions:

> Whether the related transaction is completed in contemplation of the common law series requires an assessment of whether the parties to the transaction knew of the common law series, such that it could be said that they took it into account when deciding to complete the transaction. If so, the transaction can be said to be completed in contemplation of the common law series.[175]

It is therefore important to ensure that a distribution of property to an unrelated person is not contemplated at the time of planning or implementing the related-party butterfly transactions. The safest avenue may be to avoid any distribution until the years become statute-barred. However, waiting three years for a trust distribution may not be feasible in many instances. In those cases, taxpayers will have to rely on evidence to demonstrate that a subsequent distribution to an unrelated party was not contemplated as part of the original series.

Capital-Gains-Stripping Planning

Prior to the 2015 amendments to subsection 55(2), the CRA commented on transactions where taxpayers intentionally triggered subsection 55(2). Previously, the CRA had stated that it would seek to apply GAAR in such situations, including in cases where a taxpayer did not deduct safe income on hand (by not making the designation under paragraph 55(5)(f)) from a taxable dividend self-assessed as a capital gain under subsection 55(2).[176]

At the 2015 CTF annual conference, however, the CRA changed its position, stating that "the GAAR Committee was of the view that it would be unlikely that the GAAR could be successfully applied to the Transactions given the current state of the jurisprudence."[177] These concerns were then addressed by amendments to ensure that paragraph 55(5)(f) automatically applied. Therefore, a taxpayer can no longer choose not to utilize safe income on hand when intentionally triggering subsection 55(2).

Reducing or isolating safe income, so that paragraph 55(5)(f) does not apply, can be achieved by dropping funds into a new subsidiary with no safe income and then paying a dividend back up. Alternatively, it can be achieved by increasing the stated capital on a class of shares and triggering a subsection 84(1) deemed dividend.[178]

Despite the various amendments and CRA comments above, methods still remain by which capital gains can be triggered at the corporate level to generate CDA. These were addressed in the previous section.

The last section of this paper discusses the intentional triggering of a SAAR and whether GAAR could apply. It also addresses GAAR and paying out capital versus non-eligible taxable dividends.

Revocable Trust SAAR: Subsection 75(2)

Subsection 75(2) is an attribution rule that can apply to the settlor of a trust. Where it applies, the income or loss associated with the subject property is attributed back to the settlor.[179]

The provision is intended to ensure that a taxpayer cannot avoid the tax consequences of the use or disposition of property by transferring it to another person in trust while retaining a right of reversion or a right of disposition with respect to the property (or substituted property). As noted by the Federal Court of Appeal in *Sommerer*, "A common example of the application of subsection 75(2) is the settlement of a trust where the settlor is also a beneficiary with an immediate or contingent right to a distribution of the trust property."[180]

Subsection 75(2) does not apply in situations where a person sells property to a trust at FMV (that is, in a bona fide sale transaction).[181]

In *Brent Kern Family Trust v. The Queen*,[182] the Tax Court noted that "the absence of intent and subjectivity is the hallmark of subsection 75(2). . . . [T]hat situational applicability of the subsection is unacceptable because it applies to every situation it describes."[183]

The subsection reads in part as follows:

> 75(2) If a trust, that is resident in Canada and that was created in any manner whatever since 1934, holds property on condition
>
> (a) that it or property substituted therefor may
>
> (i) revert to the person from whom the property or property for which it was substituted was directly or indirectly received (in this subsection referred to as "the person"), or
>
> (ii) pass to persons to be determined by the person at a time subsequent to the creation of the trust, or
>
> (b) that, during the existence of the person, the property shall not be disposed of except with the person's consent or in accordance with the person's direction. . . .

Therefore, the provision applies when property is held by a trust under any of the following conditions:

> (1) the property may revert to the person from whom the property or substituted property was directly or indirectly received . . . ; (2) the property or substituted property may pass to persons to be determined by the person after the creation of the trust; or (3) during the existence of the person, the property cannot be disposed of except with the person's consent or in accordance with the person's direction.[184]

Commentators have noted the potential breadth and ambiguity associated with subsection 75(2). In that manner, it differs from other attribution rules in the Act. The provision can apply to attribute income regardless of whether

> (1) the settlor and the beneficiaries deal at arm's length; (2) the settlor intends to reduce income or benefit another person; or (3) the income or gain is in fact paid or distributed to any particular beneficiary under the trust.[185]

For example, contrast subsection 75(2) with the attribution rule in subsection 74.4(2), which is triggered when "one of the main purposes of the transfer or loan may reasonably be considered to be to reduce the income of the individual and to benefit . . . a person who is a designated person in respect of the individual."[186]

As discussed in the first section of the paper, *Satoma*[187] was an "evil trust" case. The CRA defines an evil trust as "a trust which is structured to deliberately cause the application of subsection 75(2). Sometimes the purpose of the arrangement is to cause the attribution of dividend income to a connected corporation, where the income will not be taxable, while at the same time distributing proceeds in the form of cash by way of either a capital distribution or a loan to the intended recipient (usually a shareholder of the corporate group or someone closely related to that person)."[188]

In *Satoma*, the Federal Court of Appeal began the analysis by noting that the purpose of the structure was clear: to invoke the attribution of the taxable dividends from Satoma Trust to a corporate beneficiary so that the beneficiary could avail itself of the deduction provided for under subsection 112(1) and allow Satoma Trust to hold and dispose of these funds on a tax-free basis.[189]

There was some discussion about whether the GAAR assessment was premature in that the trust had not yet made distributions of these "tax-free" amounts. The court found that the tax benefit was obtained by the appellant when the attribution rule in subsection 75(2) became operational. Specifically, it allowed the trust to avoid paying tax on the taxable dividends that it received.[190]

The court summarized the abuse as the combined use of subsections 75(2) and 112(1):

> In my view, the combined use of subsections 75(2) and 112(1) gave rise to an abuse. This abuse arose when the optional deduction provided for under subsection 112(1) was claimed. Subsection 75(2) is an anti-avoidance provision designed to prevent income splitting. Although this provision when looked upon on its own operated in a manner that is consistent with this objective, its combined use with subsection 112(1) offends the object, spirit and purpose of this latter provision. . . . [T]he object, spirit and purpose of subsection 112(1) is to allow dividends to be passed on tax-free within corporate groups subject to tax being eventually paid when the dividends reach the final recipients. This objective has been frustrated as the dividends can now be passed on to the beneficiaries without tax.[191]

Prior to *Satoma*, the CRA had stated on several occasions that it would seek to apply GAAR to similar transactions considered by the Federal Court of Appeal.[192] At the 2011 STEP conference, the CRA indicated that it would challenge arrangements structured to invoke subsection 75(2) in a manner that ensures that neither the trust nor the beneficiaries are taxable on the income.[193]

Similar attribution rules for non-resident trusts are found in subsections 94(8.1) and (8.2),[194] because subsection 75(2) does not apply to deemed resident trusts under subsection 94(3). Under these non-resident trust (NRT) attribution rules, certain arm's-length transfers of property to an NRT will result in the trust being a deemed-resident trust.[195]

Trust Arrangements

Another interesting issue in the subsection 75(2) context is whether a trust relationship even exists in order to trigger the attribution rule. This issue has not been extensively, or recently, litigated directly, but it has come up in other contexts.[196]

The issue arose in *Fraser v. MNR*,[197] where the court considered whether an investment vehicle arrangement was actually a trust. The issue in the case dealt with the correct characterization of the structure that was set up for the purpose of investing in mortgages. If the arrangement constituted a trust (as argued by the minister), then the disputed losses were losses of the trust and did not flow through to the taxpayer. However, if the arrangement constituted an agency relationship, then the losses would flow through to the taxpayer.

The court found that a trust relationship existed because the three certainties (intention, subject matter, and objects; see below) were established. On the point of certainty of intention, the court found that "intention is determined by all of the evidence, including the conduct of the parties and the terms of the written documentation which flowed between them, and not merely on the basis of one person's subjective view."[198]

The taxpayer argued that even if a trust relationship was found to exist, subsection 75(2) should apply to attribute the losses back to the taxpayer. The court disagreed and ruled that subsection 75(2) did not apply, finding that "the property was not held by the trustees subject to the right of reversion."[199]

The Federal Court of Appeal agreed with the conclusions of law and fact on the trust issue. Interestingly, the taxpayer then argued that it was a bare trust arrangement (with the effect that the bare trust would be ignored for tax purposes), but the court said that "the high degree of autonomy and independence of action enjoyed by the trustees was incompatible with any notion of a bare trust."[200]

Fraser was followed in *Markovzki v. R*,[201] in which the Tax Court denied the taxpayer's losses on the basis that a trust relationship existed.

The issue of whether a trust exists in the tax context has arisen in a few recent instances. In *Yu v. Canada*,[202] the Federal Court of Appeal outlined the criteria that must be met in order for the Tax Court to find that a trust exists, by quoting *Waters' Law of Trusts*:

> For a trust to come into existence, it must have three essential characteristics. As Lord Langdale M.R. remarked in *Knight v. Knight*, in words adopted by Barker J. in *Renehan v. Malone* and considered fundamental in common law Canada, (1) the language of the alleged settlor must be imperative; (2) the subject-matter or trust property must be certain, (3) the objects of the trust must be certain. This means that the alleged settlor, whether he is giving the property on the terms of a trust or is transferring property on trust in exchange for consideration, must employ language which clearly shows his intention that the recipient should hold on trust. No trust exists if the recipient is to take absolutely, but he is merely put under a moral obligation

> as to what is to be done with the property. If such imperative language exists, it must, second, be shown that the settlor has so clearly described the property which is to be subject to the trust that it can be definitively ascertained. Third, the objects of the trust must be equally and clearly delineated. There must be no uncertainty as to whether a person is, in fact, a beneficiary. If any one of these three certainties does not exist, the trust fails to come into existence or, to put it differently, is void.[203]

While the Tax Court is a creation of statute and thus not a court of equity, taxpayers frequently request that judges make use of equitable doctrines to relieve them of their tax liabilities. One such technique is to ask the court to recognize a form of trust that can alter the legal relationships, and corresponding liabilities, for tax purposes. A recent example of this can be found in the Federal Court of Appeal decision in *Canada v. Cheema*.[204] The case dealt with the new housing rebate for goods and services tax purposes, but the Tax Court and the dissent in the Court of Appeal addressed the application of a bare trust in the tax context.

At issue in the case was whether a person who signs an agreement of purchase and sale for a residential unit, solely for the purpose of assisting another person in obtaining the mortgage (and who does not acquire a beneficial interest in that complex), must satisfy the occupancy requirements of subsection 254(2) of the Excise Tax Act (ETA). The minister reassessed the appellant to deny the new housing rebate on the basis that Dr. Akbari, who was not related to Mr. Cheema and who signed the agreement of purchase and sale, did not intend to occupy the residential complex.

The majority decision of the Federal Court of Appeal in *Cheema* went against an established line of cases that have recognized a bare trust relationship and applied such relationship to determine the tax consequences. The majority ignored the existence of the bare trustee and denied the rebate. Dr. Akbari signed the sale agreement only as a bare trustee, to assist the appellant in obtaining financing, and never intended to occupy the property at issue. The Court of Appeal found that the Tax Court had ignored the ETA requirements in relation to Dr. Akbari.

In dissent, Webb JA agreed with the Tax Court and emphasized the jurisprudence supporting his analysis:

> In *De Mond Jr. v. The Queen*, [1999] 4 C.T.C. 2007, 99 D.T.C. 893, Justice Lamarre (as she then was) stated that:
>
> > 37 Bare trustees have also been compared to agents. The existence of a bare trust will be disregarded for income tax purposes where the bare trustee holds property as a mere agent or for the beneficial owner. . . .
> >
> > > It is quite clear that in many situations trustees will also be agents. This occurs, for example, in the familiar case of investments held by an investment dealer as nominee or in the case of

> land held by a nominee corporation. In such cases, the trust relationship that arises by virtue of the separation of legal and equitable ownership is often described as a bare trust and for tax and some other purposes it is quite understandably ignored.[205]

In *Markou v. The Queen*,[206] the Tax Court commented on the jurisdiction of the court in response to the Crown's argument that a certain type of trust could not be recognized since that was outside the Tax Court's jurisdiction. The court stated that its role was to determine the correctness of an assessment. It cannot grant orders that a court of equity can. For example, the Tax Court cannot issue an order for specific performance.

The court found that acknowledging the existence of a resulting or constructive trust cannot lead to an order that a court of equity could grant, but it can and should allow the Tax Court to determine the correctness of the assessment, which entails being aware of all of the circumstances—factual, legal, and equitable.

The court affirmed its ability to recognize whether a trust exists for the purposes of determining the correctness of a tax assessment:

> The Tax Court of Canada can look at a taxpayer's circumstances and make a determination as to what facts are true and what legal and equitable rights are available to the taxpayer where such findings will assist the court deciding the correctness of the assessment. . . . It can . . . analyze the correctness of an assessment acknowledging any and all rights a taxpayer may have. . . .
>
> Perhaps, the question on this Determination would have created less jurisdictional controversy if it had been framed in terms of what interest, if any, did the Appellants have in the funds prior to delivery to the charity. The Respondent would allow me to take into account an express trust in making that finding, but not a constructive or resulting trust. With respect, that amplifies the absurdity of extending the limitations on this Court of not being a court of equity to cover a simple acknowledgment of the circumstances of a resulting or constructive trust.[207]

When faced with a subsection 75(2) assessment, taxpayers and practitioners should consider going back to the basics of trust law. The facts surrounding the three certainties and whether a trust even exists should be examined. If it is beneficial to the particular assessment to ignore the trust for tax purposes, arguing that a bare trust relationship exists may also assist in challenging the CRA.

The majority decision in *Cheema* should be confined to the circumstances of the new housing rebate and the unique facts of that case. The Tax Court is free to determine whether a trust exists and apply the attendant consequences of that relationship to the tax liability. The court in *Fraser* did exactly that in a subsection 75(2) context.

Intentional Triggering of a SAAR

Only a few cases have analyzed the consequences of intentionally triggering a SAAR. At issue in *Lipson*[208] was the use of the spousal attribution rules to facilitate the taxpayer claiming his spouse's interest deduction. Specifically, the taxpayer utilized subsections 74.1(1) and 73(1) to deduct interest pursuant to paragraph 20(1)(c) and subsection 20(3).

The spousal attribution rules are targeted anti-avoidance provisions that are designed to prevent certain types of income splitting. Although the Act contains no general policy against income splitting,[209] some rules are clearly directed at preventing certain types of it.[210]

In *Lipson*, the Supreme Court found that the tax benefit of the interest deduction resulting from the refinancing of the family corporation by Mrs. Lipson was not abusive when viewed in isolation, but that the ensuing tax benefit of the attribution of Mrs. Lipson's interest deduction to Mr. Lipson was. It followed that this latter tax benefit was denied under GAAR, which was triggered because the series of transactions included the attribution of the interest deduction under subsection 74.1(1) and such "attribution frustrated the object, spirit and purpose of that provision."[211]

The court also found that it did not matter that subsection 74.1(1) was automatically triggered when no election was made under subsection 73(1) because the taxpayer's motivation or purpose was irrelevant:

> The only way the Lipsons could have produced the result in this case was by taking advantage of their non-arm's length relationship. . . . It does not matter that s. 74.1(1) was triggered automatically when Mr. Lipson did not elect to opt out of s. 73(1). His motivation or purpose is irrelevant. But to allow s. 74.1(1) to be used to reduce Mr. Lipson's income tax from what it would have been without the transfer to his spouse would frustrate the purpose of the attribution rules. Indeed, a specific anti-avoidance rule is being used to facilitate abusive tax avoidance. . . .
>
> The GAAR is a residual provision, but it is designed to address the complexity of transactions which fall outside the scope of specific anti-avoidance provisions. As I mentioned above, it relates specifically to the impact of complex series of transactions which often depend on the interplay of discrete provisions of the ITA.[212]

In *Mathew v. Canada*,[213] the taxpayers relied on a combination of subsection 18(13) and the partnership provisions of the Act (section 96) to claim losses. The series of transactions undertaken by the taxpayers was essentially "aimed at transferring unrealized losses from one arm's length taxpayer to another."[214]

The court found that the purpose of subsection 18(13) was to prevent a taxpayer who is in the business of lending money from claiming a loss on the superficial disposition of a mortgage (or similar non-capital property). According to the court, "[t]his purpose is achieved by confining the loss that would ordinarily be claimed by the transferor to a non-arm's length transferee."[215]

The court found that when subsection 18(13) and section 96 are examined together, they "do not permit arm's length parties to purchase the tax losses preserved by s. 18(13) and claim them as their own."[216] The court then said that to allow a new arm's-length partner to buy into the transferee partnership and thus 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." Subsection 18(13) permits the preservation and transfer of a loss because of the non-arm's-length relationship between transferor and transferee. Absent that relationship, there is no reason for the provision to apply.

The court summarized the abuse as the artificiality of the non-arm's-length relationship in this situation:

> 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 Partnership A and STC. 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 Partnership A nor Partnership B ever dealt with real property, apart from STC's original mortgage portfolio. Nor was STC ever in a partnership relation with either OSFC [an arm's-length corporation] 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.[217]

The discussion of *Satoma* in the previous section is also relevant here, as is the earlier discussion of *Pomerleau*.

Although courts in the past have found that the intentional triggering of a SAAR can be abusive, such abuse was grounded in clear policy in the Act. In almost all cases, it was also the combined use of one or more other sections that led to the abuse. It is difficult to see how intentionally triggering subsection 55(2) would be subject to GAAR. The purpose of the provision can be partially gleaned from the case law (see *Placer*, above) and budget documents in respect of the original enactment in 1979 and the amendments in 2015.

The 1979 budget documents stated:

> Concerns have been expressed as to the legislative scope and intended application of this anti-avoidance provision. A number of plans have been developed whereby, as a preliminary step to certain sales of shares, a corporate vendor extracts what are in substance sale proceeds in the form of tax-free intercorporate dividends or deemed dividends to decrease the value—or increase the cost base—of the shares to the point where capital gains tax is avoided. These tax-free dividends frequently exceed the earnings of the corporation to be sold. Such excessive dividends are usually motivated only by the vendor's desire to reduce his exposure to capital gains tax.

> As a general rule, the objective of the tax law is that on most arm's-length and on certain non-arm's-length intercorporate share sales, a capital gain should arise at least to the extent that the sale proceeds reflect the unrealized and untaxed appreciation since 1971 in the value of underlying assets. This objective will generally be achieved where tax-free dividends on shares are limited to post-1971 taxed retained earnings.
>
> Rules will be introduced to clarify the intention of the law in this respect. These rules will ensure that where it can reasonably be considered that one of the main purposes of a tax-free intercorporate dividend was to reduce the proceeds on a disposition of a share, the capital gain otherwise determined will be adjusted to reflect the extent to which aggregate tax-free dividends have exceeded post-1971 taxed retained earnings.[218]

In the 2015 budget, the Department of Finance simply stated that an amendment was proposed to ensure that the anti-avoidance rule applied "where one of the purposes of a dividend is to effect a significant reduction in the fair market value of any share or a significant increase in the total cost of properties of the recipient of the dividend."[219] It also stated that related rules were proposed to ensure that this amendment is not circumvented.[220]

The main purpose of subsection 55(2) is clear from the case law and the budget documents: to prevent the use of the intercorporate dividend deduction from reducing the capital gain on a disposition of shares. Intentionally triggering this provision does not frustrate that purpose.

The CRA and the Department of Finance also seem to recognize this, as evidenced by the change in their GAAR position with respect to gaming the previous election under paragraph 55(5)(f) and the recent attempted introduction of section 246.1. There is no apparent policy in the Act against realizing or triggering capital gains in a corporation to generate CDA. In recognizing this, Finance attempted to introduce piecemeal fixes to paragraph 55(5)(f) and then enact section 246.1. The fact that section 246.1 was considered necessary demonstrates that there is no abuse of any particular provision when subsection 55(2) is intentionally triggered.

Further, the court in *Univar Holdco Canada ULC* was clear that in determining whether GAAR applies, one should have regard to alternative transactions. In the previous section of this paper, we outlined how to realize a capital gain in a corporation to generate CDA that was outside the scope of section 55. This alternative transaction achieves the same result as an intentional triggering of subsection 55(2). It is difficult to imagine how GAAR would apply to this alternative transaction, which is another reason why the intentional triggering of subsection 55(2) should not be subject to GAAR.

The only reason why Finance may be opposed to a situation where a shareholder can ultimately realize capital gains rates rather than dividend rates is that the capital gains inclusion rate and dividend rates have significantly diverged over the years.[221] The Act was not drafted with any clear policy stating that surplus must be extracted from a corporation by an individual through non-eligible dividends rather than capital dividends. Obviously, realizing a capital gain is not inherently offensive.

For example, as of June 2018, the differences in rates for a top marginal earner throughout Canada[222] were as follows:

	Capital gains rate (%)	*Non-eligible dividend rate (%)*
British Columbia	24.90	43.73
Alberta	24.00	41.64
Saskatchewan	23.75	39.60
Manitoba	25.20	45.92
Ontario	26.76	46.84
Quebec	26.65	44.83
New Brunswick	26.65	46.88
Nova Scotia	27.00	47.33
Prince Edward Island	25.69	44.26
Newfoundland and Labrador	25.65	43.81
Northwest Territories	23.53	35.98
Nunavut	22.25	36.78
Yukon	24.00	41.42

The fact that rates between the two options have changed over the years is not indicative of a legislative policy that could support a misuse or abuse argument against generating CDA and paying out capital dividends. Since this rate mismatch has caused the perceived "abuse," we are left with an incoherent legislative state for divestitures.[223]

Conclusion

SAARs are a patchwork of different legislative approaches, and as a result it is difficult to set out a unifying principle for the interpretation and application of SAARs. From the standpoint of a tax administrator, GAAR generally works as an effective supplement to SAARs in accomplishing the objectives set out by the SAAR drafters. From the standpoint of a taxpayer, GAAR arguably applies in an overbroad and somewhat unpredictable fashion when a SAAR has been avoided through creative tax planning. The trend toward broader SAARs as mini-GAARs is unwelcome, but practitioners have little control over drafting style and therefore have little choice but to adapt.

Notes

1 Section 245 of the Income Tax Act, RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as "the Act"). Unless otherwise stated, statutory references in this paper are to the Act.

2 Finances Québec, *Aggressive Tax Planning, Working Paper* (Quebec: Gouvernement du Québec, January 2009), at 2.2.1 (www.finances.gouv.qc.ca/documents/Autres/en/AUTEN_DocCons_PFA.pdf).

3 Paul Wirz, "Anti-Avoidance Measures in International Tax Planning: Overview to and Description of the Main Anti-Avoidance Measures" (2009) 4:2 *Der Schweizer Treuhänder* [The Swiss Trustee], at 369-76.

4 Jinyan Li, Joanne Magee, and J. Scott Wilkie, *Principles of Canadian Income Tax Law*, 9th ed. (Toronto: Thomson Reuters, 2017), at 17.2 and 20.3.

5 Thomas E. McDonnell, "Legislative Anti-Avoidance: The Interaction of the New General Rule and Representative Specific Rules," in *Report of Proceedings of the Fortieth Tax Conference*, 1988 Conference Report (Toronto: Canadian Tax Foundation, 1989), 6:1-34.

6 In *Outerbridge Estate v. Canada*, 90 DTC 6681, at paragraphs 12-13 (FCA); aff'g 89 DTC 5304 (FCTD), the Federal Court of Appeal adopted the argument that subsection 15(1) was a generic provision and not a SAAR. We believe that this conclusion was correct, because subsection 15(1) prescribes the consequences of a shareholder receiving a benefit or appropriating property from a corporation in most circumstances.

7 David G. Duff, Benjamin Alarie, Kim Brooks, and Lisa C. Philipps, *Canadian Income Tax Law*, 2d ed. (Markham, ON: LexisNexis Butterworths, 2006), at 183; Brian M. Studniberg, "Minding the Gap in Tax Interpretation: Does Specificity Oust the General Anti-Avoidance Rule Post-Copthorne" (2012) 38:1 *Queen's Law Journal* 209-58, at 214.

8 In subsections 40(3.3) and (3.4), subparagraph 40(2)(g)(i), and the definition of "superficial loss" in section 54, as identified by Favreau J in *Triad Gestco Ltd. v. The Queen*, 2011 TCC 259, at paragraph 102; aff'd 2012 FCA 258.

9 In particular, sections 74.1 and 74.2, as identified by Jorré J in *Gervais v. The Queen*, 2016 TCC 180, at paragraph 125; aff'd 2018 FCA 3.

10 As identified by Hogan J in *Mady v. The Queen*, 2017 TCC 112, at paragraph 110.

11 As identified by Lyons J in *1245989 Alberta Ltd. v. The Queen*, 2017 TCC 51, at paragraph 101; rev'd 2018 FCA 114.

12 As identified by Noël CJ in *Pomerleau v. Canada*, 2018 FCA 129, at paragraph 30; aff'g 2016 TCC 228.

13 As identified by Favreau J in *101139810 Saskatchewan Ltd. v. The Queen*, 2017 TCC 3, at paragraph 11.

14 As identified by Lamarre ACJ in *Fiducie Financière Satoma v. The Queen*, 2017 TCC 84, at paragraph 2; aff'd 2018 FCA 74.

15 See *MacDonald v. The Queen*, 2012 TCC 123, at paragraph 67; rev'd 2013 FCA 110, on other grounds.

16 See, for example, Michael N. Kandev, "Tax Law Drafting and FA Dumping" (2012) 20:10 *Canadian Tax Highlights* 3-4; Robert McCue, "An Update on Statutory Interpretation and Specific Anti-Avoidance Rules," in *Report of Proceedings of the Sixty-Ninth Tax Conference*, 2017 Conference Report (Toronto: Canadian Tax Foundation, 2018), 35:1-30.

17 Brian J. Arnold and James R. Wilson, "The General Anti-Avoidance Rule—Part 2" (1988) 36:5 *Canadian Tax Journal* 1123-85, at 1128, footnote 9, citing Canada, *Report of the Royal Commission on Taxation*, vol. 3 (Ottawa: Queen's Printer, 1966), 554-56.

18 Ibid.

19 For example, in *LJP Sales Agency Inc. v. The Queen*, 2003 TCC 851, at paragraph 31, Miller J appears to accept that if a transaction would have been undertaken in any event in the absence of a tax benefit, the tax benefit cannot be a main reason for the transaction. The Federal Court of Appeal in *Groupe Honco Inc. v. Canada*, 2013 FCA 128, at paragraph 24; aff'g 2012 TCC 305, approached the determination in a less formal way, appearing to hold that there was no minimum or maximum number of main reasons and that the status of a reason as a main reason was a question of fact. In *Gerbro Holdings Co. v. Canada*, 2016 TCC 173; aff'd 2018 FCA 197, Lamarre ACJ effectively concluded that the distinction between a reason and a main reason is a question of fact, with the distinction to be made by weighting the relative importance of the various reasons for a transaction.

20 Including McCue, supra note 16, and Ben Hudson and Scott McCamis, "Refresher on Specific Anti-Avoidance Provisions," in *2014 Prairie Provinces Tax Conference* (Toronto: Canadian Tax Foundation, 2014), 12:1-41.

21 *Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54, at paragraph 10; aff'g 2004 FCA 67; aff'g 2003 TCC 215.

22 *Canada Ltd. v. Ontario (Minister of Finance)*, 2006 SCC 20, at paragraphs 21-23; rev'g (2004), 190 OAC 157 (CA); rev'g (2002), 61 OR (3d) 628 (Sup. Ct.).

23 *Pangaea One Acquisition Holdings XII S.À.R.L. v. The Queen*, 2018 TCC 158.

24 Ibid., at paragraphs 18-22 and 30-43.

25 In subsection 56.4(1).

26 *Pangaea*, supra note 23, at paragraphs 47-63.

27 Pursuant to paragraph 212(1)(i).

28 *101139810 Saskatchewan*, supra note 13, at paragraphs 22-27.

29 Most notably *729658 Alberta Ltd. v. The Queen*, 2004 TCC 474.

30 *101139810 Saskatchewan*, supra note 13, at paragraphs 63-80.

31 *Gillen v. The Queen*, 2017 TCC 163, at paragraphs 73 and 107-28.

32 *Mady*, supra note 10, at paragraphs 110-20, citing *Lipson*, infra note 208, at paragraph 105 (SCC) (per Rothstein J).

33 *Canada v. Green*, 2017 FCA 107, at paragraphs 17-31.

34 Proposed paragraphs 96(1)(e) and (f) and proposed subsection 96(2.11).

35 *Gerbro*, supra note 19, at paragraphs 89-126 (TCC).

36 *Plains Midstream Canada ULC v. The Queen*, 2017 TCC 207, at paragraphs 55-60.

37 Ibid., at paragraphs 62-84.

38 *Montminy v. Canada*, 2017 FCA 156, at paragraphs 37-43; rev'g 2016 TCC 110.

39 Ibid., at paragraphs 44-61.

40 Ibid., at paragraph 19; *Canada v. Lehigh Cement Ltd.*, 2014 CFA 103, at paragraph 61; aff'g 2013 TCC 176.

41 *Canada Trustco*, supra note 21, at paragraph 45 (SCC).

42 Studniberg, supra note 7, at 232-33.

43 *Canada v. Landrus*, 2009 FCA 113; aff'g 2008 TCC 274.

44 *Canada v. Collins & Aikman Canada Inc.*, 2010 FCA 251; aff'g 2009 TCC 299.

45 *Landrus*, supra note 43, at paragraphs 44-47 (FCA).

46 *Lipson*, infra note 208 (SCC).

47 There was disagreement between the majority (per LeBel J) and Rothstein J with respect to whether the potentially applicable SAAR in subsection 74.5(11) had in fact been avoided. However, LeBel J characterized subsection 74.1(1) as a SAAR, which the taxpayers relied on in order to achieve their desired result.

48 *Lipson*, infra note 208, at paragraph 47 (SCC).

49 Ibid., at paragraph 34 (SCC).

50 Julie D'Avignon and Curtis Stewart, "The Interaction of Specific Anti-Avoidance Rules Under GAAR," in *Report of Proceedings of the Sixty-Eighth Tax Conference*, 2016 Conference Report (Toronto: Canadian Tax Foundation, 2017), 10:1-24.

51 For example, Jorré J in *Birchcliff Energy Ltd. v. The Queen*, 2017 TCC 234, at paragraphs 136-37, considered overall results when confronted with artificiality, which in that case was due to the existence of shares for a very short period of time and solely for the purpose of avoiding a SAAR.

52 2018 FCA 166; rev'g 2016 TCC 288. The taxpayer's application for leave to appeal to the Supreme Court of Canada was dismissed on February 21, 2019.

53 Ibid., at paragraph 62 (FCA).

54 Ibid., at paragraph 63 (FCA).

55 Ibid., at paragraphs 75-76 (FCA).

56 We do not agree that the extent to which Woods J relied on the overall result of the series of transactions in identifying a misuse or abuse of either subsection 103(1) or subsection 96(1) was correct, although a fuller discussion on this point is beyond the scope of this paper.

57 2018 FCA 30; rev'g in part 2016 TCC 204. The taxpayer's application for leave to appeal to the Supreme Court of Canada was dismissed on December 13, 2018.

58 Ibid., at paragraph 38 (FCA).

59 Ibid., at paragraph 100 (FCA).

60 Ibid., at paragraphs 102 and 107-13 (FCA).

61 Ibid., at paragraphs 59-61 and 72-73 (FCA).

62 2017 FCA 207; rev'g 2016 TCC 159.

63 Ibid., at paragraphs 17-20 (FCA).

64 Ibid., at paragraphs 21-24 (FCA).

65 Ibid., at paragraphs 23-31 (FCA).

66 D'Avignon and Stewart, supra note 50.

67 *Satoma*, supra note 14. The taxpayer has sought leave to appeal to the Supreme Court of Canada.

68 Ibid., at paragraph 52 (FCA).

69 *Lipson*, infra note 208, at paragraph 42 (SCC).

70 *Collins & Aikman Canada Inc*., supra note 44, at paragraph 62 (TCC).

71 For all provinces and territories, the effective tax rate on either eligible or non-eligible dividends is lower than the tax rate on ordinary income.

72 As defined in subsection 110.6(1).

73 Entitlement to claim LCGE is affected if the individual has a cumulative net investment loss balance or has previously claimed an allowable business investment loss.

74 Note that, as a result of subsection 84.1(2.1), the claiming of a capital gain reserve deems a transferor to have claimed the LCGE for the purpose of determining the reduction in ACB.

75 2011 SCC 63.

76 Ibid., at paragraph 95.

77 2014 TCC 75.

78 Ibid., at paragraph 53.

79 *1245989 Alberta Ltd.*, supra note 11, at paragraph 28 (FCA).

80 T.E. McDonnell and E.J. Richardson, "Through the Looking Glass Darkly: Surplus Distributions and the 1974-1975 Amendments" (1975) 23:3 *Canadian Tax Journal* 276-314, at 278.

81 *Copthorne*, supra note 75.

82 *Univar Holdco Canada ULC*, supra note 62, at paragraph 15 (FCA).

83 Canada, Department of Finance, *Technical Notes to Bill C-139* (Ottawa: Department of Finance, June 1988), at clause 188.

84 *RMM Canadian Enterprises Inc. v. The Queen*, 97 DTC 302, at paragraph 53 (TCC).

85 *Canada Trustco*, supra note 21, at paragraph 41 (SCC).

86 *Evans v. The Queen*, 2005 TCC 684.

87 Ibid., at paragraph 30.

88 *Pomerleau*, supra note 12, at paragraph 75 (TCC).

89 Canada, Department of Finance, "Minister Morneau Announces Next Steps in Improving Fairness in the Tax System by Closing Loopholes and Addressing Tax Planning Strategies," *News Release*, July 18, 2017.

90 Canada, Department of Finance, "Targeted Tax Fairness Measures Will Protect Small Business Owners Including Farmers and Fishers," *News Release*, October 19, 2017.

91 *Poulin v. The Queen*, 2016 TCC 154.

92 *Turgeon v. Canada*, 2017 FCA 103; aff'g 2016 TCC 154. *Turgeon* was heard with *Poulin* at the Tax Court of Canada.

93 *Poulin*, supra note 91. For an in-depth analysis, see also Darryl Antel and Kenneth Keung, "Section 84.1: What Brought Poulin and Turgeon to the Table?" Moodys Gartner, August 19, 2016 (www.moodysgartner.com/section-84-1-brought-poulin-turgeon-table/).

94 *Turgeon*, supra note 92.

95 *Desmarais v. MNR*, 2006 TCC 329.

96 Ibid.

97 *1245989 Alberta Ltd.*, supra note 11 (TCC).

98 Ibid.

99 In the judgment, the Federal Court supported its finding by citing *OSFC Holdings Ltd. v Canada*, 2001 FCA 260, where it was concluded that the prepackaging of tax losses in OSFC did not result in a tax benefit.

100 *1245989 Alberta Ltd.*, supra note 11 (FCA).

101 *Pomerleau*, supra note 12 (FCA).

102 Ibid.

103 CRA document no. 2013-0479402C6, November 25, 2012.

104 For further discussion on this matter, see Edward A. Heakes, "Employee Share Ownership and Similar Arrangements for CCPCs," in *2017 Ontario Tax Conference* (Toronto: Canadian Tax Foundation, 2017), 14:1-13.

105 *Pomerleau*, supra note 12, at paragraphs 81-82 (FCA).

106 Subsections 70(5) and (6).

107 *Pomerleau*, supra note 12.

108 The definition of "excluded amount" in subsection 120.4(1).

109 Part of the conditions in subsections 120.4(4) and (5).

110 2013 TCC 86.

111 Ibid., at paragraph 65.

112 Ibid., at paragraphs 49-51.

113 *MacDonald*, supra note 15.

114 Ibid., at paragraphs 21 and 28-29 (FCA).

115 See, for example, H. Michael Dolson and Jon D. Gilbert, "Accessing Surplus: What Works, What Doesn't, What's Left," in *2014 Prairie Provinces Tax Conference* (Toronto: Canadian Tax Foundation, 2014), 9:1-57; and Marc Graham and Lucinda Main, "Ante-Mortem and Post-Mortem Estate Planning," in *2015 Ontario Tax Conference* (Toronto: Canadian Tax Foundation, 2015), 7:1-18.

116 The corporate tax rate on the taxable portion of the capital gain is 50.7 percent, but the tax is offset by a 30.7 percent dividend refund under subsection 129(1) by virtue of the non-eligible dividend paid.

117 Paragraph 13(7)(e) limits the addition to undepreciated capital cost on a non-arm's-length disposition to the taxable portion of the gain realized by the vendor, that is, 50 percent.

118 See Rick McLean, Jeff Oldewening, and Jonas Lau, "Capital Gains Stripping and Surplus Stripping," in *Report of Proceedings of the Sixty-Ninth Tax Conference*, 2017 Conference Report (Toronto: Canadian Tax Foundation, 2018), 4:1-35; Eoin Brady and Gwendolyn Watson, "The 'Purpose' of Subsection 55(2)," in *2015 Ontario Tax Conference* (Toronto: Canadian Tax Foundation, 2015), 8:1-16; and Kenneth Keung and Kim G.C. Moody, "Subsection 55(2)—The Road Ahead," in *2016 Prairie Provinces Tax Conference* (Toronto: Canadian Tax Foundation, 2016).

119 *The Queen v. Placer Dome Inc.*, 96 DTC 6562, at 6564 (FCA).

120 Emphasis added. What constitutes "significant" throughout this provision is also up for debate but is outside the scope of this paper.

121 Budget Implementation Act, 2016, No. 1, SC 2016, c. 7.

122 Department of Finance, *Legislative Proposals Relating to the Income Tax Act and Regulations* (Ottawa: Department of Finance, July 31, 2015).

123 2013 TCC 318.

124 See Rick McLean, "Subsection 55(2): What Is the New Reality?" in *Report of Proceedings of the Sixty-Seventh Tax Conference*, 2015 Conference Report (Toronto: Canadian Tax Foundation, 2016), 22:1-71.

125 Stéphane Charette and Stéphane Prud'Homme, "Canada Revenue Agency Round Table," in *Report of the Proceedings of the Sixty-Ninth Tax Conference*, 2017 Conference Report (Toronto: Canadian Tax Foundation, 2018), 3:1-29, question 3, at 3:4.

126 *Ludco Enterprises Ltd. v. Canada*, 2001 SCC 62.

127 Supra note 125.

128 [1994] 4 SCR 695.

129 Supra note 125.

130 *Placer*, supra note 119.

131 Supra note 125.

132 CRA document no. 2015-0613821C6, November 17, 2015. The CRA has also said that a safe harbour exists for regular dividends, in that subsection 55(2) will not apply to a situation where a dividend is paid pursuant to a well-established policy of paying regular dividends.

133 *Placer*, supra note 119, at 6566.

134 Ibid.

135 Ibid., at 6567 (emphasis in original).

136 Ibid.

137 95 DTC 5253 (FCTD).

138 Ibid., at 5259 (emphasis added).

139 98 DTC 2073 (TCC).

140 Ibid., at paragraph 32.

141 Ibid., at paragraph 31.

142 *101139810 Saskatchewan*, supra note 13.

143 Ibid., at paragraph 35.

144 Ibid., at paragraphs 26 and 36.

145 *Ludco*, supra note 126, at paragraphs 54-55 (emphasis added).

146 *Symes*, supra note 128.

147 Ibid., at paragraph 72 (emphasis added).

148 *Gerbro*, supra note 19.

149 Ibid., at paragraph 62 (TCC).

150 Ibid., at paragraph 155 (TCC) (emphasis in original).

151 Ibid., at paragraph 161 (TCC). Also see ibid., at paragraph 157, for a set of interpretive rules in the context of the offshore investment fund property rules.

152 *Groupe Honco Inc.*, supra note 19.

153 Ibid., at paragraph 24 (FCA).

154 See McLean et al., supra note 118, at 11.

155 Or property that derives more than 10 percent of its value from any combination of shares and debt of the dividend recipient or the dividend payer (other than, in the latter case, shares of the dividend recipient).

156 Or shares that derive more than 10 percent of their value from any combination of shares and debt of the dividend recipient or the dividend payer.

157 See paragraph 55(3)(a); subsection 55(3.01), which contains interpretive rules for paragraph 55(3)(a); and Siobhan Monaghan, "Divisive Reorganizations: Butterfly Transactions," paper presented at CBC Tax Law for Lawyers conference, June 4-9, 2017, Niagara-on-the-Lake, Ontario.

158 CRA document no. 2017-0693411C6, June 13, 2017.

159 CRA document no. 2015-0604521E5, January 13, 2016.

160 Ibid.

161 Ibid.

162 Ibid.

163 Canada, Department of Finance, *Explanatory Notes Relating to the Income Tax Act, Excise Act, 2001, Universal Child Care Benefit Act, Children's Special Allowances Act and Related Legislation* (Ottawa: Department of Finance, April 2016), at clause 5.

164 See Rick McLean, *Understanding Section 55 and Butterfly Reorganizations*, 3d ed. (Toronto: CCH Canadian, 2010), at 101-40.

165 Paragraph 55(3.01)(a).

166 Paragraph 251(2)(b).

167 The two corporations are related to each other as well because they are controlled by the same person: paragraph 251(2)(c)(i).

168 Paragraph 55(5)(e)(ii) and McLean, supra note 164, at 137.

169 Persons connected by blood relationship are related pursuant to paragraph 251(2)(a).

170 Pursuant to subparagraphs 251(2)(b)(iii) and 55(5)(e)(ii). See CRA document nos. 9819515, August 18, 1998, situation 1, and 9801425, November 10, 1998.

171 CRA document no. 2014-0538021C6, October 10, 2014. Also see John F. Oakey, "Understanding Section 55 and Butterfly Reorganizations" (2016) 13:12 *Tax Hyperion* 1-2.

172 Paragraph 251(2)(b).

173 For the purposes of subparagraph 251(2)(b)(iii) as it applies to section 55, a brother or sister would not be related to the person who controls Newco or Opco.

174 Subsection 248(10).

175 *OSFC Holdings Ltd.*, supra note 99, at paragraph 36. Also see *Canada Trustco*, supra note 21, at paragraphs 25 and 26 (SCC): "in contemplation of" is read not in the sense of actual knowledge but in the broader sense of "because of" or "in relation to" the series. The phrase can be applied to events either before or after the basic avoidance transaction found under subsection 245(3).

176 See "Canada Tax Service," infra note 193, section 55, and CRA document nos. 2014-0522991C6, June 16, 2014 and 2011-0412091C6, October 7, 2011. Also see Jin Wen and Vicky Liu, "Deliberate Triggering of Subsection 55(2)" (2016) 6:1 *Canadian Tax Focus* 11-12.

177 CRA document no. 2015-0610701C6, November 24, 2015.

178 See Keung and Moody, supra note 118, at 41.

179 The application of subsection 75(2) has other consequences, which are outside the scope of this discussion. For example, subsection 107(2) may allow certain trusts to distribute property on a rollover basis to a capital beneficiary. Subsection 107(4.1) may prevent a rollover from applying where subsection 75(2) was at any time applicable in respect of any property of the trust.

180 *Canada v. Sommerer*, 2012 FCA 207, at paragraphs 48 and 49.

181 Ibid.

182 2013 TCC 327; aff'd 2014 FCA 230.

183 Ibid., at paragraph 26 (TCC).

184 Elie S. Roth, Tim Youdon, Chris Anderson, and Kim Brown, *Canadian Taxation of Trusts* (Toronto: Canadian Tax Foundation, 2016), at 424.

185 Ibid., at 427.

186 For more comparators, see ibid.

187 *Satoma*, supra note 14 (FCA).

188 CRA document no. 2014-0523001C6, June 16, 2014.

189 *Satoma*, supra note 14, at paragraph 33 (FCA).

190 Ibid., at paragraph 45 (FCA).

191 Ibid., at paragraph 52 (FCA).

192 CRA document no. 2014-0523001C6, June 14, 2014 and 2011-0401951C6, June 3, 2011.

193 CRA document no. 2011-0401951C6, June 3, 2011. See "Canada Tax Service—McCarthy Tétrault Analysis," *TaxnetPro*, subsection 75(2).

194 These amendments overturned the result in *Sommerer*, supra note 180, in that subsection 75(2) would apply only to trusts that are factually resident in Canada.

195 A full discussion of these rules is beyond the scope of this paper. See the "Canada Tax Service" commentary, supra note 193, for a thorough discussion.

196 See Roth et al., supra note 184, at 456.

197 91 DTC 5123 (FCTD); aff'd 95 DTC 5684 (FCA).

198 Ibid., at 5128 (FCTD).

199 Ibid., at paragraph 5130 (FCTD). The court also provided, ibid., an odd and likely incorrect interpretation of the scope of the reversionary right: "[S]ubsection 75(2) anticipates a situation in which the whole corpus of the trust is capable of reverting to the settlor (75(2)(a)) or where the corpus during the life of the trust remains under the control of the settlor (75(2)(b))."

200 Ibid., at paragraph 2 (FCA).

201 98 DTC 2040 (TCC).

202 2018 FCA 68.

203 Ibid., at paragraph 22.

204 2018 FCA 45. Leave has been sought to appeal to the Supreme Court.

205 Ibid., at paragraph 59, citing paragraph 37 and 38 of *De Mond Jr. v. The Queen*, 99 DTC 893.

206 2016 TCC 137.

207 Ibid., at paragraphs 19-20.

208 *Lipson v. Canada*, 2009 SCC 1; aff'g 2007 FCA 113; aff'g 2006 TCC 148. Also see *Gervais*, supra note 9 (FCA), for the application of GAAR in the context of certain attribution rules. See D'Avignon and Stewart, supra note 50.

209 See *Neuman v. MNR*, [1998] 1 SCR 770, at paragraph 35.

210 Such as the expanded TOSI rules introduced in 2017.

211 *Lipson*, supra note 208, at paragraph 48 (SCC).

212 Ibid., at paragraphs 42 and 47 (SCC).

213 2005 SCC 55.

214 Ibid., at paragraph 34.

215 Ibid., at paragraph 53.

216 Ibid., at paragraph 58.

217 Ibid., at paragraph 62.

218 Canada, Department of Finance, 1979 Budget, Budget Papers, December 11, 1979, at 72 (www.budget.gc.ca/pdfarch/1979-pap-eng.pdf). Also see *101139810 Saskatchewan*, supra note 13, at paragraph 51.

219 Canada, Department of Finance, 2015 Budget, Tax Measures, Supplementary Information, April 21, 2015, at 465.

220 For example, if a dividend is paid on a share of a corporation, and the value of the share is or becomes nominal, the dividend will be treated as having reduced the fair market value of the share. As well, changes addressed the use of stock dividends (that is, dividends that consist of additional shares of the same corporation) as a means of impairing the effectiveness of the anti-avoidance rule.

221 For example, the capital gains inclusion rate was 75 percent from 1990 to 1999.

222 See "Historical Tax Rates and Reference Tables," *TaxnetPro*.

223 See McLean et al., supra note 118, at 29-31, for a thorough discussion of the incoherent legislative state along with helpful examples.