MNP LLP

SUBMISSION TO THE DEPARTMENT OF FINANCE MODERNIZING AND STRENGTHENING THE GENERAL ANTI-AVOIDANCE RULE

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Submitted electronically at: GAAR-RGAE@fin.gc.ca

MNP LLP (MNP) is pleased to make a submission in response to the Department of Finance, Tax Policy Branch (the "Department") request for comments on the consultation paper, "Modernizing and Strengthening the General Anti-Avoidance Rule" ("GAAR") released on August 9, 2022 (the "Paper"). We appreciate the opportunity to provide our comments and recommendations.

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Executive Summary

> ***Every man is entitled, if he can, to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax.***[1]

This basic tenet has been a foundation of tax law in Canada for almost a century and is still referred to by all levels of our courts, most recently in the *Loblaw*[2], *Alta*[3] and *Collins Family Trust*[4] cases. Given the existing complexity of Canada's income tax legislation, and the inherent challenges in interpreting and applying the GAAR, it is important to ensure that certainty, predictability and fairness to all taxpayers is considered when amending the GAAR. These principles, and the right to legitimate tax minimization, have been and continue to be the "bedrock of tax law" [5]. MNP believes legislation that might adversely impact the above principles and rights must be undertaken only after very careful and fulsome consideration – including from the taxpayers' perspective so that the legislation can be understood and complied with.

Our greatest concern with the Paper is consistent with what was outlined by the Supreme Court of Canada (the "Supreme Court") in *Copthorne*[6]:

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[1] *Inland Revenue Commissioners v. Duke of Westminster*, 1936, A.C. 19 TC 490, at p. 19.
[2] *The Queen v Loblaw Financial Holdings Inc.,* 2021 SCC 51, at paragraph 41.
[3] *The Queen v Alta Energy Luxembourg S.A.R.L.*, 2021 SCC 49, at paragraph 29.
[4] *AGC et al v Collins Family Trust et al*, 2002 SCC 26.
[5] *Ibid.* at paragraph 1.
[6] *Copthorne Holdings Ltd. v. Canada*, 2011 SCC 63, at paragraph 67.

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> A court must be mindful that a decision supporting a GAAR assessment in a particular case may have implications for innumerable "everyday" transactions of taxpayers. A decision affecting paid-up capital ("PUC") is a good example. There are undoubtedly hundreds, and perhaps thousands of share transactions each year in which the PUC of a certain class of shares may be a relevant consideration. Because of the potential to affect so many transactions, the court must approach a GAAR decision cautiously. It is necessary to remember that "Parliament must...be taken to seek consistency, predictability and fairness in tax law" (*Trustco*[7], at para. 42). As this Court stated in *Trustco*:
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>> Parliament intends taxpayers to take full advantage of the provisions of the *Income Tax Act* that confer tax benefits. Indeed, achieving the various policies that the *Income Tax Act* seeks to promote is dependent on taxpayers doing so. [para. 31]

In our view (and detailed below), several concepts and suggestions discussed in the Paper challenge these basic principles and the outlined approach could unintentionally impact widely accepted and commonly implemented planning for all taxpayers. This is contrary to the long-standing application of the GAAR. We believe that the current provisions and the manner in which the courts analyze and apply them appropriately curtail abusive tax planning while ensuring taxpayers also have certainty, predictability and fairness.

The Paper describes significant changes to the GAAR that are under consideration but does not specifically explain the reason why, in the Government's view, the current rules do not adequately prevent abusive tax avoidance. A review of the statistics in the Paper and Annex A of the Paper provides that the Minister of National Revenue (the "Minister") applied the GAAR as a primary or alternative basis of assessment more than 1,300 times out of the 1,600 instances where it was considered. The Paper identifies that the GAAR was the primary basis for assessment in approximately 50% of the more than 1,300 cases. Annex A then identifies the 24 specific cases where the Minister was unsuccessful in arguing the GAAR in court. In at least three of those cases, the Crown was in fact successful on other technical issues and in six of these cases, a tax benefit (one of the three hallmarks of the GAAR) could not be determined.

Yet, the Government is considering an expansive reform of the provisions when only 1.85% (i.e., 24/1,300) of the cases where the GAAR was applied as a primary or alternative basis of assessment were decided by a court in a manner which interpreted the application of the GAAR differently than the Minister argued. Pursuant to the Paper, it appears that the Minister was ultimately successful in court, settled, or was not required to resort to the GAAR in approximately 98% of the cases it identified where the GAAR was ultimately applied by the CRA as a primary or alternative assessing position.

Creating legislation that would override almost a century of jurisprudence, which has operated as the fundamental cornerstone of stakeholders' understanding of the Canadian tax system, will create significant uncertainty ultimately taking decades to resolve through the courts. While we provide recommendations on specific matters addressed in the Paper throughout our submission, **our overall recommendation is for the Department to engage in a more comprehensive stakeholder consultation process to fully consider the impact**

[7] *The Queen v Canada Trustco Mortgage Co*, 2005 SCC 54.

of any changes to the GAAR and the ability to maintain certainty in our tax system without placing undue and unnecessary burdens on taxpayers.

Technical Discussion

1. Tax Benefit

We do not have any further comments or suggested wording changes to the definition of "tax benefit".

2. Avoidance Transaction: Mixed Purpose Transactions

The Paper states that both the *Canadian Pacific*[8] (pre-*Trustco*) and *Spruce Credit*[9] (post-*Trustco*) cases may illustrate a "fundamental problem" with the current purpose-based avoidance transaction test. These two cases highlight that a specific transaction will not be considered an avoidance transaction if it has a primary business purpose, even if the same business purpose could have been achieved with a different commercial transaction that would have resulted in higher taxes for the taxpayer. The Paper asserts that "…the choice to effect the transactions in a particular way was made in order to obtain those tax benefits and the tax planning abused the provisions of the [Income Tax] Act relied upon (or at least a reasonable argument could be made to that effect)." The Government is suggesting that the current test is not effective and is proposing three potential measures to override well-established case law:

1. Providing an interpretive rule to specify what is not a "*bona fide*" purpose;
2. Extending the definition of "transaction" to include a choice; and
3. Lowering the threshold under the purpose test.

Providing Interpretive Rules Specifying Bona Fide Purposes

We agree with the view that the GAAR is intended to "prevent abusive tax avoidance transactions while not interfering with legitimate commercial and family transactions," and that a balance must be struck. The inherent concern is how the legitimacy of these transactions should be determined. Jurisprudence has indicated that **it is not the role of the Minister to dictate or second guess the reasoning behind taxpayers' business decisions**. In *Alta*, Côté J. wrote[10]:

> First and foremost, tax avoidance is *not* tax evasion… In addition, tax avoidance should not be conflated with abuse. Even if a transaction was designed for a tax avoidance purpose and not for a *bona fide* non-tax purpose, such as an economic or commercial purpose, it does not mean that it is necessarily abusive within the meaning of the GAAR. The purpose of a transaction is relevant mainly to characterize it as either an avoidance transaction or a *bona fide* transaction and, specifically, to assess the abusive nature of the transaction. In their factual analysis, courts

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[8] *The Queen v Canadian Pacific Ltd.,* 2001 FCA 398.
[9] *The Queen v Spruce Credit Union*, 2014, FCA 143.
[10] *Alta, supra* note 3, at paragraph 47.

> may consider whether an avoidance transaction was "motivated by any economic, commercial, family or other non-tax purpose". However, a finding that a *bona fide* non-tax purpose is lacking, taken alone, should not be considered conclusive evidence of abusive tax avoidance.

Whether or not the purpose of a transaction is *bona fide* is often subjective and particular to an individual taxpayer and/or their business activities. We agree with the view expressed in the Paper that identifying and quantifying specific purposes would only serve to add another layer of complexity requiring interpretation, thus creating uncertainty, to these situations. It could also provide additional opportunities for the Minister to override business decisions. As such, the introduction of interpretative rules in determining what is considered a "*bona fide* purpose" would not support taxpayer fairness.

Extending the Definition of "Transaction" to Include a Choice

This proposal directly conflicts with the principle outlined in the *Duke of Westminster*. Choosing an alternative is an action, not a transaction. This was specifically addressed in *Spruce Credit Union*[11]:

> The act of choosing or deciding between or among alternative available transactions or structures to accomplish a non-tax purpose, based in whole or in part upon the differing tax results of each, is not a transaction. Making a decision cannot be an avoidance transaction.
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> …A decision to choose between options is not a transaction. Similarly, a decision to choose to do something or not is not a transaction. A decision is not considered a transaction as that term is commonly understood nor is it within the extended, inclusive definition of transaction in subsection 245(1).

Reclassifying a choice as a transaction would remove the freedom of taxpayers to operate their businesses as they see fit and would override a principle which has operated as a cornerstone of Canadian tax jurisprudence for almost a century. Even in situations not involving the application of the GAAR, the Minister and their representatives have been seen to question and override or replace taxpayers' business decisions with their own when conducting reviews of tax filings. To illustrate, the Court comments at paragraph 24 in *Jolly Farmer Products Inc. v The Queen*[12]:

> This case is an excellent example of the CRA seeking to substitute its business judgment for that of the taxpayer. The alternatives suggested by the respondent would have made the operation far less profitable. The way in which the appellant chooses to carry on its highly successful commercial operation is a business decision and the Minister of National Revenue has no right to substitute his business judgment and advance other alternatives that are more palatable to him.

Further, at paragraph 48 of *Alta*, Côté J. referenced Rothstein J.'s remarks in *Copthorne*, stating[13]:

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[11] Spruce*, supra* note 9*,* at paragraphs 93 and 100*.*
[12] 2008 TCC 409.
[13] Alta, *supra* note 3.

> …courts should not infuse the abuse analysis with "a value judgment of what is right or wrong nor with theories about what tax law ought to be or ought to do. Taxpayers are allowed to minimize their tax liability to the full extent of the law and to engage in "creative" tax avoidance planning, insofar as it is not abusive within the meaning of the GAAR.

This highlights the rights of taxpayers to make choices and decisions about their businesses and to undertake transactions provided they do not engage in tax avoidance transactions that are abusive.

In our view, extending the definition of "transaction" to include a choice would be broad enough to capture even the most basic transaction in the GAAR regime. This is inconsistent with Parliament's intent for the GAAR, which was to prevent abusive tax avoidance transactions or arrangements without interfering with legitimate commercial and family transactions.

Lowering the Threshold Under the Purpose Test

The definition of an "avoidance transaction" is a hallmark of the GAAR that ensures that transactions created primarily for non-tax purposes are not subject to the GAAR – it plays an important gatekeeping function. The Paper recognizes that "the Crown has been successful in the courts in a significant proportion of GAAR cases and that many aggressive tax plans do not go forward due to the likelihood that the GAAR would apply". On this basis, it is not clear why lowering the threshold for the finding of an "avoidance transaction" is required. To the extent that this definition operates as a gatekeeping function, it should not be expanded to such an extent that results in findings of an "avoidance transaction" in all or substantially all instances. This would not be an equitable result.

One of the options presented is to reduce the threshold for the purpose test from the current "primary purpose is to obtain the tax benefit" to "one of the main purposes is to obtain the tax benefit". This would be similar to other specific anti-avoidance provisions found in the Income Tax Act (the "Act"). As this phrase operates in other provisions of the Act and has been interpreted in existing jurisprudence, its use offers a degree of understanding as to application and meaning for taxpayers. However, while this may be a more acceptable option than the others presented as it allows for more taxpayer certainty, it will undoubtedly result in additional transactions being considered avoidance transactions.

It is noted that adopting this option would be consistent with purpose tests used by other countries in applying similar anti-avoidance rules. Other jurisdictions, however, have the ability to enter into compromised settlements, which is not currently an available option in Canadian tax disputes. The option to undertake compromised settlements on files which will be resource intensive for both sides is a significant and important distinction which should be considered when undertaking comparisons to other jurisdictions.

It is important to mention that the burden is on the taxpayer to refute both the existence of a tax benefit and that the primary purpose of the transaction or series of transactions was tax motivated. In our view, particularly given the proposed expansion of "tax benefit", the analysis of misuse or abuse of the relevant provisions is more important and where efforts should be applied by the Minister.

Finally, Finance's Explanatory Notes on subsection 245(3) reiterate this[14]:

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[14] Canada, Department of Finance, *Explanatory Notes to Legislation Relating to Income Tax* (Ottawa: Department of Finance, June 1988), clause 186.

> Subsection 245(3) does not permit the "recharacterization" of a transaction for the purposes of determining whether or not it is an avoidance transaction. In other words, it does not permit a transaction to be considered to be an avoidance transaction because some alternative transaction that might have achieved an equivalent result would have resulted in higher taxes. It is recognized that tax planning – arranging one's affairs so as to attract the least amount of tax – is a legitimate and accepted part of Canadian tax law. If a taxpayer selects a transaction that minimizes his tax liability and this transaction is not carried out primarily to obtain a tax benefit, he should not be taxed as if he had engaged in other transactions that would have resulted in higher taxes.

It is clear that there are several targeted areas of "mischief" that are concerning to the Government and the Minister. These targeted areas are evidenced by the newly proposed mandatory disclosure rules regime, and particularly the notifiable transactions reporting. In our view, the new proposed mandatory disclosure reporting will deter many taxpayers from pursuing tax-motivated planning. Instead of broad changes to the GAAR which may increase uncertainty and override almost a century of jurisprudence, the Minister's objectives as outlined in the Paper might be better achieved by the Minister identifying and disclosing a list of the potential misuses and/or abuses that are concerning and applying the mandatory disclosure rules to such transactions. In the interest of transparency, predictability and fairness, it would be paramount that controls be in place (for this as well as for notifiable transactions) so that the list could not be amended without due consultation or notice to taxpayers.

Recommendations:

- Choices that are made by taxpayers should not form part of the definition of a "transaction".
- Consider the impact of compromised settlements on other jurisdictions' GAAR files when drawing comparisons in how general anti-avoidance rules are applied.
- Consider specifying transactions that, in the Minister's view, involve a misuse or abuse of the Act and apply the mandatory disclosure reporting rules to such transactions rather than amending the GAAR to address.

3. Misuse or Abuse: Determining Object, Spirit and Purpose and General Schemes

Legislative Preambles and Purpose Statements

Purpose statements and greater statutory clarity benefit all parties. **The inclusion of preambles and purpose statements in income tax legislation, particularly for provisions that are frequently the subject of GAAR consideration, may be a welcome addition for practitioners.** It may also serve to assist in the determination of tax avoidance transactions. We acknowledge that this may be a significant undertaking and would not alleviate the need for the courts to determine if transactions misuse or abuse certain provisions. However, general statements of purpose by section will serve to identify planning that frustrates that main purpose. As new legislation is introduced or amended more specific purpose statements may be added to those provisions where appropriate.

We recommend that if this option is pursued, a very extensive consultation process be undertaken wherein stakeholders, including tax professionals, can provide input.

Extrinsic Aids

A greater emphasis on purpose statements in extrinsic aids is suggested as a possible option; this may be a feasible option if these various publications are widely available. Aids such as explanatory notes are often helpful due to the level of detail they contain and certainly purpose statements could be included in them as well. However, as the Paper notes, explanatory notes are produced by Finance and may not be enacted or specifically approved by Parliament.

Insofar as reliance on extrinsic aids such as guidance from the Organisation for Economic Cooperation and Development (the "OECD") is proposed, this suggestion may not be practical. The guidance in various OECD documents does not consider the nuances in each country's tax regime and therefore requires appropriate and suitable modifications for Canadian income tax context. In addition, interpretation issues could exist. For example, who would be the "expert" or correct authority on OECD interpretation?

Other extrinsic aids that have been utilized and referenced by the courts include academic papers and texts written by tax professionals and advisors; while these could also be appropriate reference documents, interpretive challenges may arise, as reasonable minds can always differ.

Abuse of the Act Read as a Whole

As stated in *Canada Trustco*[15]:

> The interpretation of the provisions giving rise to the tax benefit must, in the words of s. 245(4) of the *Act*, have regard to the *Act* "read as a whole". This means that the specific provisions at issue must be interpreted in their legislative context, together with other related and relevant provisions, in light of the purposes that are promoted by those provisions and their statutory schemes. In this respect, it should not be forgotten that the GAAR itself is part of the *Act*.

We do not support the proposition to afford general schemes of the Act more consideration but do concur with the approach that has been adopted by the Supreme Court in the cases referenced. The Minister and their representatives have taken the position that general schemes exist in the Act and assessing positions are rooted in that context. For example, CRA auditors consistently put forth the notion that there is an overarching scheme in the Act against surplus-stripping. Courts have dispelled this notion, pointing instead to specific provisions that prevent certain transactions. Rothstein J. held in *Copthorne* that, in determining whether there has been abusive tax avoidance, "what is not permissible is basing a finding of abuse on some broad statement of policy, such as anti-surplus stripping, which is not attached to the provisions at issue."[16]

The Act was not written as a whole, but rather updated periodically to respond to various policy changes and court decisions. Because it has not been written in a fluid or harmonious way, changing only the GAAR provisions in isolation without fully considering the impact on other provisions of the Act is likely not going to address the Department's concerns.

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[15] Canada Trustco, *supra* note 7, at paragraph 51.
[16] Copthorne, *supra* note 6, at paragraph 118.

Interpretive Rule for Assessing Certainty, Predictability and Fairness

The Paper suggests the inclusion of interpretative rules in GAAR to achieve an appropriate balance with respect to fairness. The example given is the addition of an interpretive rule that GAAR applies to foreseen as well as unforeseen tax planning.

However, "fairness" in the context of tax is already a well considered term. General tax textbooks like *The Fundamentals of Canadian Income Tax* explain the concept of fairness in tax as follows:

> To be effective, a tax system must be fair. Anything less than a fair system of taxation invites blatant tax avoidance and evasion. Tax equity is concerned with the optimality of distribution. An equitable tax policy is one that treats similarly situated taxpayers in a similar manner (horizontal equity) and promotes a fair distribution of income (vertical equity). That said, however, it is not always easy to settle upon a common measure of fairness. Fairness is a value judgment that incorporates social, political and moral values. Hence, determining whether a tax system is fair (in in tax parlance, "equitable") is contentious.[17]

A discussion of the Courts' comments in *Alta* and *Copthorne* about how and why an abuse analysis should not be a value judgement is included above. Specifically, in *Copthorne* the Court warns against the use of "a value judgment of what is right or wrong or theories about what tax ought to be or ought to do."[18] Any discussion of fairness in tax must consider both horizontal and vertical equity, but legislation should not be amended to include rules which subject taxpayers to indefinite or philosophical ideals of "fairness". This would create significant uncertainty (due to a constantly evolving social, political, and moral landscape) and again, override almost a century of tax jurisprudence premised on the ideal that taxpayers are permitted to minimize their tax liability to the full extent of the law and even engage in non-abusive tax avoidance planning.

In light of the example given of an interpretive rule which states that GAAR applies to foreseen as well as unforeseen tax planning, it is our view this would overstep the purpose of the GAAR. The Act already contains hundreds of provisions that were written to address foreseen tax planning. In *Canada Trustco*, the Court stated[19]:

> Although Parliament's general purpose in enacting the GAAR was to preserve legitimate tax minimization schemes while prohibiting abusive tax avoidance, Parliament must also be taken to seek consistency, predictability and fairness in tax law. These three latter purposes would be frustrated if the Minister and/or the courts overrode the provisions of the *Income Tax Act* without any basis in a textual, contextual and purposive interpretation of those provisions.

The Supreme Court in *Shell*[20], a non-GAAR case, said it best:

> …this Court has made it clear in more recent decisions that, absent a specific provision to the contrary, it is not the courts' role to prevent taxpayers from relying on the sophisticated structure of their transactions, arranged in such a way that the particular provisions of the Act are met, on the basis that it would be inequitable to those taxpayers who have not

[17] Krishna, V. (2004). *The Fundamentals of Canadian Income Tax, 8th Edition* (p. 16). Carswell.
[18] Copthorne, *supra* note 6, at paragraph 70.
[19] *Ibid.* at paragraph 42.
[20] *Shell Canada Ltd. v. Canada,* [1999] 3 SCR 622, at paragraph 45.

> chosen to structure their transactions that way…The courts' role is to interpret and apply the Act as it was adopted by Parliament…Unless the Act provides otherwise, a taxpayer is entitled to be taxed based on what it actually did, not based on what it could have done, and certainly not based on what a less sophisticated taxpayer might have done.

This paragraph goes to the heart of fairness for taxpayers and why horizontal and vertical equity are important. What is fair is not necessarily what is equal, and what is equal is not necessarily what is fair. It is both inequitable and unfair to require taxpayers to structure their business affairs to keep them on the same footing as others. Horizontal equity stands for the proposition that only similarly situated taxpayers should be treated in a similar manner. Consequently, taxpayers who chose to or must structure their business affairs differently should not find themselves deemed to be treated in a similar manner as taxpayers with different structures. In particular, it is contradictory to deem taxpayers with different circumstances to be treated in a similar manner (contrary to horizontal equity) in the pursuit of fairness.

The ability of certain taxpayers to understand and apply the complex language and provisions of the Act to organize their affairs should not be diminished by the Government or the Minister.

Changing the Burden Under the Misuse or Abuse Test

The Government proposes to change the judicially established onus under the misuse or abuse exception such that the taxpayer would be required to demonstrate that the tax benefit sought would be consistent with the object, spirit and purpose of the provisions relied upon by the taxpayer. An alternative suggestion is to presume that all tax avoidance is abusive unless the taxpayer can establish to an appropriate standard that the provisions being relied upon were used in the manner Parliament intended them to be used. It is difficult to comprehend how this alternative promotes fairness for Canadian taxpayers. By shifting the burden of proof to the taxpayer, the Minister is effectively granted powers akin to those of Parliament in that the Minister does not have to be compliant with Parliament's intention for provisions of the Act when assessing taxpayers under those provisions.

In *Birchcliffe*[21], taxpayers demanded the Minister disclose their view on the tax policy or abuse alleged in the assessment of GAAR. The Minister refused to provide this, stating that only the allegation of misuse or abuse was required. In the context of this case the Tax Court stated the following with respect to abuse:

> Moving on to the request for particulars of an assumption of the abuse, clearly it is impossible to determine the abuse without knowing what it is that is allegedly being abused. That is why disclosure of the Policy in the Reply, I find, is critical. Abuse, however, <u>is not a question of fact either but is a determination to be made by the Court, having concluded what the Policy is and then whether the facts are such that they in some fashion abuse that Policy</u>. … It is up to the Minister to make clear in the reasons how those facts lead to an abuse. It is not a reason in answer to the issue, was there an abuse, by simply stating there was an abuse, which is effectively all the Minister has said in paragraph 25. That is not a reason. The reason is because, putting it in terms of the Supreme Court of Canada in *Copthorne Holdings Ltd. v. R.*[footnote removed]:
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> i) the transaction achieves an outcome the statutory provision was intended to prevent;

[21] *Birchcliff Energy v The Queen*, [2013] 3 CTC 2169.

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ii) the transaction defeats the underlying rationale (policy); and

iii) the transaction circumvents the provision in a manner that frustrates or defeats its object, spirit or purpose (policy). [Emphasis added] [22]

Changing the onus with respect to abuse would require the taxpayer to determine any and all policies that the Minister might believe to be relevant and then consider whether the transaction achieves an outcome that the statutory provision was intended to prevent, the transaction defeats the underlying rationale, or the transaction circumvents the provision in a manner that frustrates or defeats its object, spirit, or purpose.

In our view, the Minister is in a better position to establish both the policy which they believe is relevant and the underlying rationale and object, spirit and purpose of a provision.

As outlined by the Federal Court of Appeal in *Orly Automobiles Inc.*, where the onus was on the Taxpayer,

> [t]here is a very simple and pragmatic reason going back to over 80 years ago as to why the burden is on the taxpayer: see *R. v. Anderson Logging Co.* (1924), [1925] S.C.R. 45 (S.C.C.), *Pollock v. R.* (1993), 161 N.R. 232 (Fed. C.A.), *Vacation Villas of Collingwood Inc. v. R.*, [1996] G.S.T.C. 13 (Fed. C.A.), *Anchor Pointe Energy Ltd. v. R.*, 2003 FCA 294 (Fed. C.A.). It is the taxpayer's business. He knows how and why it is run in a particular fashion rather than in some other ways. He knows and possesses information that the Minister does not. He has information within his reach and under his control. The taxation system is a self-reporting system. Any shifting of the taxpayer's burden to provide and to report information that he knows or controls can compromise the integrity, enforceability and, therefore, the credibility of the system. That being said, we recognize that there are instances where the shifting of the burden may be warranted. This is simply not one of those cases.[23]

In the context of the GAAR generally, and the misuse or abuse test specifically, it is the Minister that has unmatched access to the institutional knowledge and history on legislation over the years as well as to internal policy discussions that are not available to the public. As observed in *Canada Trustco,* "the Minister is in a better position than the taxpayer to make submissions on legislative intent with a view to interpreting the provisions harmoniously within the broader statutory scheme that is relevant to the transaction at issue".[24]

Recommendations:

- If pursuing the introduction of purpose statements to all provisions of the Act, undertake a more fulsome stakeholder consultation.
- The onus of proving misuse or abuse should remain with the Minister to preserve taxpayer fairness and certainty.

[22] *Ibid.* at paragraph 20.
[23] *Orly Automobiles Inc. v Canada,* 2005 FCA 425, at paragraph 20.
[24] Canada Trustco, *supra* note 7, at paragraph 65.

4. Economic Substance

Explicitly adding an economic substance rule to the GAAR attempts to regulate taxpayer business decisions. The Paper does not adequately express why it is necessary or appropriate to turn away from the courts' heavy emphasis on the misuse or abuse component of arguing the GAAR and instead turn to an emphasis on economic substance. The in-depth analysis in the Paper on this concept implies that its introduction is a forgone conclusion. This concept is already somewhat woven into the analysis required to determine whether a transaction that resulted in a tax benefit is also an avoidance transaction. Case law is clear that taxpayers are not obligated to structure a transaction to maximize tax. Canadian tax legislation focuses on the legal form and substance of transactions undertaken by taxpayers, and those are taken at face value in the absence of a sham. Unless there is a deeming rule to do so, legislation does not "recharacterize" transactions based on economic substance. Supreme Court GAAR cases have repeatedly rejected the notion that transactions that appear to lack economic substance are automatically abusive. This "recharacterization" concept was also discussed at length in *Shell*[25]:

> This Court has repeatedly held that courts must be sensitive to the economic realities of a particular transaction, rather than being bound to what first appears to be its legal form…there are at least two *caveats* to this rule. First, this Court has never held that the economic realities of a situation can be used to recharacterize a taxpayer's *bona fide* legal relationships. To the contrary, we have held that, absent a specific provision of the Act to the contrary or a finding that they are a sham, the taxpayer's legal relationships must be respected in tax cases. Recharacterization is only permissible if the label attached by the taxpayer to the particular transaction does not properly reflect its actual legal effect.
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> Second, it is well established in this Court's tax jurisprudence that a searching inquiry for either the "economic realities" of a particular transaction or the general object and spirit of the provision at issue can never supplant a court's duty to apply an unambiguous provision of the Act to a taxpayer's transaction. Where the provision at issue is clear and unambiguous, its terms must simply be applied.
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> Inquiring into the "economic realities" of a particular situation, instead of simply applying clear and unambiguous provisions of the Act to the taxpayer's legal transactions, has an unfortunate practical effect. This approach wrongly invites a rule that where there are two ways to structure a transaction with the same economic effect, the court must have regard only to the one without tax advantages. With respect, this approach fails to give appropriate weight to the jurisprudence of this Court providing that, in the absence of a specific statutory bar to the contrary, taxpayers are entitled to structure their affairs in a manner that reduces the tax payable. An unrestricted application of an "economic effects" approach does indirectly what this Court has consistently held Parliament did not intend the Act to do directly.

Inserting an economic substance test into the GAAR is not only contrary to decades of both GAAR and non-GAAR court decisions, but also reflects hints of the previously proposed (and widely rejected) section 3.1 reasonable

[25] Shell*, supra* note 20*,* at paragraphs 39, 40 and 46.

expectation of profit test. This proposal was met with instantaneous and sound criticism by tax professionals and taxpayers alike and was swiftly abandoned.

In our view, implementing this notion into any legislation would not only deter entrepreneurs from investing in or starting up new businesses, but would also undermine investor confidence in Canada's tax regime. It would create a level of uncertainty and volatility that would be unacceptable to many outside investors. Canada needs business investment and it needs economic stimulus to create jobs and aid in our post-Covid-19 recovery; enacting legislation that would deter either of these is undesirable.

Recommendation:

- An assessment of economic substance should not be incorporated as an additional test for purposes of the GAAR. Doing so will not only have a detrimental impact on established jurisprudence but will also adversely impact business investments in Canada.

5. Penalties and Other Deterrents

The Paper notes the Minister's statement of issue as "the GAAR does not have a sufficient deterrent effect on abusive tax planning." This statement implies that taxpayers intentionally carry out abusive tax plans. In our view, very few taxpayers knowingly enter into transactions that are abusive; the fact that even the courts have disagreed on the misuse or abuse analysis highlights the complexity of this issue. Opposing viewpoints are, most often, genuinely the result of interpretative differences rather than willful disregard for the law. Consider the case of *Lipson v. Canada*[26], where seven Supreme Court justices arrived at three different conclusions based on a single set of facts. How can a taxpayer be penalized for a difference in their interpretation and that of the Minister? For many taxpayers, the possibility of years of expensive litigation is already a deterrent to undertaking certain types of planning. In addition, as previously noted, the new mandatory disclosure reporting regime will likely deter even more taxpayers from entering into what the Minister considers "aggressive" transactions. We suggest this regime will have a greater impact on deterring aggressive planning than the addition of penalties to the GAAR.

Penalties should not apply if files are resolved on the basis of primary technical positions. In addition, an explicit due diligence exception should be included in any penalty provision; this should not only apply to taxpayers who are compliant with the proposed mandatory reporting disclosure rules, but also apply where there has been consideration of the application of GAAR in conjunction with any planning. Those taxpayers who can show they undertook a thorough and supportable review of the GAAR and an analysis of the provisions relied upon and concluded that GAAR should not apply should not be penalized if the Minister later disagrees. This is particularly applicable in light of the Government's suggestion that the onus of disproving misuse or abuse should shift to taxpayers. It would not be in the interest of fairness, certainty or predictability for taxpayers to be penalized due to a *bona fide* interpretative difference.

[26] 2009 SCC 1.

One practical problem we see with this approach is that due diligence arguments relating to strict liability penalties are commonly not accepted at the Notice of Objection stage in Appeals; this results in these files proceeding to court. Where penalties apply, the Department could consider placing the onus on the Minister to establish the facts justifying the assessment of the penalty, similar to the rules in place in subsection 163(3) of the Act.

A penalty may be appropriate for those taxpayers who

- show a wilful disregard for the requirement to complete a GAAR analysis on transactions;
- knowingly fail to be compliant with the proposed mandatory reporting regimes; or
- repeatedly enter into transactions previously assessed under the GAAR.

However, to provide elements of both fairness and predictability for taxpayers, it would be necessary for the Government to publish, publicly and on a timely basis, transactions that have been found to be subject to the GAAR. We suggest, as noted earlier, that further consultation be undertaken to compile this information.

We are concerned with the suggestion of a penalty calculated as a percentage of the tax benefit. This is not consistent with the application of penalties in other instances. In particular, for taxpayers who have obtained tax benefits that are not yet used or realized, a large penalty is not appropriate as the Crown has not been negatively impacted. The same can be said of an increased interest rate on unused tax attributes whereby if no tax benefit has yet been realized, there is no amount on which to calculate interest.

We unequivocally do not support the suggestion of extending a reassessment period for GAAR assessments, particularly in light of the proposed mandatory disclosure regime where it is proposed that taxpayers have only 45 days from the earliest transaction to file the relevant information with the Minister. Extension of the reassessment period for taxpayers assumes culpable conduct or wrong-doing and in our view, undermines taxpayers' rights to certainty and predictability. Granting the Minister the ability to reassess under the GAAR, a highly complex and technical provision, for up to seven years after a filing does not aid in the promotion of certainty, predictability or fairness for taxpayers. We are aware of the existing constraints on the Minister's resources and are concerned that CRA's auditors may automatically default to the GAAR simply to extend the reassessment period.

Recommendations:

- An explicit due diligence exception or similar relief should apply in respect of GAAR penalties.
- Penalties assessed under the GAAR should not be determined as a percentage of the tax benefit, particularly when the tax benefit in question is unrealized.
- The reassessment period should not be extended in respect of GAAR assessments to prevent misuse of such assessments by the Minister to indefinitely prolong a taxpayer's regular assessment period.

CONCLUSION

The approaches outlined in the Paper vary greatly in fairness and feasibility, but they will all have widespread impact if implemented. Some of the suggestions appear to favor enacting a broad restriction and utilizing the GAAR as a stop-gap measure, but to carve out possible exceptions. If there is a desire to invest resources to identify exceptions, for example based on intent or past court decisions, then in our view it would be more ideal to revisit the Act more broadly and address the overwhelming complexity of some of the existing provisions and the Act. Some of the proposed concepts would impose impractical burdens on everyday taxpayers to prove their transactions do not abuse the Act as a whole.

Decades of sound case law should not be overturned to bias the GAAR for either the taxpayer or the Crown - the number of instances where the Minister was successful in applying the GAAR as outlined in the Paper gives the appearance that it is being applied as intended. The proposed departure from the existing and commonly understood philosophy of the GAAR regime seems directed at large, sophisticated taxpayers, but the breadth of the proposals will most certainly impact all taxpayers, including our farmers and small and medium-sized business owners. This will limit reinvestment into the economy, and into innovation. In our view, major structural changes to the tax system should consider how they may disincentivize entrepreneurial risk taking and undermine investor confidence, which could stifle our economic growth as a nation. It is paramount that the Minister is not granted the ability to second guess taxpayer business decisions. Canada should not be viewed as an undesirable place in which to conduct business.

We are also concerned that these proposals will not mitigate the Government's concern regarding the resource-intensive nature of these files; ultimately taxpayers who believe they are in compliance with the law will still pursue these matters in the courts where they have the resources to do so. The proposals will likely not alter this as GAAR cases are a matter of interpretation for both the Minister and the taxpayer. The courts will still be needed to determine the outcomes.

Summary of Recommendations

Our primary recommendation is for the Department to engage in a more comprehensive stakeholder consultation process to consider the full impact of any changes to the GAAR and to ensure that certainty, predictability and fairness can be maintained without placing undue burden on taxpayers, in particular, farms and small and medium-sized businesses. Taxpayers need to maintain confidence in the Government that they will not incur punitive costs to operate their businesses. Based on the concerns raised throughout this submission, the concepts introduced in the Paper require far more extensive consultation than the short time-period provided for feedback.

We also offer the following specific recommendations in response to the Paper:

- Choices that are made by taxpayers should not form part of the definition of a "transaction".
- Consider the impact of compromised settlements on GAAR files in other jurisdictions when undertaking a comparative analysis.
- Consider specifying transactions that, in the Minister's view, involve a misuse or abuse of the Act and apply the mandatory disclosure reporting rules to such transactions rather than amending the GAAR.

- If pursuing the introduction of purpose statements to all provisions of the Act, undertake a more fulsome stakeholder consultation.
- The onus of proving misuse or abuse should remain with the Minister.
- An assessment of economic substance should not be incorporated as an additional test for purposes of the GAAR.
- An explicit due diligence exception or similar relief should apply in respect of GAAR penalties.
- Penalties assessed under the GAAR should not be determined as a percentage of the tax benefit, particularly when the tax benefit in question is unrealized.
- The reassessment period should not be extended in respect of GAAR assessments.

MNP is pleased to continue to work with the Government, parliamentarians and policy makers across Canada to further discuss our observations, comments and recommendations in this submission.