

Minding the Gap in Tax Interpretation: Does Specificity Oust the General Anti-Avoidance Rule Post-*Copthorne*?

*Brian M Studniberg**

Following the Supreme Court of Canada's divided decision in Lipson, the Tax Court of Canada and the Federal Court of Appeal have struggled with the role of the Income Tax Act's specific anti-avoidance rules in the context of the misuse and abuse analysis when applying the general anti-avoidance rule (GAAR). Interestingly, this problem was predicted at the time of the GAAR's advent, but has not yet been dealt with definitively and convincingly by the courts.

The author suggests that in Copthorne, the Supreme Court missed an opportunity to provide greater guidance on how to conduct the misuse and abuse analysis, and left taxpayers with many unanswered questions. What weight should be given to specific rules? What is the proper role of the GAAR? And, by implication, should the GAAR be applied to transactions that fall outside an existing anti-avoidance rule, or should its application be limited to novel situations where no specific rules yet apply? The author argues that in situations where no specific rule applies to an avoidance transaction that runs contrary to the object and purpose of the Act, the GAAR may have a residual purpose. However, he contends that the GAAR should not be used as a second chance to find a taxpayer's conduct abusive, particularly where a specific rule applies or is relied upon by the taxpayer. It is the role of Parliament, and not the judiciary, to amend a specific rule—or the GAAR itself—if Parliament is unsatisfied with the results of the rule's application.

* Associate, Couzin Taylor LLP. I would like to thank Daniel Sandler, Yi-Wen Hsu, Tim Edgar and an anonymous reviewer for their comments on earlier versions of this article. The views expressed and any errors that remain are solely my own.

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Introduction

Writing laws with indefinite, prospective application was never going to be easy. Legislatures have long faced the tension of drafting general purpose statutes that are outdated as soon as the ink has dried, if not sooner. Of course, legislatures can always amend the legislation they pass, in a perhaps vain effort to keep up with developments in the real world.

Tax evasion is surely as old as taxation itself. But so too is a more benign form of human ingenuity in response to written laws: tax minimization. The difference between the two forms of response boils down to the former's illegality and the latter's lawfulness.¹ But why is minimization legal and evasion illegal? When does tax *avoidance* become *abuse*?

The core challenge of interpreting laws in a way that deals with today's problems while respecting the limits of the democratic lawmaking process is by no means unique to tax law. However, tax law does provide an instructive context in which to explore and address that interpretive challenge. As Robert Couzin has observed, a "legislative approach to tax

1. See Tim Edgar, "Designing and Implementing a Target-Effective General Anti-Avoidance Rule" in David G Duff & Harry Erlichman, eds, *Tax Avoidance in Canada After Canada Trustco and Mathew* (Toronto: Irwin Law, 2007) 221; David G Duff, "Tax Avoidance in the 21st Century" in Richard Krever & Chris Evans, eds, *Australian Business Tax Reform in Retrospect and Prospect* (Sydney: Thomson Reuters, 2009) 477 at 479–83 [Duff, "21st Century"].

avoidance is intimately linked to the problem of complexity and ensuing difficulties in compliance”.² Couzin recalls a scene in Plato’s *Republic* where Socrates asked his interlocutor whether one can realistically legislate over business transactions and market regulations. For Plato the answer was no: attempting to do so will only amount to a life spent “making a host of petty regulations and amending them in the hope of reaching perfection”.³ Plato’s understanding of what happens in the lawmaking sphere is incisive: “All they gain from being doctored is that their ailments grow more severe and complicated, though they are always expecting to be cured by every fresh remedy that someone recommends”.⁴

Couzin uses this classical reference to stress that Canada’s modern tax system has fallen into an endless cycle of action and reaction, that efforts to eliminate tax avoidance have merely led to greater complexity, and that this complexity only engenders further avoidance behaviour.⁵ When the general anti-avoidance rule (GAAR) was introduced in the late 1980s in section 245(2) of the *Income Tax Act*, it might have been regarded at the time as an attempt to end this cycle.⁶ Of course, anyone who really believed that the GAAR would have such an effect has since been proven wrong. As Canadians do not live in Plato’s Republic, they cannot be counted on to refrain from avoidance behaviour on their own: “Specific anti-avoidance legislation will always be with us, regardless of the potential enrichment of general rules”.⁷ But when the law at issue includes the GAAR and the uncertainty it creates as to when a taxpayer’s conduct amounts to a misuse or abuse, the need for balance in the rule’s understanding and application becomes clear.

I will argue in this article for one such manifestation of balance in Canadian tax law: a taxpayer who arranges her affairs according to an

2. “Simplification and Reform” (1988) 26:3 Osgoode Hall LJ 433 at 446 [Couzin, “Simplification”].

3. *Ibid.*

4. *Ibid.*

5. *Ibid.* at 434.

6. *Income Tax Act*, RSC 1985, c 1 (5th Supp) (“[w]here a transaction is an avoidance transaction, the tax consequences to a person shall be determined as is reasonable in the circumstances in order to deny a tax benefit that, but for this section, would result, directly or indirectly, from that transaction or from a series of transactions that includes that transaction”, s 245(2)).

7. Couzin, “Simplification”, *supra* note 2 at 447.

appropriately “textual, contextual and purposive”⁸ interpretation of the *Income Tax Act* (the *Act*) should not be subject to having her conduct recharacterized later by virtue of the GAAR. There are various responses to the question of whether the application of a specific rule should preclude the operation of the general rule. For the Canada Revenue Agency (CRA), a taxpayer who structures his or her transaction to fall immediately outside the scope of a specific anti-avoidance rule (SAAR) has either misused that rule or abused the scheme of the *Act* as a whole. Canadian courts have been far less decisive, though, and have yet to conclusively determine the role that SAARs should play in the GAAR analysis.

Addressing the purpose of a SAAR raises the fascinating question of whether it might be possible to give that rule a modern textual, contextual and purposive interpretation that would enlarge its scope to cover a situation to which it might have been intended to apply but to which its actual text does not quite reach. I believe, though, that using a modern interpretive approach does not resolve the problem taken up in this article.⁹ To understand why, it is important to begin with the “*Duke of Westminster* principle”, as expressed concisely in Lord Tomlin’s statement in the famous case from which the principle took its name: “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”.¹⁰ As the Supreme Court of Canada has explained, the *Act* remains a statute dominated by provisions which set out specific consequences for specific transactions, thereby inviting what is largely a textual interpretation. But Parliament spliced a very different sort of provision into this body of detailed rules: the GAAR is broadly drafted and deliberately intended to negate abusive arrangements that would be allowed under a literal reading of the provisions of the *Act*.¹¹

Notwithstanding the literalist tradition evident in the *Duke of Westminster* principle, by the time the Supreme Court came to rule on the GAAR, things had dramatically changed. Under the “modern” approach

8. *Canada Trustco Mortgage Co v Canada*, 2005 SCC 54 at para 10, [2005] 2 SCR 601.

9. But see Brian J Arnold, “Confusions Worse Confounded: The Supreme Court’s GAAR Decisions” (2006) 54:1 Can Tax J 167 at 176 [Arnold, “Confusions”].

10. *Inland Revenue Commissioners v Westminster (Duke)* (1935), [1936] AC 1, [1935] All ER 259 (HL Eng) at 19 (decided at a time when tax law was seen as akin to a penal statute).

11. *Canada Trustco*, *supra* note 8 at para 13.

to statutory interpretation, “the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament”.¹² Yet, following David Weisbach, “any method of statutory interpretation that is deemed inappropriate under the internal logic or canons of statutory interpretation can be directly incorporated into the statute, converting the inappropriate interpretive method into a mandatory one”.¹³ On this reasoning, Weisbach contends that statutory interpretation is a red herring—the appropriate focus is on whether the law is to emerge from the legislature alone or from some combination of legislative, executive and judicial acts.¹⁴

If specificity is to take precedence over generality, as I argue it normally should, then what is left for the GAAR? Will it apply where there is a SAAR that seeks to deal with the area in question, but does not cover the taxpayer’s particular strategy?¹⁵ I argue that the *Act*’s specificity must remain relevant. The challenge is that abuse is easy to “smell”, but hard to specify. If a taxpayer is to be subjected to uncertainty about whether or not she can carry out her aggressive transaction, that uncertainty should arise from a textual, contextual and purposive interpretation of the SAAR itself, not from questions about how the GAAR will be applied.

This article proceeds as follows. In Part I, I examine the nature and role of SAARs and the need for a GAAR. Then, in Part II, I consider the evolution of the relevant case law. In Part III, I ask what it means to misuse a SAAR in the present context. Part IV illustrates what I argue is the preferred interpretive approach to the relationship between the SAARs and the GAAR in the context of the *Act*’s thin capitalization rules. I conclude that it is up to Parliament, and not the courts, to “fill any gaps” that remain in the *Act* after the courts have run the relevant SAAR through a suitable interpretative exercise. Given the GAAR’s residual role, it is appropriate to use it to catch taxpayers who engage in

12. *Ibid* at para 10.

13. “Ten Truths About Tax Shelters” (2002) 55:2 Tax L Rev 215 at 218.

14. *Ibid* at 220.

15. See Brian Arnold, “Reflections on the Relationship Between Statutory Interpretation and Tax Avoidance” (2001) 49:1 Can Tax J 1 at 13 [Arnold, “Reflections”] (defining tax avoidance as an action taken by a taxpayer either to put her *outside* of the literal wording of a specific provision, but not outside of its spirit or intent, or to bring her *within* the literal wording of the provision, but not within its spirit or intent).

avoidance behaviour that abuses the scheme of the *Act* as a whole. But when a specific rule speaks to a given point, a taxpayer's reliance on that rule should not be seen as a misuse of it. If Parliament disapproves of the result in a given case, it can amend the specific rule at issue (or indeed the GAAR itself).

I. Backdrop: A Typology of Specificity and the Place for Generality

The *Act* is replete with provisions designed to target particular types of situations and transactions in order to further its policy objectives. The *Act*'s SAARs can be classified in a number of ways, and competing categorizations may well be overlapping and non-exhaustive.¹⁶ One helpful way of thinking about these rules is offered by David Duff and his colleagues, who divide them into four categories: (1) those requiring the inclusion of precise amounts; (2) those disallowing or restricting the deduction of certain amounts; (3) those governing the timing of inclusions and deductions; and (4) those providing for certain consequences ("deeming provisions") which recharacterize certain amounts or their recipients.¹⁷

Not all SAARs are created equal. Some contain elements that circumscribe their own application, most notably by including "bright line" tests,¹⁸ which of course may vary considerably in their luminosity. Yet even outside of such "bright lines", the question remains how the CRA will handle situations where relevant (specific) rules exist but are less detailed. While some of the *Act*'s anti-avoidance rules are very specific and are intended to apply only to a particular type of transaction, others

16. See Peter W Hogg et al, *Principles of Canadian Income Tax Law*, 6th ed (Toronto: Thomson Carswell, 2007) at 619–20; Thomas E McDonnell, "Legislative Anti-Avoidance: The Interaction of the New General Rule and Representative Specific Rules" in *1988 Conference Report: Report of Proceedings of Fortieth Tax Conference* (Toronto: Canadian Tax Foundation, 1989) 6:1 [McDonnell, "Legislative Anti-Avoidance"].

17. David G Duff et al, *Canadian Income Tax Law*, 2d ed (Markham, Ont: LexisNexis Canada, 2006) at 183.

18. See Robert Couzin, "Canada GAAR: Trap Set for the Unwary" (1999) 10:1 Int'l Tax Rev 41 at 43. A ready example is the *Act*'s treatment of superficial losses. Where a taxpayer realizes a capital loss on the disposition of property but reacquires that property within thirty days, the loss is denied. On the other hand, if the same taxpayer waits 31 days before reacquisition, the superficial loss rule does not apply.

are more general and have wider application. The question then, is how this increased particularization affects the role of the GAAR. As Harry J Rudick has said, “particularization in a statute leaves less room for the play of judicial interpretation and hence, while a particular device is eliminated, avoidance in general is not decreased”.¹⁹ The difficulty that must be resolved is whether that is still true in light of the recent tax jurisprudence on the role of the GAAR.

The legislative history of the GAAR need only be briefly mentioned. In 1984, the Supreme Court of Canada rejected the validity of a judicial business purpose test in tax law in *Stuart Investments Ltd v The Queen*.²⁰ Three years later, the federal government released a white paper proposing the enactment of a new general anti-avoidance rule in order to combat tax avoidance schemes. Following a number of amendments to the proposed rule, the GAAR came into effect in September 1988.²¹

In setting out the rationale for enacting the GAAR, the 1987 Budget referred to the “undesirable features” of SAARs: “[a]part from the added complexity that they generate, these rules tend to create other loopholes and they generally do not apply to transactions carried out before the rules [are] announced”.²² Vern Krishna states that the Department of Finance saw three main difficulties with a web of SAARs. First, specific rules targeting specific transactions “close the barn door only after the

19. “The Problem of Personal Income Tax Avoidance” (1940) 7:2 Law and Contemp Probs 243 at 246–47.

20. [1984] 1 SCR 536, [1984] CTC 294.

21. See e.g. Duff et al, *supra* note 17 at 190–91; Vern Krishna, *The Fundamentals of Canadian Income Tax*, 9th ed (Toronto: Thomson Carswell, 2006) at 1013–17 [Krishna, *Fundamentals*]. See also Vern Krishna, *Tax Avoidance: The General Anti-Avoidance Rule* (Toronto: Carswell, 1990) [Krishna, *Avoidance*]; William I Innes et al, *The Essential GAAR Manual: Policies, Principles and Procedures* (Toronto: CCH Canadian, 2006) at 27–36; Brian J Arnold & James R Wilson, “The General Anti-Avoidance Rule—Part 1” (1988) 36:4 Can Tax J 829 [Arnold & Wilson, “Part 1”]; Brian J Arnold & James R Wilson, “The General Anti-Avoidance Rule – Part 2” (1988) 36:5 Can Tax J 1123 [Arnold & Wilson, “Part 2”]; Brian J Arnold & James R Wilson, “The General Anti-Avoidance Rule—Part 3” (1988) 36:6 Can Tax J 1369 [Arnold & Wilson, “Part 3”]; Harry Erlichman, ed, *Tax Avoidance in Canada* (Toronto: Irwin Law, 2002) ; Harry Erlichman, ed, “Tax Reform Exercise Finally Ends” (1988) 10:19 Can Taxpayer 145.

22. See Department of Finance, *Supplementary Information Relating to Tax Reform Measures* (Ottawa, Department of Finance, 1987) at 99.

horse has bolted”.²³ Second, adding specific rules complicated the *Act* by attempting to anticipate numerous conceivable forms of tax avoidance.²⁴ Finally, “the tax avoidance industry is far more productive, both in terms of intellectual energy and efficiency, than tax collectors and policy advisors”.²⁵ The Department of Finance wanted a more potent weapon against increasingly aggressive tax planners. The Department’s Technical Notes released on the introduction of the GAAR characterize it as an attempt “to distinguish between legitimate tax planning and abusive tax avoidance and to establish a reasonable balance between the protection of the tax base and the need for certainty for taxpayers in planning their affairs”.²⁶

Subsection 245(4) of the *Act* sets out the most significant limitation on the GAAR.²⁷ As the Technical Notes explain, where a taxpayer carries out a transaction primarily to use the *Act*’s specific rules to obtain a tax benefit not intended by those rules or by the *Act* when read as a whole, the GAAR should apply.²⁸ The Notes go on to state that “this would be the case even though the strict words of the relevant specific provisions may support the tax result sought by the taxpayer. Thus, where applicable, section 245 will override other provisions of the *Act* since, otherwise, its

23. Krishna, *Fundamentals*, *supra* note 21 at 1016.

24. *Ibid.*

25. *Ibid.*

26. Canada, Department of Finance, *Technical Notes to Bill C-139*, (Don Mills, Ont: CCH Canadian, 1988) at 313.

27. *Supra* note 6, s 245(4):

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

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

(i) this Act,

(ii) the *Income Tax Regulations*,

(iii) the *Income Tax Application Rules*,

(iv) a tax treaty, or

(v) any other enactment that is relevant in computing tax or any other amount payable by or refundable to a person under this Act or in determining any amount that is relevant for the purposes of that computation; or

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

28. See *supra* note 26 at 316.

object and purpose would be defeated”.²⁹ Moreover, a transaction that does not amount to a misuse of any specific provision may still be deemed abusive having regard to the *Act* as a whole.³⁰

Thomas McDonnell provides a number of guidelines that establish when, in his view, the GAAR should not override a SAAR. These include the following: (1) where the SAAR is based on a “results test” and the taxpayer’s transaction does not fall within the specific rule; (2) where the SAAR itself specifies in some detail the tax consequences of a transaction, and the taxpayer’s transaction falls within a relieving provision; (3) where the SAAR applies to determine tax consequences that are “reasonable in the circumstances”; and (4) where it is apparent from the scheme of the *Act* that Parliament did not intend to address a particular type of transaction (such as where the rule includes a “bright line”).³¹ On the other hand, McDonnell suggests that the GAAR may be applied where the taxpayer’s compliance with the SAAR is a consequence of an “artificial” or “contrived” series of transactions.³²

More generally, the very existence of a GAAR indicates a legislature’s honest admission that the only way to deal with the problem of tax avoidance is to prohibit undesirable activities that are not foreseen and cannot be described in advance. The GAAR is a practical attempt to authorize the courts to make assumptions about legislative intent in certain circumstances.³³ A great many comparative studies have examined broad approaches to avoidance in tax law.³⁴ From such studies it seems

29. *Ibid.*

30. See *ibid.* See also Krishna, *Fundamentals*, *supra* note 21 at 1027–28.

31. See McDonnell, “Legislative Anti-Avoidance”, *supra* note 16 at 6:34.

32. *Ibid.*

33. See David Dunbar, “Tax Avoidance: A Judicial or Legislative Solution; Lessons for the United States from the British Commonwealth” (Nov 2010) *Corporate Business Taxation Monthly* 21 at 23–24.

34. See e.g. Arnold & Wilson, “Part 1”, *supra* note 21; Tracey Bowler, *Countering Tax Avoidance in the UK: Which Way Forward?*, Tax Law Review Committee Discussion Paper No 7 (London, UK: The Institute for Fiscal Studies, 2009); Duff, “21st Century”, *supra* note 1; Dunbar, *supra* note 33; Gilles Larin et al, *Effective Responses to Aggressive Tax Planning: What Canada Can Learn from Other Jurisdictions*, Canadian Tax Paper No 112 (Toronto: Canadian Tax Foundation, 2009) at 91–92; Nabil Orow, *General Anti-Avoidance Rules: A Comparative International Analysis* (Bristol, UK: Jordans Ltd, 2000); Frans Vanistendael, “Legal Framework for Taxation” in Victor Thuronyi, ed, *Tax Law Design and Drafting* (Washington, DC: International Monetary Fund, 1998) 15. See also Steven A Dean &

clear that a GAAR (or a judicial doctrine operating to much the same effect) is a necessary adjunct to the legislative apparatus. Yet this says nothing about how such a rule or doctrine should operate. In Brian Arnold's view, a GAAR exists in Canada "because that was the only alternative that was left to Parliament to deal with abusive tax avoidance. Specific anti-avoidance rules do not work".³⁵ The question, however, is not *whether* specific anti-avoidance rules work, but *how* they work in conjunction with a general anti-avoidance rule. The following section looks at how the courts have tried to answer this question.

II. Jurisprudence: The Courts Grapple with the Treatment of the General Anti-Avoidance Rule

A. OSFC and Canada Trustco: *The First Wave*

In *OSFC Holdings Ltd v Canada*,³⁶ the majority of the Federal Court of Appeal emphasized that the GAAR targeted tax avoidance transactions that were contrary to the intent of the *Act's* specific provisions. While this could be read as permitting some judicial "gap-filling", the majority also asserted that where "a clear and unambiguous relevant policy could not be ascertained", the existing statutory provisions must be given a purposive interpretation.³⁷ If this favoured a taxpayer who had engaged in an avoidance transaction, so be it. In Rothstein JA's words, "to deny a tax benefit where there has been strict compliance with the Act, on the grounds that the avoidance transaction constitutes a misuse or abuse, requires that the relevant policy be clear and unambiguous".³⁸ In *OSFC* itself, the Court of Appeal was able to ascertain fairly easily that the *Act*

Lawrence M Solan, "Tax Shelters and the Code: Navigating Between Text and Intent" (2007) 26:4 Va Tax Rev 879 at 881-82; Marvin A Chirelstein & Lawrence A Zelenak, "Tax Shelters and the Search for a Silver Bullet" (2005) 105:6 Colum L Rev 1939 at 1950.

35. Brian Arnold et al, "The Future of GAAR", *2005 Conference Report: Report of Proceedings of the Fifty-Seventh Tax Conference* (Toronto: Canadian Tax Foundation, 2006) 4:1 at 4:2 [Arnold et al, "Future"].

36. 2001 FCA 260, [2001] DTC 5471, leave to appeal to SCC refused, 28860 (June 20, 2002).

37. *Ibid* at para 115.

38. *Ibid* at para 69.

carried a general policy against the transfer of losses by corporations and that the taxpayer in this case had abused the provisions of the *Act*.³⁹

After *OSFC*, the Supreme Court of Canada next considered the GAAR in *Canada Trustco Mortgage Co v Canada*,⁴⁰ which dealt with a company's scheme to obtain capital cost allowance against its leasing income.⁴¹ Writing for the Court, McLachlin CJC and Major J noted that the case (and its companion, *Mathew v Canada*)⁴² raised the issue of the interplay between the GAAR and the *Act*'s more specific provisions.⁴³ The judgment observed that the line drawn by the GAAR between minimization and abuse "is far from bright". Most significantly, the purpose of the GAAR is to deny the tax benefits from arrangements that complied with a literal reading of the *Act*, but nevertheless amounted to an abuse of its provisions. However, "precisely what constitutes abusive tax avoidance remains the subject of debate".⁴⁴

The core of the subsection 245(4) analysis lies in a purposive interpretation of the specific provisions relied on by the taxpayer and of how these provisions, properly interpreted, apply to the facts of the case. The first task is to interpret the provisions to determine their object, spirit and purpose. The second is to determine whether the transaction can be said to fall within or to frustrate that purpose. In the Court's words in *Canada Trustco*:

This analysis will lead to a finding of abusive tax avoidance when a taxpayer relies on specific provisions of the *Income Tax Act* in order to achieve an outcome that those provisions seek to prevent. As well, abusive tax avoidance will occur when a transaction defeats the underlying rationale of the provisions that are relied upon. An abuse may also result from an arrangement that circumvents the application of certain provisions, such as specific anti-avoidance rules, in a manner that frustrates or defeats the object, spirit or purpose of those provisions.⁴⁵

39. *Ibid* at para 98.

40. *Supra* note 8.

41. *Ibid* at paras 2–4, Appendix.

42. 2005 SCC 55, [2005] 2 SCR 643.

43. *Supra* note 36 at para 1.

44. *Ibid* at paras 1, 16.

45. *Ibid* at para 45.

In contrast, abuse will not be established where the court can reasonably conclude that the avoidance transaction falls within the object, spirit or purpose of the provisions that confer the tax benefit.⁴⁶

The Court in *Canada Trustco* also considered the role of the *Duke of Westminster* principle under the GAAR. The Court observed that the Department of Finance's Explanatory Notes on the GAAR stated that Parliament recognized that arranging one's affairs so as to attract the least tax was legitimate under Canadian tax law. It is important, then, for the Minister or the courts "to search for an overriding policy of the *Income Tax Act* that is not anchored in a textual, contextual and purposive interpretation of the specific provisions that are relied upon for the tax benefit would run counter to the overall policy of Parliament that tax law be certain, predictable and fair, so that taxpayers can intelligently order their affairs".⁴⁷

Ultimately, the Court held in *Canada Trustco* that the GAAR applies where the transaction passes a literal reading of the *Act's* provisions but nevertheless defeats their object and spirit.⁴⁸ The GAAR cannot be taken to rewrite the substantive provisions of the *Act*, but simply to require the taxpayer to structure her transactions consistently with the statutory provisions she is relying on. Abusive tax avoidance will be found if her transactions frustrate or defeat those provisions.⁴⁹

B. Lipson: A Fragmented Supreme Court Raises but Avoids the Issue

Despite having come to a unanimous decision in *Canada Trustco*, the Supreme Court unfortunately split three ways in *Lipson v Canada*.⁵⁰ The case essentially dealt with a plan by a taxpayer to convert non-deductible interest on a home mortgage into deductible interest on funds borrowed to purchase shares.

46. *Ibid.*

47. *Ibid* at para 42 (the Minister is the Minister of National Revenue).

48. *Ibid* at para 49.

49. Following *Mathew*, *supra* note 42 at para 62, can the transaction be said to involve "vacuity and artificiality"? See *Canada Trustco*, *supra* note 8 at paras 75-78 (the Court ruling that the transaction was not so dissimilar from an ordinary sale-leaseback situation as to take it outside of the purpose of the *Act's* capital cost allowance provisions, rejecting the Minister's argument that these provisions entail economic risk on the taxpayer).

50. 2009 SCC 1, [2009] 1 SCR 3.

Justice LeBel’s majority decision (Fish, Abella and Charron JJ, concurring) cautioned against relying on the *Duke of Westminster* principle, noting that it has never been absolute, and echoed *Canada Trustco* in insisting on a textual, contextual and purposive approach to statutory interpretation. He added that Parliament enacted the GAAR “to limit the scope of allowable avoidance transactions while maintaining certainty for taxpayers”.⁵¹ Justice LeBel stated further that courts should not shift the focus of the inquiry to the “overall purpose” of the taxpayer’s transactions, as that would “incorrectly imply that the taxpayer’s motivation or the purpose of the transaction is determinative. In such a context, it may be preferable to refer to the “overall result”, which more accurately reflects the wording of s. 245(4) and this Court’s judgment in *Canada Trustco*”.⁵²

Unfortunately, the majority did not elaborate on how or why the taxpayer’s behaviour amounted to misuse and abuse, perhaps because it reasonably saw the GAAR outcome as straightforward. Justice LeBel did state that “[t]o the extent that it may not always be obvious whether the purpose of a provision is frustrated by an avoidance transaction, the GAAR may introduce a degree of uncertainty into tax planning, but such uncertainty is inherent in all situations in which the law must be applied to unique facts”.⁵³ He also noted that while the GAAR is a residual rule, it is designed to address the complexity of situations which “fall outside the scope” of SAARs.⁵⁴ But is it unreasonable to read a SAAR’s scope as *not* covering transactions tangential to those explicitly caught by the rule? If two transactions are clearly from the same “family”, is that enough to bring the matter within the SAAR’s scope? If so, why have a *specific* anti-avoidance rule if its very specificity cannot be relied on? Following the majority in *Lipson*, these were live questions.

The dissenting opinions in *Lipson* took a different approach to the GAAR. Justice Binnie (joined by Deschamps J) prefaced his dissent by questioning the health of the *Duke of Westminster* principle. His concerned response was that “[t]he GAAR is a weapon that, unless contained by the jurisprudence, could have a widespread, serious and unpredictable

51. *Ibid* at paras 21, 26. See also David G Duff, “*Lipson v Canada*—Whither the Canadian GAAR?” [2009] 2 Brit Tax Rev 161 at 166 [Duff, “*Lipson*”].

52. *Lipson*, *supra* note 50 at paras 33–34.

53. *Ibid* at para 52.

54. *Ibid* at para 47.

effect on legitimate tax planning. At the same time, of course, the GAAR must be given a meaningful role”.⁵⁵ Interestingly, Binnie J also asserted that “[t]he approbation by the Court of the Minister’s resort to vague generalities or ‘overriding policy’ would only increase the element of uncertainty in tax planning that *Canada Trustco* sought to avoid”.⁵⁶ As he emphasized, under subsection 245(4), the question is whether a transaction is abusive, not whether it amounts to avoidance.⁵⁷ The Minister has the onus of demonstrating that, in relying on a specific provision to claim a tax benefit, the taxpayer is abusing the specific “object, spirit or purpose” of that provision.⁵⁸ Justice Binnie concluded that it was not clear that the taxpayer’s transactions were abusive.⁵⁹

On the other hand, Rothstein J would have held that the GAAR did not apply because a specific anti-avoidance rule pre-empted its application. For present purposes, whether or not Rothstein J was correct on this point is less interesting than his reasoning: “This Court was clear in *Canada Trustco* that the GAAR is a provision of last resort. It can only be relied upon by the Minister to address abusive tax avoidance when a relevant specific anti-avoidance rule in the Act does not apply. . . . The GAAR is a supplementary rule. It is not a catch-all provision that the Minister can choose to deploy any or every time that he suspects a taxpayer of abusive tax avoidance”.⁶⁰

According to Rothstein J, if a specific provision properly applies to the facts, it should preclude the application of the residual GAAR.⁶¹ However, where a specific provision does not (yet) exist, should a court read the *Act* as if it did exist, by applying the GAAR in such circumstances? Arguably the better interpretive approach is to not do so. For a taxpayer to attempt to do indirectly what she could not do directly is one thing, but if she acts in accordance with a purposive reading of the statute as it *is*, that is another thing entirely. Therefore, although the majority judgment

55. *Ibid* at paras 54–55.

56. *Ibid* at para 67.

57. *Ibid* at para 86.

58. *Ibid* at para 96.

59. *Ibid* at para 98.

60. *Ibid* at para 116.

61. *Ibid* at paras 102, 105 (Justice Rothstein believed that s 74.5(11) served as a SAAR prohibiting the taxpayer’s conduct). See also Lebel J (*ibid* at para 44); Rothstein J, dissenting (*ibid* at para 118).

in *Lipson* declared that “a specific anti-avoidance rule is being used to facilitate abusive tax avoidance”,⁶² the real interpretive question is this: if the statute prescribes specific results for one type of situation but not another, what is to be the effect of this statutory silence?

C. Landrus: The Problem Provokes the Federal Court of Appeal

Landrus v Canada involved the transfer of properties from two limited partnerships to a newly formed limited partnership for the purpose of deducting terminal losses, as permitted by subsection 20(16) of the *Act*.⁶³ In this case, the original partners became the partners in the new partnership.⁶⁴ At the Tax Court, Paris J found that while the taxpayer’s transactions amounted to avoidance transactions, he did not misuse the specific provisions relied on and his actions did not constitute abuse of the *Act* as a whole.⁶⁵ The provision was not ambiguous and the conditions necessary for its application were met on the facts of the case. The Court also noted that there was nothing in subsection 20(16) to prevent a taxpayer from claiming a terminal loss when depreciable property was disposed of to a related party.⁶⁶ Justice Paris asserted that it was inappropriate for the Minister to attempt to use the GAAR to “fill in the gaps left by Parliament”.⁶⁷ As the Federal Court of Appeal explained, the Tax Court held, in Noël JA’s words, that the “precise and detailed nature” of the *Act*’s stop-loss rules indicates that they are intended to deny losses in the specific circumstances set out therein. However, the variation among these rules suggested that “Parliament intended to promote particular purposes rather than a general unexpressed policy. The specificity of these rules indicates that they are exceptions to a general policy of allowing losses on all dispositions”.⁶⁸

The Federal Court of Appeal agreed that *Lipson* had established that the improper use of a SAAR amounted to its misuse, but held that on

62. *Ibid* at para 42.

63. 2009 FCA 113, 392 NR 54 [*Landrus* FCA], aff’g 2008 TCC 274, [2008] DTC 3585 [*Landrus* TCC].

64. *Landrus* FCA, *supra* note 63 at paras 5–19.

65. *Ibid* at para 2.

66. *Ibid* at paras 27–28.

67. *Landrus* TCC, *supra* note 63 at para 124.

68. *Landrus* FCA, *supra* note 63 at paras 44–45 [footnotes omitted].

the facts of *Landrus* no such misuse had been made out.⁶⁹ Justice Noël agreed with the Crown that the inapplicability of any SAAR to a particular situation did not in itself mean that Parliament had condoned the result.⁷⁰ Unfortunately, the Court did not attempt to resolve the apparent conflict between what the majority of the Supreme Court said in *Lipson* about the improper use of a SAAR and the view that planning around a SAAR does not constitute abuse. Instead, as Noël JA explained, the Crown’s most powerful argument was that despite a new legal form (a transfer of property to a new partnership) the economic substance was left unchanged.⁷¹ Nevertheless, Noël JA added that “where it can be shown that an anti-avoidance provision has been carefully crafted to include some situations and exclude others, it is reasonable to infer that Parliament chose to limit their scope accordingly”.⁷²

Landrus, then, is a provocative decision but ultimately avoids deep engagement with the issue. While this may have been appropriate on the facts, the case left an emerging need for direct appellate guidance on what is a misuse or abuse for the purposes of subsection 245(4) in the context of the interaction between the GAAR and SAARs.⁷³

D. Collins & Aikman: Gaps as Parliament’s Choice?

In *Collins & Aikman Products v Canada*,⁷⁴ the Collins & Aikman group of companies pursued a reorganization that had the effect of vastly increasing the paid-up capital (PUC) in a Canadian company from an

69. See Joanna Barsky & Timothy Fitzsimmons, “*Landrus v. R.*: The Federal Court of Appeal Specifically Avoids the Important Issue” (2009) 16:3 Tax Litigation 998 at 1001.

70. *Landrus* FCA, *supra* note 63 at para 47, citing *Central Supply Company (1972) Ltd v Canada*, [1997] 3 FC 674, 215 NR 46 (CA).

71. *Landrus* FCA, *supra* note 63 at para 55 [footnotes omitted]. The Crown argued that the deduction allowed under subsection 20(16) of the *Act* is predicated on the fact that the taxpayer is no longer able to use the property after its disposal; here, the taxpayers retained use of the property.

72. *Ibid* at para 47.

73. See Timothy Fitzsimmons, “Mind the Gap” (2008) 56:4 Can Tax J 936 at 941 (a taxpayer today could not replicate the transaction in *Landrus* and obtain the same result, as subsection 13(21.2) of the *Act* would now operate to deny her loss because she would own or have a right to acquire the property within thirty days after the disposition).

74. 2009 TCC 299, [2009] DTC 1179 [*Collins & Aikman* TCC], *aff’d* 2010 FCA 251, [2010] DTC 5164 [*Collins & Aikman* FCA].

effectively nominal amount.⁷⁵ A significant portion of the increase was then paid out as a (tax-free) return of capital to the Canadian group's American parent company.⁷⁶

At the Tax Court, the Crown argued that corporate distributions are to be included in income except where specific provisions of the *Act* provide otherwise. In rejecting the Crown's arguments, Boyle J affirmed that "[w]hen considering the statutory provisions dealing with corporate distributions there is no clear need to step back from the *Act* altogether, begin from an unstated premise, and then treat the *Act* as only setting out the exceptions".⁷⁷ In response to the question of whether the transactions in the case at hand could be said to defeat or frustrate the object, spirit or purpose of subsection 84(4), which deems a dividend to have been paid on excessive reductions of PUC, Boyle J remarked that the taxpayers' transactions did not rely on any particular provision in the tax statute to accomplish what subsection 84(4) sought to prevent. Indeed, the real question was whether any abuse resulted from those transactions' circumvention of a provision in a way that frustrated or defeated the *Act's* object, spirit or purpose.⁷⁸

With regard to the relevant specific provisions in this case, Boyle J said that they were introduced when the *Act's* drafters specifically turned their minds to the precise issue of what should happen to the Canadian tax accounts of a corporation upon that firm becoming resident in Canada. However, none of these specific rules applied to the taxpayer. If they did, there would be no need to resort to the GAAR.⁷⁹ Justice Boyle concluded that none of the transactions in question "involved the degree of artificiality, boldness, vacuity or audacity to rise to the level of being a loophole or gimmick in common parlance, nor abusive tax avoidance

75. PUC is a significant tax attribute because, of course, it represents the amount invested in the corporation that can later be returned to shareholders tax-free by way of a return of capital.

76. *Collins & Aikman TCC*, *supra* note 74 at paras 9–19.

77. *Ibid* (where the Court stated that "[s]ubdivision h of the *Act* is drafted as a régime, not as a series of exceptions" at para 62).

78. *Ibid* at paras 81–83.

79. *Ibid* at para 99.

using the language of the *Act* and the GAAR”.⁸⁰ He agreed with Paris J in *Landrus* that using the GAAR for gap filling would not be appropriate.⁸¹

The Federal Court of Appeal dismissed the appeal from the bench without even hearing from counsel for Collins & Aikman, and somewhat cryptically noted that it agreed with Boyle J’s decision, “substantially for the reasons he gave”.⁸² Justice Sharlow did go on to remark that she would not reach a different conclusion based on the Crown’s argument on appeal that subsections 84(1) and 212(1) of the *Act*⁸³ should be considered as part of the relevant statutory scheme for determining whether there had been misuse or abuse. Those provisions, she observed, were carefully drafted by Parliament so as not to apply to certain situations, including the case at hand.⁸⁴ In other words, where the *Act* sets out highly specific rules, the courts need not try to infer Parliament’s intent with respect to the scheme of the *Act*, but are to rely on the specificity of the rules as enacted. So while *Collins & Aikman* did not definitively settle the issue, it serves as another reminder that the courts will continue to turn their attention to the limits of the GAAR, and to assert that it should not be used to fill a gap in the *Act* or where a specific anti-avoidance provision is relevant to the facts of a given transaction.⁸⁵

80. *Ibid* at para 109. The term “artificial” was never a good descriptive word for the standard of abuse under subsection 245(4), and the Tax Court in *Collins & Aikman* may indeed have gotten the terminology wrong. However, this does not mean that what the Court was trying to refer to was irrelevant. See also Arnold & Wilson, “Part 2”, *supra* note 21 at 1144; Arnold & Wilson, “Part 3”, *supra* note 21 at 1409.

81. *Collins & Aikman* TCC, *supra* note 74 at para 109.

82. *Collins & Aikman* FCA, *supra* note 74 at para 1.

83. See *Coptborne Holdings Ltd v Canada*, 2011 SCC 63 at para 95, [2011] 3 SCR 721 [*Coptborne* SCC] (describing subsections 84(1) and 212(1) of the *Act* as designed to prevent “surplus stripping” through the creation of paid-up capital or the removal of retained earnings as capital) aff’g 2009 FCA 163, [2009] DTC 5101 [*Coptborne* FCA], aff’g 2007 TCC 481, [2007] DTC 1230 [*Coptborne* TCC].

84. *Ibid* at para 4.

85. See also *Remai et al v The Queen*, 2009 FCA 340, [2009] DTC 5188 aff’g 2008 TCC 344, [2008] DTC 4567.

E. Lehigh Cement: A New Resolve?

*Lehigh Cement Ltd v Canada*⁸⁶ reinforces the deference to specificity over generality shown in *Collins & Aikman*. Part XIII of the *Act* imposes a tax on every non-resident who receives passive income (such as interest or dividends) from a person resident in Canada. The Canadian resident who pays passive income to a non-resident is obliged to withhold and remit tax payable by the non-resident, as a necessary collection mechanism. At the Tax Court level in *Lehigh Cement*, the parties raised the question of whether the taxpayer's interest payments qualified for an exemption under (the now repealed) subsection 212(1)(b)(vii), which set out an exemption from the withholding requirement on interest payments.⁸⁷ That clause was not really a SAAR, but it still provides a helpful example of statutory specificity in the context of a GAAR analysis.⁸⁸

While Mogan J's decision in *Lehigh Cement* does not help to explain what it means to frustrate the purpose of a SAAR, he did ask whether the transaction frustrated or defeated the object, spirit or purpose of the specific provision. He stated that the provision's exemption from the withholding tax on arm's length borrowing from foreign lenders helped to make such borrowing more competitive with domestic borrowing.⁸⁹ However, his conclusion that the transaction did not meet the exemption's specific requirements meant that the question of what it actually takes to misuse a specific provision remained unanswered.⁹⁰

In the Federal Court of Appeal, Sharlow JA observed that the meaning of the phrase "object, spirit or purpose" in a GAAR analysis had not been fully explained in *Canada Trustco*, but that in the context of *Lehigh Cement* it meant "the purpose of the exemption in subparagraph 212(1)

86. 2010 FCA 124, [2010] DTC 5081 [*Lehigh* FCA].

87. *Lehigh Cement Ltd v Canada* 2009 TCC 237 at paras 25, 27, [2009] DTC 1148 [*Lehigh* TCC].

88. See e.g. Arnold, "Reflections", *supra* note 15 (defining what constitutes tax avoidance).

89. *Lehigh* TCC, *supra* note 87 at paras 39–40.

90. *Ibid* at para 45 (Justice Mogan concluded that because the taxpayer did not borrow money from the Belgian bank or any other non-resident lender, the sale transaction at issue abused subsection 212(1)(b)(vii) and hence the GAAR applied. The question left open was whether a similar transaction that met the requirements for section 212(1)(b)(vii) could nonetheless amount to a misuse of the provision or an abuse of the *Act* when read as a whole).

(b)(vii), determined on the basis of a textual, contextual and purposive interpretation”.⁹¹ Significantly, Sharlow JA added that “if there is any doubt as to whether the transaction in issue results in a misuse” of a specific provision, the taxpayer should be entitled to the benefit of that doubt.⁹²

The Court of Appeal noted that on the facts of *Lehigh Cement* (and as conceded by the Crown), the taxpayer had met the statutory conditions for the exemption both “technically and substantively”.⁹³ But the Crown argued that the taxpayer’s transaction still offended the provision’s fiscal policy objective.⁹⁴ Justice Sharlow found no authority for that proposition: “the fact that an exemption may be claimed in an unforeseen or novel manner, as may have occurred in this case, does not necessarily mean that the claim is a misuse of the exemption”.⁹⁵ On the other hand, she said, when Parliament adds a new specific rule, such as an exemption to the *Act*, it cannot possibly be expected to describe every transaction that falls inside or outside the intended scope of the rule, so it is conceivable that a taxpayer might misuse a statutory exemption comprised of a bright line test. For the Court of Appeal, “the Crown cannot discharge the burden of establishing that a transaction results in the misuse of an exemption merely by asserting that the transaction was not foreseen or that it exploits a previously unnoticed legislative gap”.⁹⁶ The taxpayer’s appeal was thus allowed.

91. *Lehigh FCA*, *supra* note 86 at para 22.

92. *Ibid* at para 23.

93. *Ibid* at para 25.

94. *Ibid*.

95. *Ibid* at para 37. The Court of Appeal recognized that there is no systemic requirement that principal and interest must be owed to the same entity, consistent with widespread commercial practice. On the other hand, this does not necessarily mean that it is acceptable for the principal to be owed to a related party with the interest paid to an arm’s length party in the context of the specific rule at issue in this case. It is on this latter point that the Federal Court of Appeal judgment in *Lehigh Cement* might be vulnerable. That said, while the Court might be wrong on whether there was a gap in the *Act* with reference to the facts in *Lehigh Cement*, the Court was not wrong to insist that if a gap did exist, filling it was Parliament’s job.

96. *Ibid*.

F. Copthorne: Not Quite the End of the Line

The Supreme Court of Canada's divisions in *Lipson* have now been overtaken by its unified decision in *Copthorne Holdings Ltd v Canada*.⁹⁷ The corporate taxpayer in *Copthorne* undertook a series of transactions to consolidate its losses. At the end of these transactions, a Canadian corporation that the Court referred to as Copthorne I held all of the issued and outstanding shares in another Canadian corporation, VHHC, which had a PUC of \$67 million, but only at nominal fair market value. Since Copthorne I had realized a significant capital gain and VHHC had a significant capital loss, the plan was to amalgamate the two corporations. A vertical amalgamation, however, would have led to a loss of the PUC on the VHHC shares. To preserve the PUC, VHHC's shares were first transferred in 1993 to a related non-resident corporation, causing Copthorne I and VHHC to become sister corporations. The two corporations were then amalgamated in early 1994. The taxpayer in this case was the amalgamated corporation (Copthorne II).⁹⁸

Later in 1994, Copthorne II was sold to a new non-resident corporation and was then horizontally amalgamated with another Canadian corporation, creating what the Court referred to as Copthorne III, which had a total PUC of \$164 million. Copthorne III redeemed its shares for \$142 million and the proceeds were paid to the non-resident corporate shareholder as a tax-free return of capital. No withholding tax was paid on this redemption because it was considered a return of capital in an amount not greater than the PUC of the shares redeemed. The Minister disagreed with this result, and sought to apply the GAAR to reduce the PUC of Copthorne III, thereby implying that Part XIII tax should have been paid on what would have been a deemed dividend.⁹⁹

The Tax Court upheld the GAAR assessment, finding both a tax benefit in the redemption and an avoidance transaction in the 1993 share sale. Interestingly, the Tax Court did not find misuse or abuse on the basis of the specific provisions in the *Act*, but nonetheless held that the taxpayer had abused the *Act* insofar as its preservation of PUC amounted

97. *Copthorne* SCC, *supra* note 83.

98. *Copthorne* FCA, *supra* note 83 at paras 6–14.

99. *Ibid* at paras 16–22.

to a double counting of the \$67 million.¹⁰⁰ The Federal Court of Appeal dismissed the taxpayer's appeal, effectively agreeing with the Tax Court that the rationale for eliminating PUC on vertical amalgamations was circumvented in this case. The Court of Appeal, however, did not explain what was abusive about such a preservation of capital,¹⁰¹ and interestingly did not refer to *Lipson* at all in its decision.

Justice Rothstein delivered the Supreme Court's unanimous decision, dismissing the taxpayer's appeal.¹⁰² The Supreme Court expressly confirmed the Tax Court's finding that there was a tax benefit in choosing a horizontal rather than a vertical amalgamation,¹⁰³ and that selling the shares to create sister companies instead of the previously existing parent-subsidiary relationship was an avoidance transaction.¹⁰⁴ As Rothstein J noted, the most difficult issue was whether the avoidance transaction amounted to misuse or abuse of the *Act*. He accepted the Tax Court's finding that the transactions in the case resulted in "double counting" of the PUC,¹⁰⁵ but like the Court of Appeal, he did not explain why this was abusive. While it is perhaps not surprising to members of the tax bar that the Supreme Court upheld the finding of abuse given the "double counting" of PUC in this case, the tax community did hope that the Court would provide some clarity on how one decides whether a taxpayer has been abusive in her avoidance of the tax consequences flowing from the application of specific rules of the *Act*. The Court was mindful that the GAAR's potential application to cases where the taxpayer has

100. *Ibid* at paras 31–34.

101. *Ibid* at paras 73–74.

102. *Copthorne* could arguably be read as rejecting the main argument of this paper, in that the taxpayer identified a specific rule which would not apply to its double counting of PUC and attempted to plan around it accordingly. The taxpayer later redeemed shares of its non-resident shareholder, and thus appeared to escape the rule that would have stopped the PUC preservation. The Supreme Court agreed that this was an abuse of the *Act* under the GAAR. My response is that given the extent of the split in *Lipson* and the comments subsequently made by the lower courts, it would be reading too much into *Copthorne* to assert that the Court has sanctioned gap-filling in all or even some cases. Much more directed guidance would be needed to support that reading.

103. *Copthorne* SCC, *supra* note 83 at paras 37–38.

104. *Ibid* at para 63.

105. See Mark Meredith & Nancy Diep, "Duplication of Tax Attributes", *2010 Conference Report: Report of Sixty-Second Tax Conference* (Toronto: Canadian Tax Foundation, 2011) 10:1 at 10:18.

complied with the text of the *Act* inherently creates some uncertainty, and that because a GAAR ruling can affect many taxpayers, a court has to approach the matter with care.¹⁰⁶ The Court also reiterated its affirmation in *Canada Trustco* that the GAAR only applied where “the abusive nature of the transaction is clear” and that the *Act* had to be read with an eye to “consistency, predictability and fairness”.¹⁰⁷

Perhaps more interesting is Rothstein J’s distinction between statutory interpretation of a traditional sort and statutory interpretation under the misuse and abuse analysis. Under the former, the court applies a textual, contextual and purposive approach to determine what the specific language of a statute means; under the latter, it seeks to ascertain the object, spirit or purpose of a provision of the *Act*.¹⁰⁸ The Court applied the latter type of analysis to subsection 87(3), which reduces the PUC of the shares of an amalgamated corporation if it exceeds the PUC of the shares of the predecessor companies in certain circumstances. The Court observed that in considering whether the GAAR applies, the text of the provisions at issue will not preclude the tax benefit (otherwise there would be no reason to rely on the GAAR), but that does not mean that the text is irrelevant—it may shed light on what Parliament intended the provision to do.¹⁰⁹ The Court considered why the specific provision limited PUC on vertical but not horizontal amalgamations. Justice Rothstein noted that since subsection 87(3) is one of many provisions in the *Act* that seeks to reduce PUC in certain circumstances, it is reasonable to conclude that it shares the general purpose of precluding the preservation of PUC where doing so would allow for a tax-free withdrawal of capital that exceeded what had been invested with tax-paid funds.¹¹⁰

The Supreme Court, however, did not examine the implications of the fact that Parliament had specifically contemplated vertical and not horizontal amalgamations. Before the Court’s decision, some practitioners were of the view that Parliament had set out clear rules for when PUC should be reduced. Since the transactions in *Copthorne* appeared to respect these rules, it would have been helpful for the Court

106. *Copthorne* SCC, *supra* note 83 at paras 65–67.

107. *Ibid* at paras 67–68.

108. *Ibid* at para 70.

109. *Ibid* at para 88.

110. *Ibid* at para 96.

to explain why preservations of PUC in horizontal amalgamations were abusive. The taxpayer argued that since Parliament had put a number of provisions into the *Act* to restrict taxpayers from inappropriately increasing or preserving PUC, the fact that its amalgamation was not caught by those provisions meant that the actions in question were not abusive. Justice Rothstein’s answer was open-ended: “I do not rule out the possibility that in some cases the underlying rationale of a provision would be no broader than the text itself”, and that the text of a provision is more likely to be conclusive where it “fully explains” its underlying rationale.¹¹¹ That said, Rothstein J also noted that the taxpayer’s implied exclusion argument is “misplaced where it relies exclusively on the text of the PUC provisions without regard to their underlying rationale. If such an approach were accepted, it would be a full response in all GAAR cases, because the actions of a taxpayer will always be permitted by the text of the *Act*”.¹¹² The difficulty is that while Rothstein J was right to say this, his answer does not explain how to identify and examine that rationale in the challenging cases where the text of the *Act* does not clearly establish the *Act*’s purpose.

The Supreme Court concluded that the object, spirit and purpose of subsection 87(3) is to preclude the preservation of PUC on an amalgamation where such preservation would allow a shareholder (on a later share redemption) to be paid tax-free amounts in excess of the investment of tax-paid funds. The Court explained that while the text of subsection 87(3) was not infringed in this case, the taxpayer’s conduct nevertheless frustrated its purpose.¹¹³ Perhaps the Court was sensible in stating its reasons for dismissing the taxpayer’s appeal narrowly. However, given the struggles sometimes seen in the Tax Court and the Federal Court of Appeal in squaring the GAAR’s application with the specificity of the *Act*’s other provisions, and the possibility for inconsistency in how those courts resolve the conflict, the Supreme Court might have elaborated on the proper method for parsing tax abuse. After *Cophorne*, the problem

111. *Ibid* at para 110.

112. *Ibid* at para 111.

113. *Ibid* at paras 126–27. This conclusion can be seen as implicitly based on the broader finding that, but for the GAAR, the result would contradict the very purpose of PUC and therefore defeat the scheme of the *Act*.

of reconciling the GAAR's application with the *Act's* SAARs remains largely unresolved.

III. Question: How Does a Taxpayer Misuse or Abuse a Gap in the Act?

A. *The Contested Legitimacy of Tax Minimization*

The judicial treatment of the GAAR has been met with much criticism from legal scholars and commentators. As Vern Krishna remarked in the aftermath of *Lipson*, “*Westminster* prevails over GAAR, except in those circumstances where GAAR prevails over *Westminster*”.¹¹⁴ After *Canada Trustco*, the limited guidance on the GAAR's application from the Supreme Court of Canada was, in David Louis' words, “repeated, mantra-like, throughout the cases”.¹¹⁵ Brian Arnold similarly noted that the Court provided no basis for making the critical determination of when a taxpayer's transaction was abusive on account of being “wholly dissimilar” to that contemplated by the statutory provisions relied on by the taxpayer.¹¹⁶ Judith Freedman agreed that there was a need for directed guidance on the GAAR's application—mere reference to a misuse or abuse does not suffice.¹¹⁷ These views would be unaltered post-*Coptborne*.

The broad challenge for the GAAR is this: when faced with a specific anti-avoidance provision, what does it mean for the taxpayer to misuse that rule or to abuse the scheme of the *Act* read as a whole? Of course, if it was impossible for taxpayers to misuse or abuse the *Act's* SAARs, the GAAR would be meaningless. The CRA provided its own interpretation of the GAAR in Information Circular 88-2, released shortly after the GAAR's advent in October 1988:

114. “GAAR Trumps *Westminster* in *Lipson*” (2009) 19:8 Can Curr Tax 85 at 89 [Krishna, “Trumps”].

115. “Magical Mystery Tour—The Supreme Court's GAAR Cases” (2005) 514 Tax Notes 1 at 2.

116. “Confusions”, *supra* note 9 at 194.

117. “Interpreting Tax Statutes: Tax Avoidance and the Intention of Parliament” (2007) 123:1 Law Q Rev 53 at 74.

Transactions that rely on specific provisions, whether incentive provisions or otherwise, for their tax consequences, or on general rules of the Act can be negated if these consequences are *so inconsistent* with the general scheme of the Act that they cannot have been within the contemplation of Parliament. On the other hand, a transaction that is consistent with the object and spirit of provisions of the Act is not to be affected. Revenue Canada will follow this principle in interpreting section 245 of the Act.¹¹⁸

According to the CRA, it appears that the GAAR will not normally apply when a SAAR directly applies to the transaction or provides an exception for the transaction at issue. While this reading raises the problem of what it means for the *Act* to make an exception—whether it must be done expressly or can be done by inference—it does suggest that the GAAR should only apply to areas not yet covered by specific rules.¹¹⁹ While taxpayers should not be able to achieve indirectly what they could not accomplish directly, my central argument is that a taxpayer does not frustrate the object and spirit of a SAAR when she relies on a specific rule as formulated and plans her affairs accordingly. In other words, if there is a “gap” in the *Act*, it should be left to Parliament, and not the courts, to fill it.

Brian Arnold and James Wilson cautioned more than twenty years ago that applying the GAAR’s misuse and abuse standard would be problematic. Their conclusion, based on the CRA’s examples in the Information Circular, was that subsection 245(4) “is based on some unspecified standard that looks very much like a ‘smell’ test”.¹²⁰ More recently, reflecting on the GAAR jurisprudence between *Lipson* and *Copthorne*, Al Meghji remarked that the GAAR had been virtually collapsed into the misuse and abuse analysis, which appeared to be “an open invitation for judges to engage their own fiscal morality”.¹²¹ Former Chief Justice Bowman of the Tax Court added, somewhat worryingly, that it was “absolutely certain” that “whether you win or lose a GAAR case depends on the judge you get in the first instance”.¹²² While Meghji

118. Canada Revenue Agency, Information Circular IC88-2, “General Anti-Avoidance Rule Section 245 of the Income Tax Act” (21 October 1988) at para 5 [emphasis added].

119. See Innes et al, *supra* note 21 at 183–84.

120. Arnold & Wilson, “Part 3”, *supra* note 21 at 1376.

121. Donald GH Bowman et al, “GAAR: Its Evolution and Application” in *2009 Conference Report: Report of Proceedings of the Sixty-First Tax Conference* (Toronto: Canadian Tax Foundation, 2010) 2:1 at 2:14.

122. *Ibid* at 2:14–17.

referred to this as “judicial subjectivity”, Bowman described it more directly as a “certain visceral element”, inelegantly called a “smell test”.¹²³

Arnold has remarked that “where there are specific anti-avoidance rules, the GAAR is either superfluous because the specific rule applies or *ineffective because a transaction that is not subject to the specific rule cannot be considered to be abusive*”.¹²⁴ Other commentators have similarly observed that where the taxpayer has used a provision according to its very purpose —“where each section operates exactly the way it is supposed to”—it cannot be said that “there is an abuse of the provisions of the *Act*”.¹²⁵ It is also worth mentioning that in *Neuman v MNR* (decided before *Canada Trustco*), Iacobucci J, writing for the Court, suggested that the Minister can only rely on a SAAR for a given result when the statutory requirements for its application are “specifically met”.¹²⁶ This appears to be non-controversial given current Canadian tax law: if a taxpayer’s conduct does not fit within the purposive interpretation of a specific rule in the *Act*, that rule cannot be relied on to govern the result of the taxpayer’s transaction.

The counter argument would be that a sophisticated taxpayer who relies on specific provisions in order to engage in aggressive avoidance transactions is appropriately subject to the uncertainty surrounding the application of the GAAR. David Dodge, perhaps the most prominent proponent of this view, argues that while SAARs may provide more certainty, and thus are more in line with the rule of law, they cannot represent a general response to tax avoidance.¹²⁷ Here Dodge is on solid

123. *Ibid.* This is not necessarily problematic, as in Bowman’s experience, a “smell test” under the misuse and abuse analysis had worked fairly well. But something more objective than a smell test would be better for determining whether a taxpayer has engaged in misuse or abuse; relying on the discretion of the court is like relying on the discretion of prosecutors (or the CRA). It is an outcome to be avoided unless it is in fact what the law seeks.

124. “Confusions”, *supra* note 9 at 206 citing *XCO Investments Ltd v The Queen*, 2005 TCC 655, [2005] DTC 1731 and *Univar Canada Ltd v R*, 2005 TCC 723, [2005] DTC 1478 [emphasis added].

125. See Brian Kearn & Bruce Lemons, “GAAR in the Tax Court After *Canada Trustco*: A Practitioner’s Guide” (2007) 55:4 Can Tax J 745 at 768–69.

126. [1998] 1 SCR 770 at para 35, 225 NR 190.

127. “A New and More Coherent Approach to Tax Avoidance” (1988) 36:1 Can Tax J 1 at 8. See also David G Duff, “Justice Iacobucci and the ‘Golden and Straight Metwand’ of Canadian Tax Law” (2007) 57:2 UTLJ 525 at 574 [Duff, “Justice Iacobucci].

ground, and what he says is not inconsistent with the GAAR having a residual role. However, he goes much further and points to several limits of a specific rules approach: the practical impossibility of foreseeing every avoidance scheme; the “fact” that every new rule would open up new loopholes; the inequity of catching transactions that were not intended to be covered; and the added complexity such rules bring to the scheme of the *Act*.¹²⁸

On the first of these points, Dodge asserts that the GAAR “is precisely intended to minimize the need to respond repeatedly to abusive strategies by enacting specific legislation every time a purely tax-motivated scheme is marketed”.¹²⁹ Arnold also argues that the “certainty argument,” while easily made, has too often been merely asserted without assessment. While certainty is undoubtedly a worthy goal in interpreting legislation, it is not the only one and is not necessarily the most important. Other objectives such as “fairness, neutrality and raising revenue” are also significant goals in Arnold’s view.¹³⁰ Moreover, the “dire consequences” predicted if the courts pursue anti-avoidance doctrines are “exaggerated and lack credibility”.¹³¹

On Dodge’s second point, additional specific rules may create new planning opportunities. However, if the *Duke of Westminster* principle is alive and (mostly) well, it is hardly inappropriate to permit ingenious taxpayers and their advisers to devise transactions that play off of the existing specific rules. If their conduct in such cases is truly egregious, the rules can be amended. If it is not egregious, then the taxpayers are merely using the statute and case law as it has been laid down. As for potential inequity, Dodge argues that the specific rules approach “hurts those who cannot afford the most astute tax advisers” and, accordingly, is unfair.¹³² To this, I would respond that if taxpayers are to have the freedom to pursue legitimate tax minimization strategies, the most sophisticated among them would invariably be the first to do so. If there is a moral

128. Dodge, *supra* note 127.

129. *Ibid.*

130. *Supra* note 15 at 27.

131. *Ibid.*

132. *Supra* note 127 at 8–9.

problem with this reality, the difficulty is not unique to the domain of tax law, and the solution is not likely to be found in that domain.¹³³

Finally, Dodge may not be right to state that the complexity of the *Act* works against most taxpayers.¹³⁴ Couzin notes that “a tax measure may generally be said to achieve tax simplification if it facilitates compliance”.¹³⁵ William Strain further argues that “[t]he complexity of the law is not the real issue. As long as the application of the law leads to fair and reasonably predictable results, the fact that the law may be complex is of lesser importance”.¹³⁶ In addition, the complexity created by adding new SAARs may pale in comparison to the complexity created by applying the GAAR. In Howard Kellough’s words, “[a]t least with specific rules, only the particular mischief is addressed, and the added complexity and uncertainty are isolated to a particular area”.¹³⁷ Kellough observes that the introduction of the GAAR offers no reason to believe that the government has discontinued using specific rules to cover specific situations.¹³⁸

Along the same line, David Sohmer asserts that predictability “can be preserved by requiring clear and unambiguous arguments as to legislative

133. Does fairness demand that tax policy concern itself primarily with the majority of taxpayers, or with those who pay the majority of taxes? This is not an insignificant question.

134. See John Avery Jones, “Tax Law: Rules or Principles?” (1996) 17:3 *Fiscal Studies* 63 (“[t]here is nothing new in complaining about the complexity of tax legislation. Every generation does it” at 76). See also William J Strain, David A Dodge & Victor Peters, “Tax Simplification: The Elusive Goal” in *1988 Conference Report: Report of Proceedings of the Fortieth Tax Conference* (Toronto: Canadian Tax Foundation, 1989) 4:1 (“[c]hanges to increase the fairness of the system almost always result in increased complexity” at 4:2); Angelo Nikolakakis, “Tax Law: Rules or Principles—Madness or Genius? Mind the Gaps!” in Philip Baker & Catherine Bobbett, eds, *Tax Polymath: A Life in International Taxation Essays in Honour of John F. Avery Jones* (Amsterdam, The Netherlands: IBFD, 2010) 337.

135. “The Process of Simplification” (1984) 32:3 *Can Tax J* 487 at 489.

136. *Supra* note 134 at 4:5. See also Dodge and Peter’s response to Strain (*ibid* at 4:63); Judith Freedman “Defining Taxpayer Responsibility: In Support of a General Anti-Avoidance Principle” [2004] 4 *Brit Tax Rev* 332 [Freedman, “Responsibility”] (arguing that with respect to a GAAR, certainty is the wrong test).

137. “A Review and Analysis of the Redrafted General Anti-Avoidance Rule” (1988) 36:1 *Can Tax J* 23 at 35.

138. *Ibid.* See also Arnold & Wilson, “Part 1”, *supra* note 21 at 887.

intent”.¹³⁹ Given that a unanimous Supreme Court in *Canada Trustco* explicitly supported the predictability standard nine times in its decision, it would be concerning if future judgments diluted that standard in any major way without dealing squarely with the issue.¹⁴⁰ Even where recourse to the GAAR would seem appropriate, it is implicit that “it will be possible to identify the characteristics of an abusive transaction. In a statute as arcane as the Income Tax Act, this may prove to be no easy task in practice”.¹⁴¹ It may be debatable whether Parliament’s actual intent in a given situation can be adequately discerned. However, this might imply that in situations where Parliament clearly did not extend the scope of a SAAR to cover a particular transaction, or where Parliament’s intention is ambiguous, the benefit of the doubt should go to the taxpayer and to sustaining a restricted *Duke of Westminster* principle.¹⁴²

Even Arnold, a sceptic with respect to the *Duke of Westminster* principle, has argued that the GAAR should not always apply to a taxpayer who has arranged her affairs to fall outside the scope of a SAAR. An example would be the superficial loss provisions, which state that a transaction taking place 31 days either before or after the disposition does not offend the *Act*, and the GAAR should therefore not apply. However, there may be circumstances where it is appropriate for the GAAR to supplement SAAR.¹⁴³ If a taxpayer’s transaction falls outside the scope of a clear anti-avoidance rule, the rule itself should dictate the result. If the scope of the specific rule is less clear, then the matter is arguable and the interpretive exercise of deciding what is abuse is considerably more important. This is simply a reflection of the fact that the burden is on the Crown in the misuse and abuse analysis.¹⁴⁴

In *Canada Trustco*, the Supreme Court stated that “precisely what constitutes abusive tax avoidance remains the subject of debate”.¹⁴⁵ The

139. “Some Reflections on the GAAR and Predictability” (2006) 28:18 Can Taxpayer 137 at 137–38.

140. *Ibid* at 139.

141. See McDonnell, *supra* note 16 at 6:30–31. See also Lipson, *supra* note 50 at para 63.

142. But see Hogg et al, *supra* note 16 at 593 (where it is remarked that the presumption in favour of the taxpayer in these cases is a residual presumption only).

143. Arnold et al, “Future”, *supra* note 35 at 4:14.

144. See McDonnell, *supra* note 16 at 6:33. For a pre-*Canada Trustco* decision, see *The Queen v Imperial Oil Ltd*, 2004 FCA 36, 247 DLR (4th) 193.

145. *Supra* note 8 at para 16.

policy objectives of consistency, predictability and fairness would be frustrated if the Minister or the courts were to override the effect of the *Act*'s specific provisions without relying on a textual, contextual and purposive interpretation.¹⁴⁶ Post-*Canada Trustco*, Daniel Sandler has argued that a court might reasonably decide that it cannot identify the clear legislative intent behind a particular statutory provision, or that the Minister has failed to prove what that intent is. This would mean that the GAAR cannot apply, since a taxpayer cannot be said to frustrate an unknown purpose.¹⁴⁷ So while it is possible that a taxpayer's attempt to circumvent the application of a SAAR may amount to abuse when the *Act* is read as a whole, a court should defer to the taxpayer if the legislative intent is ambiguous or uncertain. To do otherwise would mean that the court is inappropriately creating tax policy.¹⁴⁸ In *Canada Trustco*, the Supreme Court concluded that the taxpayer's alleged "abuse of the Act must be clear, with the result that doubts must be resolved in favour of the taxpayer".¹⁴⁹ This point was reiterated in Binnie J's dissent in *Lipson*.

B. Gap-Fillers Anonymous

The majority decision in *Lipson* asserted that tax avoidance is abusive when a taxpayer relies on a specific provision to attain outcomes that the *Act* seeks to prevent. The majority appeared to be saying that the GAAR will apply where the taxpayer has misused specific provisions of the *Act*. If this is all that the Court meant, then there would seem to be no reason why a taxpayer could not misuse a SAAR in the same way that she could misuse an enabling provision. But the question is whether arranging a transaction to fall outside the ambit of a specific rule amounts to misuse or abuse. Furthermore, the majority emphasized in *Lipson* that the court will find abuse when a taxpayer arranges her transaction to defeat the underlying rationale of the specific provisions relied on. This statement, seemingly unproblematic at first glance, appears to beg the question of

146. *Ibid* at para 42. See also *Canada v Craig*, 2012 SCC 43, 347 DLR (4th) 385 ("purposive interpretation cannot justify finding unexpressed legislative intentions" at para 38).

147. See Daniel Sandler, "The Minister's Burden under GAAR" in David G Duff & Harry Erlichman, eds, *Supra* note 1 85 at 101.

148. See Arnold, "Confusions", *supra* note 9 at 189; *Canada Trustco*, *supra* note 8 at para 41.

149. *Ibid* at para 69.

whether a court can widen the object, spirit or purpose of a SAAR after the fact, so that it would have clearly applied to the case at hand had the rule been more precisely (or better) drafted. If a SAAR cannot be read as prohibiting the taxpayer's conduct even when interpreted purposively, it seems inadvisable to give the Minister a second chance through applying the GAAR.

Stephen Bowman explains that any gap-filling exercise by Parliament becomes self-perpetuating: "Detailed legislative provisions invite the courts to conclude that the treatment of the subject is exhaustive, and that the legislation is meant to say exactly what it says and does not mean to say anything that it omits", and drafters respond "with increasing frequency to plug the gaps exposed by restrictive interpretations by the courts".¹⁵⁰ For Bowman, the result is that even experienced practitioners will need to defer to specialists who can devote the time and energy to master the interpretation of the specific provisions at issue.

Another way to look at this problem is to note that because a court will already have determined that a transaction amounts to an avoidance transaction by the time it turns to subsection 245(4), the court must at this stage decide what Parliament would have done about the transaction had it not enacted the GAAR.¹⁵¹ In other words, the court must decide whether Parliament would have allowed the taxpayer's transaction had it

150. "Interpretation of Tax Legislation: The Evolution of Purposive Analysis" (1995) 43:5 Can Tax J 1167 at 1183-84.

151. While it is beyond the scope of this paper to consider what constitutes a gap, some brief comments might be helpful. As former Israeli Chief Justice Barak noted, interpreting a statute and filling a gap in its text are different matters; the former gives meaning to a text whereas the latter creates it. As established in Part I, purposive interpretation is not an issue when dealing with the problem this article seeks to grapple with. Instead, I ask whether the GAAR authorizes judges to *create* meaning when it comes to invoking, for instance, a statutory scheme to prevent a taxpayer's circumvention of a SAAR. Several responses come to mind. First, not every silence in a statute constitutes a gap; in some cases, it may be a "conscious silence". A gap can be said to exist where the text aspires to comprehensiveness but remains incomplete. Interestingly, a legislative text may be incomplete in the sense that it explicitly or implicitly settles certain issues but fails to regulate others and there is reason to believe that the silence was not conscious. Barak observes that the common law tradition is generally reluctant to fill true gaps, although this does not bar a particular legislative text from *specifically* authorizing the judge to address a gap should one emerge (of course, a statute that includes instructions on filling in gaps is not really incomplete). See Aharon Barak, *Purposive Interpretation in Law*, translated by Sari Bashi (Princeton, NJ: Princeton University Press, 2005) at 66-74.

realized that such an avoidance scheme were possible. Kellough described this analysis as a “venture into the hypothetical”, where the court will necessarily “engage in a fictitious hunt for legislative intent”.¹⁵²

The argument that a GAAR which fails to readily identify which types of tax avoidance are objectionable is conceptually problematic is itself decades old. Michael Trebilcock raised it in the 1960s. In Trebilcock’s view, as set out by Benjamin Alarie:

[A]lthough it is clear that one motivation behind a GAAR is to combat tax avoidance that in some respect goes too far in reducing the tax liability of taxpayers, it is difficult to see how a court is supposed to determine what constitutes tax avoidance of the kind that should be considered objectionable in the absence of clear legislative guidance.¹⁵³

Distinguishing between allowable and abusive tax avoidance requires understanding what the legislature’s motivations were in establishing the assorted tax benefits provided for in the legislation. However, in Alarie’s words, “[t]his requires knowing the mind of the legislature, which, Trebilcock asserts, is a slippery fiction, since all that is enacted as law is the text of the legislation”.¹⁵⁴ He sums up the implication of the argument in this way: “In general, the more technical and arcane are the provisions that taxpayers rely on or make use of in engaging in an avoidance transaction, the less likely it is that the provision was designed in anticipation of the taxpayer’s use of the provision”.¹⁵⁵

Under Jinyan Li’s “self-defeating” theory of statutory interpretation, the courts are not to assume “that Parliament intended to allow taxpayers to defeat its intention through contrived, artificial transactions”.¹⁵⁶ Given the need to balance competing policy objectives, Li observes that where “a tax benefit is obtained in a situation that Parliament did not contemplate, or could not reasonably be expected to have contemplated, the transaction

152. “The Canadian Approach to Combat Tax Avoidance: The Early Aftermath” (1989) 43:2 Bull for Int’l Fis Doc 77 at 81.

153. “Trebilcock on Tax Avoidance” (2010) 60:2 UTLJ 623 at 634. Alarie describes how Trebilcock anticipated many of the conceptual difficulties of GAARs as a class in light of the Canadian experience (*ibid* at 638–641).

154. *Ibid* at 634. See also Michael J Trebilcock, “Section 260: A Critical Examination” (1964) 38:7 Australian LJ 237 (his early work on the Australian GAAR).

155. *Ibid* at 636.

156. “‘Economic Substance’: Drawing the Line Between Legitimate Tax Minimization and Abusive Tax Avoidance” (2006) 54:1 Can Tax J 23 at 39.

resulting in the tax benefit should be considered illegitimate”.¹⁵⁷ While this position seems reasonable, there is little disagreement that the courts will not permit taxpayers to defeat statutory intention through contrived or artificial transactions. Li’s analysis requires that Parliament’s intention be accessible, and perhaps the chief trouble emerges when it is not.

Arnold and Wilson similarly suggest that the only transactions that should be excluded from the ambit of the GAAR are legitimate commercial transactions and those “that result in unacceptable tax avoidance but are specifically sanctioned by the *Act*”.¹⁵⁸ The issue becomes one of determining when a transaction has been specifically sanctioned. Does this require commission or omission on the legislature’s part—and in the case of an omission, must it be accidental or may it be deliberate as well?

Justice Iacobucci’s response to this question was that “courts should not be quick to embellish the provisions of the *Act* in response to concerns about tax avoidance”, as “it is open to Parliament to be precise and specific with respect to any mischief to be prevented”.¹⁵⁹ Yet many tax avoidance transactions are structured in ways that take advantage of “the absence of an evident intention in the words of the statute”.¹⁶⁰ More to the point, if Parliament had considered the specific avoidance scheme entered into by the taxpayer, the statute would have set out the consequences. For David Dunbar, the problem remains that “in many cases, there is no clear [Parliamentary intent] which can be deduced from the statutory language or from *Hansard*”.¹⁶¹ This inevitably means that judges must second-guess what Parliament would have enacted if it had considered the transaction now before the court.

Not everyone would have a problem with this, of course. One response is that taxpayers should not assume that there is a right to pursue tax minimization through avoidance transactions that rely on the language of SAARs for their effects. But for Weisbach, the legislature can alter the scope of any “right” to engage in a given minimization scheme at any time

157. *Ibid* at 40.

158. “Part 2”, *supra* note 21 at 1143.

159. Duff, “Justice Iacobucci”, *supra* note 127 at 572, citing *Ludco Enterprises Ltd v Canada*, 2001 SCC 62 at para 39, [2001] SCR 1082.

160. “Statutory General Anti-Avoidance Rules: Lessons for the United Kingdom from the British Commonwealth” (2008) 62:12 *Bull for Int’l Taxation* 529 at 534.

161. *Ibid*.

by changing the statute.¹⁶² This reasoning is appealing to both taxpayers and the Crown because it recognizes the state of tax law as it currently is while simultaneously stressing the legislature's ability to change the statute at will. Instead of simply assuming that she has a right to minimize her taxes, the taxpayer determines the appropriate limits on tax planning strategies and is then permitted to conduct her affairs according to what is left over.¹⁶³

Tim Edgar argues, for his part, that tax policymakers need to enact a GAAR as the expression of a behavioural prohibition that targets the entire range of tax avoidance transactions whose consequences justify prohibition, but has to do so in such a way that applying it will not exceed the institutional competencies of the judiciary.¹⁶⁴ For Edgar, there is no requirement to engage in a search for an elusive statutory purpose in order to decide whether the taxpayer's avoidance transaction is acceptable. It should be the consequential attributes of the transaction that determine its acceptability: "[A] purpose-based standard asks the correct question directly: Was the transaction tax-motivated? If so, the transaction can be considered a behavioral adjustment to taxation with the consequential attributes that justify its prohibition".¹⁶⁵ Edgar would reframe the relevant distinction under the GAAR as being between tax avoidance behaviours sanctioned by the *Act* and all other avoidance conduct. The permitted category would be limited exclusively to those transactions undertaken to access tax benefits explicitly provided for in the legislation.¹⁶⁶

In considering the appropriate role of judges in interpreting tax legislation, Neil Brooks goes further, contending that judges should decide what result would best reflect sensible tax policy. In this way, he sees judges' roles as being "no different than the role of tax analysts in a Treasury Department who have been asked by the Minister to clarify the meaning of the statute on an issue in dispute".¹⁶⁷ For Brooks,

162. See Weisbach, *supra* note 13 ("the language of rights or legitimacy distorts the problem in favor of taxpayers and should be avoided" at 220).

163. *Ibid* at 221–22.

164. Tim Edgar, "Building a Better GAAR" (2008) 27:4 Va Tax Rev 833 at 873.

165. *Ibid* at 880–81.

166. *Ibid* at 881.

167. Neil Brooks, "The Responsibility of Judges in Interpreting Tax Legislation" in Graeme S Cooper, ed, *Tax Avoidance and the Rule of Law* (Amsterdam: IBFD Publications, 1997) 93 at 99.

“where there is a gap in the statute, or where the words are ambiguous or obviously over—and under—inclusive of any sensible interpretation, there is really no option but for the courts to engage in the creative process of law making”.¹⁶⁸ I argue that this view is vastly overreaching, as it overlooks gaps that the legislature may have left deliberately (or carelessly). Furthermore, a unanimous Supreme Court in *Canada Trustco* warned that “Parliament recognized that many provisions of the *Act* confer legitimate tax benefits notwithstanding the lack of a real business purpose”.¹⁶⁹ Add to this the Court’s earlier warning in *Shell Canada Ltd v Canada* that “[f]inding unexpressed legislative intentions under the guise of a purposive interpretation” would risk upsetting the developed body of tax jurisprudence.¹⁷⁰ This is to say that the Supreme Court is aware that judges are not well-positioned to fill gaps in a statute as complicated as the *Income Tax Act*, and that they should not assume this power unless Parliament directs them to. Where (excruciating) specificity already exists in the statute, the legislature has spoken (both in black letters and by narrow omission), and filling a gap is no longer the judiciary’s interpretive act.

C. Debating the Appropriate Role of the General Anti-Avoidance Rule

In any event, the GAAR can sensibly be regarded as capable of striking down some types of avoidance schemes that Parliament could not foresee. Following *Copthorne*, courts continue to need to determine the relevant legislative intent and then assess whether the taxpayer’s transaction is contrary to the *Act*’s underlying policy. That said, in many cases SAARs are better equipped to detect and sanction *identifiable* avoidance transactions, and the GAAR therefore cannot reasonably take the place of most specific anti-avoidance provisions. However, while SAARs can be helpful in identifying the policy intent behind the *Act*, a SAAR does not necessarily help to determine whether a taxpayer has misused or abused the *Act*. Indeed, where the legislature has chosen to include one type of transaction within the scope of a specific rule, it can sometimes be deduced that another type of transaction is not contrary to the *Act*’s

168. *Ibid* at 101.

169. *Supra* note 8 at para 33.

170. [1999] 3 SCR 622 at para 43, 178 DLR (4th) 26.

policy.¹⁷¹ It is notable that in determining whether the GAAR applied in *Canada Trustco* the Supreme Court drew inferences about statutory purpose from the *absence* of specific provisions.¹⁷²

As the Tax Court has stated, the *Act* is an outstanding example of legislation filled with specificity and sated with anti-avoidance rules designed to thwart particular abuses. However, that Court has also said:

Where a taxpayer applies those provisions and manages to avoid the pitfalls the Minister cannot say “Because you have avoided the shoals and traps of the *Act* and have not carried out your commercial transaction in a manner that maximizes your tax, I will use GAAR to fill in any gaps not covered by the multitude of specific anti-avoidance provisions”.¹⁷³

This is why some commentators recommend codifying the jurisprudence and administrative positions on identified avoidance transactions, leaving the GAAR to the residual role of handling *unforeseeable* avoidance transactions. Parliament could then draft new SAARs in a way that clearly defined which avoidance transactions were unacceptable and prescribed the tax consequences which would make that type of transaction unattractive.¹⁷⁴ However, this approach would simply redirect the problem to determining what is foreseeable.

In *65302 British Columbia Ltd v Canada*,¹⁷⁵ the Supreme Court of Canada considered the suggestion that courts develop a test for distinguishing between deductible and non-deductible levies or penalties on a case by case basis. In Iacobucci J’s view, “such an approach would be quite onerous for the taxpayer who would be forced to undertake the difficult task of determining the object or purpose of the statute under which the payment was demanded whenever he or she filled out a tax

171. See McDonnell, “Legislative Anti-Avoidance”, *supra* note 16 at 6:34.

172. *Supra* note 8 at para 75.

173. *Geransky v The Queen*, [2001] DTC 243 at para 42, [2001] 2 CTC 2147 (TCC).

174. See e.g. Dominic C Belley, “The Corporate Veil in Tax Law: In Praise of Judicial Circumspection” (2000) 48:3 Can Tax J 929 at 968 (concerning codification). Some tax practitioners might be prepared to trade off any increasing thickness of the *Act* following this type of codification for the simplification of the overall scheme that would come with removing much of the uncertainty associated with the GAAR. Of course, codification does not necessarily imply that the result the new rule attempts to prevent would not have violated the object or spirit of any pre-existing rules. See e.g. Québec, Finances Québec, *Aggressive Tax Planning* (Working Paper), (Québec: Gouvernement du Québec, 2009) at 29.

175. [1999] 3 SCR 804 at paras 1, 68, [2000] 1 CTC 57.

return”.¹⁷⁶ The task would become even more difficult given that the statute often has multiple purposes. While a taxpayer must unavoidably make such determinations in completing her tax return, even the courts may have great difficulty in ascertaining the purpose of a statutory provision. As the Court stated in *65302 British Columbia*, “this would introduce a significant element of uncertainty into our self-reporting tax system. On the other hand, Parliament could expressly prohibit the deduction of fines and penalties in a way compatible with the objectives of self-assessment and ease of administration”.¹⁷⁷

Yet so long as taxpayers continue to devise transactions to minimize taxes, the courts will need to decide whether the transactions as implemented are those contemplated by the statute.¹⁷⁸ This broad treatment of a SAAR is fitting where it can be supported on a textual, contextual and purposive interpretation. Still, since legislative authority is only expressed through the statutory language used, focusing on the text of the *Act* is appropriately the most important element in its interpretation. For this reason, the promulgation of new tax rules is properly within “the ambit of the legislature, not the courts”.¹⁷⁹ On the other hand, if the purposes of the relevant section are reasonably determinable, a broad anti-avoidance interpretation “does not contradict rule-of-law principles of certainty and predictability”.¹⁸⁰ Of course, as Duff recognizes, this conclusion crucially depends on the significant assumption that the purposes of the relevant provisions can be reasonably determined.¹⁸¹

The key interpretive question, then, is not which type of SAAR a particular provision contains, but how Parliament has prescribed its effect. Some forms of specific anti-avoidance rules make later resort to the GAAR an easier proposition to accept than others. As always, the hardest question is how a court should handle those ambiguous cases where the nature of the specific rule that the taxpayer allegedly misused does not lend itself to the conclusion that she has constructed an artifice to evade paying her fair share.

176. *Ibid* at para 68.

177. *Ibid*. Indeed, Parliament did exactly this in enacting the new subsection 67.6 following the case.

178. See Duff, “Justice Iacobucci”, *supra* note 127 at 570.

179. *Ibid* at 569–70, citing *Canada v Antosko*, [1994] 2 SCR 312 at 30, [1994] 2 CTC 25.

180. Duff, “Justice Iacobucci”, *supra* note 127 at 577.

181. *Ibid*.

This question is increasingly important after *Copthorne*. Alarie explains that a residual role “played by even a grossly ineffective GAAR provision” may be to “provide fair notice to taxpayers that the most audacious and aggressive tax-avoidance schemes would be contested by the tax authorities and, failing that, by the legislature”.¹⁸² Even under such a “worst case scenario” where the GAAR was largely ineffective as written, it could signal to taxpayers the possibility that a SAAR could be applied retroactively to foreclose avoidance opportunities.¹⁸³ Since the combination of retroactivity and specific anti-avoidance rules appears to be the most powerful policy tool governments can deploy against tax avoidance, even a GAAR that fails to fill gaps puts taxpayers on notice that they should not expect to retain the tax benefits they receive from aggressive tax planning.

Duff observes, though, that while this is a possibility, such amendments are in practice rarely retroactive, so their effectiveness in discouraging tax avoidance is restricted.¹⁸⁴ It is quite plausible that the later application of a SAAR somewhat impairs the effectiveness of Parliament’s gap-filling exercise, but the next question is whether or not the impairment is appropriate. Reflecting on *OSFC*, Duff remarks that Rothstein JA’s judgment stands to limit the GAAR’s effectiveness insofar as it requires the CRA to establish that the avoidance transaction abused a “clear and unambiguous” policy.¹⁸⁵ *Copthorne* retains the same standard. Duff contends that such a limitation stems from the *Act* as much as from the Court’s interpretation: “Therefore, if the GAAR is to police artificial tax avoidance arrangements effectively, legislative amendments may be warranted”.¹⁸⁶ This view has been circulated for some years now, and it is fair to suggest that the Department of Finance has had ample time to consider whether to amend the GAAR or to leave it—and its uncertain scope—untouched.

182. *Supra* note 153 at 632.

183. *Ibid.*

184. David G Duff, “Interpreting the Income Tax Act—Part 2: Toward a Pragmatic Approach” (1999) 47:4 Can Tax J 741 at 751 [Duff, “Part 2”]. See also Duff, “21st Century”, *supra* note 1 at 492–93; Finances Québec, *supra* note 174 at 50–55.

185. David G Duff, “Judicial Application of the General Anti-Avoidance Rule in Canada: *OSFC Holdings Ltd. v. The Queen*” (2003) 57:7 Bull for Int’l Fis Doc 278.

186. *Ibid* at 288.

Agreeing that the GAAR is appropriately a provision of last resort designed to thwart abusive tax avoidance schemes while simultaneously allowing for careful tax arrangements that comply with specific anti-avoidance rules is not self-defeating. This leaves the GAAR with a meaningful role to play, and leaves a fair amount of uncertainty still reasonably associated with its outer edges, while at the same time taking into account Parliament's role in establishing tax law.

Freedman states that “[i]t is not the function of a GAAR, any more than of the judiciary, to fill gaps left by the failure to set out parliamentary intention”.¹⁸⁷ Freedman here notes what the Supreme Court suggested about filling gaps in *Canada Trustco*: “To send the courts on the search for some overarching policy and then to use such a policy to override the wording of the provisions of the *Income Tax Act* would inappropriately place the formulation of taxation policy in the hands of the judiciary, requiring judges to perform a task to which they are unaccustomed and for which they are not equipped. . . . Notwithstanding the interpretative challenges that the GAAR presents, we cannot find a basis for concluding that such a marked departure from judicial and interpretative norms was Parliament's intent”.¹⁸⁸

If there is conflict between the uncertain scope of the GAAR and the taxpayer's freedom to legitimately engage in tax minimization, Dodge argues in favour of the GAAR: “[S]ome level of uncertainty must be seen as inevitable. Since the objective cannot be absolute certainty, it should instead be a ‘reasonably predictable result’ so that taxpayers can comply with the rule, and the administration and the courts can easily apply it”.¹⁸⁹ However, as I have suggested, if taxpayers are to have the freedom to pursue their own tax minimization strategies, they must be allowed to experiment and to contemplate novel forms. If one such form falls immediately outside a specific rule, the appropriate result is to change the rule, not to rely on the GAAR as a “catch-all” provision.¹⁹⁰ Certainly, for Freedman, “[t]his suggests that the way forward . . . is not more detailed drafting, but policy-based, principles-based drafting. . . . The detailed

187. *Supra* note 117 at 74. See also Nikolakakis, *supra* note 134 at 351.

188. *Supra* note 8 at para 41.

189. *Supra* note 127 at 22.

190. See also *Canderel Ltd v Canada*, [1998] 1 SCR 147, [1998] 2 CTC 35 (“[t]he law of income tax is sufficiently complicated without unhelpful judicial incursions into the realm of lawmaking” at para 41).

mass of rules we currently have nevertheless leaves holes in the net that courts cannot plug by referring to economic substance at a higher level of generality since there is no direction for them to do so”.¹⁹¹

There seems to be an emerging trend in tax administration toward adopting real-time disclosure regimes for uncertain tax positions, in the hope that they may give some help to tax authorities in discovering gaps. Although this does not change the vagaries of the legislative process, it could ensure that the legislature is put on earlier notice to consider amendments. While carefully drafted disclosure rules are by no means a panacea, they may supplement a principles-based GAAR in some circumstances.¹⁹² Freedman suggests that “the drafting of specific legislation needs to become more explicit about the underlying principles of the legislation”.¹⁹³ If this condition were truly fulfilled, a GAAR would no longer be needed on account of purposive interpretation, but given the impossibility of drafting legislation that covers all eventualities and the ingenuity of tax planners in coming up with avoidance schemes, Freedman argues that the best way forward is a combination of improved drafting and the introduction of “overriding general principles to which reference can be made”.¹⁹⁴ She describes the purpose of a general anti-avoidance principle (a GANTIP) as helping to enable decisions within a fair and non-arbitrary framework.¹⁹⁵ The GANTIP, she explains, would provide a legitimate framework for the courts to work out Parliament’s intent, while not permitting tax authorities or judges to go beyond what would be justifiably discerned or established as that intent.¹⁹⁶

However, it is debatable whether that approach would most effectively resolve the dilemma considered in this article. In her study of

191. *Supra* note 117 at 74. See also Duff, “21st Century”, *supra* note 1 at 494.

192. This paper is not the place to debate the merits of disclosure rules along the lines of what was recently enacted in the United States and in Québec and included in the Department of Finance’s October 2012 omnibus technical bill. See e.g. Duff, “21st Century”, *supra* note 1 at 501; Finances Québec, *supra* note 174 at 77–84.

193. *Supra* note 117 at 87.

194. *Ibid.* While a discussion of these general principles is beyond the scope of this paper, see generally John Braithwaite, *Markets in Vice, Markets in Virtue* (Oxford: Oxford University Press, 2005) at C 10.

195. See Freedman, “Responsibility” *supra* note 136 at 345–46.

196. *Ibid.* at 356. Freedman suggests that a GANTIP might help to resolve some of the “gaps” by formalizing the assumption that Parliament has intended to be rational within the scheme of the tax legislation (*ibid.* at 338).

approaches to countering tax avoidance, Tracey Bowler, for one, argues that statements of purpose in legislation often appear “otiose” as courts are capable of understanding the purpose on their own.¹⁹⁷ For Bowler, the real problem lies in situations where legislation is so technical and prescriptive that judges are left with little room to manoeuvre in order to achieve the legislation’s purpose; it is unlikely that a principles-based GAAR would be helpful in these situations.¹⁹⁸ John Avery Jones similarly warns that “general principles drafting” is often a euphemism for “less detailed drafting”.¹⁹⁹ What drafting of this type really aims at is to leave it to the courts to invent the applicable principles without much assistance from the tax legislation.²⁰⁰

As suggested, however, the principles versus rules debate could have been subsumed in the earlier discussion of the court’s ability to use a modern approach to statutory interpretation to widen the application of a SAAR to cover a novel situation. An alternative to drafting principles-based SAARs would of course be to amend the GAAR to include a GANTIP as noted above. But while the GAAR could be amended to reduce the identification of the merits of a taxpayer’s arrangements in light of prevailing tax policy to an act of judicial discretion, such a shift would represent a significant departure from the current provision. This approach should therefore be considered cautiously. In my view, the GAAR as currently legislated certainly mandates a suitably broad purposive interpretation of the relevant SAAR, but does not authorize the judiciary to take steps into policymaking by attempting to discern how Parliament would have handled a situation that it did not actually address. Before contemplating an amended GAAR, then, it is worth considering an example of a category of carefully crafted specific rules around which the taxpayer would be free to plan.

197. *Supra* note 34 at 33.

198. This is not to say that principles-based drafting would never work. See *ibid* at 33, 44–46.

199. *Supra* note 134 at 76.

200. *Ibid* at 77–78, 80, 86 (suggesting that the real choice is between detailed rules and less detailed legislation interpreted in accordance with principles. The main benefit of the latter approach, he argues, emerges where the legislation does not expressly provide for a certain situation—that is, in the more difficult cases).

IV. Illustration: The Thin Capitalization and Specific Anti-Avoidance Rules

The thin capitalization rules provide a good illustration of why a (corporate) taxpayer that arranges its affairs in accordance with the specific rules as they were reasonably intended by Parliament should not be subject to having its conduct recharacterized by the GAAR. Canada's thin capitalization rules have their origin in the 1972 overhaul of the *Income Tax Act*, and have since been revised several times. Subsections 18(4) to 18(6) of the *Act* restrict a corporation's ability to deduct interest where the amount of its interest-bearing debt owed to a "specified non-resident" is more than twice its equity.²⁰¹ These rules relate to the practice of financing a business through debt rather than equity, because the interest paid on the loan can be deducted from income. Paying dividends means returning after-tax income to shareholders—a transfer that may be subject to double taxation. The purpose of subsection 18(4) is to prevent non-residents from withdrawing profits from Canadian firms in the form of deductible interest rather than as dividends, which would be paid out of after-tax profits.²⁰²

Canada's thin capitalization rules do not apply to Canadian corporations that borrow funds from a third party with a guarantee from a specified non-resident. As well, they apply only to corporations and not to other forms of business organization such as partnerships, trusts and branches.²⁰³ A specific exemption exists if a Canadian firm owes a debt to a foreign bank that is a specified non-resident shareholder if the bank includes the interest payments in its income subject to Canadian taxation under Part I of the *Act*.²⁰⁴ On the other hand, subsection 18(6) is a specific anti-avoidance rule that prohibits "back-to-back" loans. These arrangements occur where a third party financier is introduced between the non-resident shareholder and the Canadian taxpayer. To avoid the thin

201. Under the 2012 federal budget legislation, the debt-to-equity ratio will be reduced to 3:2.

202. *Supra* note 6 ("specified non-resident" is defined in section 18(5) of the *Act*).

203. The 2012 budget legislation will also extend the thin capitalization rules to debt owed by partnerships of which a Canadian resident corporation is a member.

204. See e.g. David M Sherman, ed, 2011 Department of Finance Technical Notes, 23rd ed (Toronto: Carswell, 2011), ss 18(4)–(8).

capitalization rules, the non-resident would provide funds to the third-party intermediary, which would then pass funds along to the Canadian resident. Subsection 18(6) deems the back-to-back loan as a debt owing to the original lender.²⁰⁵ The specific rule applies only where the non-resident shareholder loans funds to the intermediary on the condition that the intermediary then makes a loan to the Canadian corporation. In Interpretation Bulletin IT-59R3, the CRA indicates that it would only apply subsection 18(6) to those situations in which the application of the thin capitalization rules in subsections 18(4) and (5) would otherwise be frustrated.²⁰⁶

As the case law following *Lipson* demonstrates, how the CRA will treat a taxpayer's reliance on and avoidance of specific anti-avoidance rules like subsection 18(6) remains a live issue. In Information Circular 88-2, the CRA describes a number of transactions in which the taxpayer's motive is assumed to be obtaining a tax benefit; the transactions are therefore avoidance transactions. The issue then is whether the transactions are a misuse of a specific provision of the *Act* or an abuse of the *Act* as a whole. The Circular considers subsection 55(3)(b) of the *Act*, which applies to a "butterfly reorganization" and states that the GAAR does not apply if the taxpayer's transactions are consistent with the object and spirit of the

205. An exception of sorts exists when a non-resident loans its Canadian subsidiary an amount which is then loaned in turn to another Canadian subsidiary. The CRA has indicated that it will not apply subsection 18(6) where each loan is in the same amount, the interest on the second loan exceeds that paid under the first and the specified non-resident shareholder of the first borrower has *de jure* control over both subsidiaries. See Dan G Fontaine & Christopher P Kong, "The March 16, 2001 Draft Legislation: Thin Capitalization, Non-Resident Owned Investment Corporations, and Foreign Spinoff Relief" (2001) 49:2 Can Tax J 383 at 388, citing Canada Revenue Agency, Interpretation Bulletin IT-59R3, "Income Tax Act: Interest on Debts Owed to Specified Non-Residents (Thin Capitalization)" (26 September 1984) at para 3. But see Allan R Lanthier, "Thin Capitalization: Cross-Border Issues and Strategies" in *2003 Conference Report: Report of Proceedings of the Fifty-Fifth Tax Conference* (Toronto: Canadian Tax Foundation, 2004) 25:1 at 25:6-9.

206. See Interpretation Bulletin, *supra* note 205.

provision. However, if the taxpayer structured the transactions to avoid subsection 55(2), the GAAR will apply.²⁰⁷

This analysis begs the question of whether a transaction can fall within the object and spirit of a specific rule while not actually being captured by it.²⁰⁸ Using the thin capitalization rules as an example, it is interesting that the CRA has stated that it would apply the GAAR to a transaction that uses a partnership rather than a corporation to acquire debts owed to a specified non-resident in order to escape the scope of subsection 18(4) if the only purpose for transferring the debts was to avoid the scope of the applicable provisions.²⁰⁹

Taking a step back, interest is deductible under subsection 20(1)(c) of the *Act* when it is paid or payable. This means that the timing of the deduction depends on the method the taxpayer regularly uses.²¹⁰ In one recent case, however, the Tax Court reiterated that a corporate taxpayer is permitted under subsection 20(1)(c) to deduct interest on a cash basis as long as it has consistently followed that method, regardless of whether the corporation accounted for the interest expense on an accrual basis in its financial statements. The Court noted that the primary benefit for the taxpayer to expense interest on a cash basis in this case was to avoid the thin capitalization rules which, if applied, would have permanently disallowed a deduction of the interest.²¹¹ Following this example, a taxpayer who relies on a sufficiently purposive interpretation of the relevant provisions

207. See Information Circular IC88-2, *supra* note 118, at paras 6–7. Subsection 55(2) is designed to prevent the conversion of taxable capital gains into tax-free intercorporate dividends. The “butterfly” under subsection 55(3)(b) is a form of divisive reorganization designed to facilitate a partial or total distribution of property by a corporation among its shareholders on a tax deferred basis and functions as an exception to subsection 55(2).

208. See e.g. *Triad Gestco Ltd v The Queen*, 2012 FCA 258 (available on QL) (where an issue was whether an amendment to subsection 251(1) of the *Act* to broaden the definition of “affiliated persons” to include a trust and a majority-interest beneficiary suggested that earlier transactions to take advantage of the under-inclusive definition were abusive). The Court held that the prior definition was carefully crafted and that Parliament chose to limit its scope accordingly (*ibid* at para 56).

209. That is, the taxpayer’s motive in arranging its affairs in such a way is to minimize its taxes (prior to the 2012 budget). See CRA Ruling 2005-0123631R3 (1 January 2005).

210. Most corporate taxpayers use the accrual method.

211. See Geoffrey Loomer, “Auditor General’s 2006 Status Report” (2006) Tax Topics No 1785 (25 May), citing *Crown Forest Industries Ltd et al v The Queen*, 2006 TCC 47, [2006] DTC 2321.

in this context cannot then be subjected to the GAAR, even if the taxpayer has arranged her affairs solely to avoid tax.

It is worth recalling that in *OSFC*, Rothstein JA held that the provisions of the *Act*, read as a whole, bear a general policy against loss transfers between corporate taxpayers. In reaching this conclusion, he examined the language of the *Act*, a number of leading tax texts and the report of the Technical Committee on Business Taxation. He noted that it is not for the courts to approve or disapprove of the government's taxation policies. Rather, "[t]he Court's only role is to identify a relevant, clear and unambiguous policy, so that it may then determine whether the avoidance transactions in question are inconsistent with the policy, such that they constitute an abuse of the provisions of the *Act*, other than the GAAR, read as a whole".²¹² The question is whether the purpose of the thin capitalization rules can be as readily identified.

Some of the recent discussion about and controversy over the evolution of the thin capitalization rules is instructive. In its 2008 Final Report, the Advisory Panel on Canada's System of International Taxation supported the expansion of the rules to cover partnerships, trusts and Canadian branches of non-resident corporations.²¹³ Even before the Advisory Panel's examination, other commentators had fiercely debated the appropriate scope of the thin capitalization rules. Arnold observed that many deficiencies in Canada's thin capitalization rules had previously been identified, and many were remedied in response to the recommendations of the Technical Committee on Business Taxation in 2000. It is important to note that the limitations of the current rules have been studied since that time.²¹⁴ Yet subsections 18(4) to 18(6) have

212. *OSFC*, *supra* note 36 at para 97.

213. Advisory Panel on Canada's System of International Taxation, *Enhancing Canada's International Tax Advantage* (Final Report) (Ottawa: Department of Finance, 2008). As noted above, the government has now indicated that it will extend the rules to partnerships. It is worth adding here that the Advisory Panel rejected the extension of the thin capitalization rules to third party and guaranteed debt.

214. See Brian J Arnold, *Reforming Canada's International Tax System: Towards Coherence and Simplicity*, Canadian Tax Paper No 111 (Toronto: Canadian Tax Foundation, 2008) at 307 [Arnold, Tax Paper]. Arnold states that the February 2000 budget documents indicated that the Department of Finance would engage in consultations on the extension of the rules to these types of organizations (*ibid* at 307, n 51).

remained as they were.²¹⁵ It is reasonable to discern that the legislators deliberately left them unamended. For the CRA to resort to the GAAR in this situation would therefore be inappropriate. Following the Advisory Panel's recommendations, if Parliament wishes to prevent tax planning around the thin capitalization rules, the appropriate response is to amend the *Act* by expanding the scope of the specific provisions.²¹⁶ Turning to the GAAR in such a situation would be inadvisable gap-filling.

Conclusion

The interpretive problem presented in this article is by no means a new one, even if it is enjoying prominence at the moment. Couzin framed the problem more than a decade ago: "Can or should GAAR apply to a transaction which is the subject matter of a specific rule but, by reason of the particular character of the transaction and the drafting of the rule, escapes its application?"²¹⁷ Although it took the Supreme Court some time to release its first GAAR decisions after the rule was established, the Court's views on the interaction between the general and specific anti-avoidance rules will undoubtedly be timely whenever they arrive. Given the divisions laid bare in *Lipson*, perhaps a desire for unanimity in *Copthorne* meant that the Court in the latter case was never going to

215. Other than the proposed changes, of course. See e.g. Brian Arnold et al, "Reforming Canada's System of International Taxation: A Perspective from Practitioners and Academics" in *2008 Conference Report: Report of Proceedings of the Sixtieth Tax Conference* (Toronto: Canadian Tax Foundation, 2009) 5:1; Tim Edgar et al, "Foreign Direct Investment, Thin Capitalization, and the Interest Expense Deduction: A Policy Analysis" (2008) 56:4 Can Tax J 803; Allan R Lanthier & Jack M Mintz, "Policy Forum: Seeking a More Coherent Approach to Interest Deductibility" (2007) 55:3 Can Tax J 629.

216. See Arnold, Tax Paper, *supra* note 214 ("the application of the general anti-avoidance rule does not appear to be a serious possibility" at 308). It is instructive to note that his recommendation for reforming Canada's thin capitalization rules involves a more precisely targeted set of rules (*ibid* at 309–10). Following the 2012 Budget, this is what is transpiring. On the other hand, one could argue that perhaps Parliament has chosen not to enact the other proposed amendments to the thin capitalization rules *because* of its belief that the GAAR could deal with those situations. For my part, I doubt whether such an argument survives Rothstein J's articulation of the interpretive exercise to be used when conducting the abuse analysis in *Copthorne*.

217. *Supra* note 18 at 42. See also Arnold & Wilson, "Part 2", *supra* note 21 at 1167.

grapple with the challenges of clarifying that interaction. This does not mean, of course, that the challenges will go away.

Following *Lipson* and *Landrus*, can it still be claimed that while the GAAR is a formidable tool for discouraging taxpayers' more brazen abuses of the *Act*, the general rule cannot provide the CRA with a means to force taxpayers to arrange their affairs in a way that leads to more tax revenue for the government?²¹⁸ Arnold, for one, clearly prefers a different basis for tax interpretation than the difficult one of trying to hold onto the *Duke of Westminster* principle but marrying it with the "modern" approach to statutory interpretation: "the alternative to the *Duke of Westminster* principle on which our tax system could be based is the more appealing principle that everyone should pay his or her fair share of tax. Such a principle is consistent with equity, basic morality, and good citizenship".²¹⁹

Arguably, if the approach favoured in this article is applied, there is a risk that the *Act* will become increasingly inaccessible to most persons to whom it applies.²²⁰ Again, though, this merely raises the familiar problem: should the interpretation of the *Act* restrict the ability of sophisticated parties to arrange their affairs to minimize their tax burden? Are the benefits of a simpler tax regime worth the costs when faced with the prospect of an ever more complicated system?

My response is that it is not inconceivable for the *Act* to be interpreted in a way that fully relegates the *Duke of Westminster* principle to history. But if the GAAR is to be read in that way, it needs to be considerably more explicit and surrounded by more directive technical commentary by the Minister of Finance explaining such intent. As an alternative that also requires legislative change, a more limited general anti-avoidance principle might supplement the GAAR, particularly with regard to the misuse and abuse analysis. Such a principle could be of more help to judges in deciding cases than their own attempts to divine the intent of the legislature by way of statutory interpretation, "if only because the exercise would have statutory legitimacy".²²¹ Of course, the merits of any legislative reform to the GAAR on this scale should be very carefully

218. See e.g. *Canada v Fredette*, [2001] 3 CTC 2468 at para 76, [2001] DTC 263 (TCC).

219. "Reflections", *supra* note 15 at 6.

220. Duff, "Part 2", *supra* note 184 at 751-52.

221. See Freedman, "Responsibility", *supra* note 136 at 347.

considered. Until then, under the current formulation of the GAAR and its jurisprudence, a taxpayer who arranges her affairs to fall outside of a specific anti-avoidance rule should not be considered to be abusing that rule, even though her conduct amounts to tax avoidance.

Of course this is a general statement, and there may well be modalities—this article has considered some of them. For example, whether a SAAR is highly technical or framed with a purpose test of its own might have some bearing on the misuse or abuse analysis under the GAAR. Yet while some degree of uncertainty is desirable in a GAAR, uncertainty based on a taxpayer's subjective intent is not.²²² As Rothstein JA explained in *OSFC*, applying the GAAR to a taxpayer's transaction essentially uses tax policy to override the express language used in the *Act*: "In answer to the argument that such an approach will make the GAAR difficult to apply, I would say that where the policy is clear, it will not be difficult to apply. Where the policy is ambiguous, it should be difficult to apply. . . . Where Parliament has not been clear and unambiguous as to its intended policy, the Court cannot make a finding of misuse or abuse, and compliance with the statute must govern".²²³

All of this is to say that where a gap remains in the statutory scheme after a sufficiently textual, contextual and purposive interpretation is given to a specific provision, it is not reasonable to ask a taxpayer to refrain from pursuing tax planning strategies on account of a perceived gap, any more than it is for a court to decide to create new tax policy in the absence of statutory direction to do so. If a statute is ambiguous, whether deliberately or accidentally—and it may sometimes be difficult to tell which is the case—Parliament is the only body that can act (if it so chooses) to resolve the ambiguity.

222. See Thomas E McDonnell, "The Relevance of 'Overall Purpose' in a GAAR Analysis" (2007) 55:3 Can Tax J 720 at 729.

223. *Supra* note 36 at paras 69–70.

