GAAR in Action: An Empirical Study of Transaction Types and Judicial Attributes in Australia, Canada, and New Zealand

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PREÇIS
Les auteurs présentent les résultats d’une étude empirique sur l’application des règles générales anti-évitement (RGAE) en Australie, au Canada et en Nouvelle-Zélande. L’étude s’appuie sur un cadre conceptuel, élaboré par Tim Edgar, qui classe les opérations d’évitement fiscal en trois types (création d’attributs fiscaux, échange d’attributs fiscaux et substitution d’attributs fiscaux) et examine les types d’opérations en relation avec les attributs des juges et dans le contexte plus vaste de la prise des décisions judiciaires. Pour contextualiser l’analyse empirique, les auteurs effectuent une analyse doctrinale des dispositions relatives aux RGAE et de l’interprétation judiciaire des RGAE, et donnent quelques exemples de divergence et de convergence entre les trois pays. Les résultats statistiques accréditent un peu l’affirmation de Tim Edgar selon laquelle la compétence institutionnelle du système judiciaire est limitée lorsqu’il s’agit de reconnaître l’évitement fiscal dans les cas de substitution, et que la RGAE du Canada pourrait être améliorée par l’incorporation d’un critère de réalité économique.

ABSTRACT
The authors report the results of an empirical study on the general anti-avoidance rules (GAARS) in action in Australia, Canada, and New Zealand. The study builds on a conceptual framework, developed by Tim Edgar, that classifies tax-avoidance transactions as falling into three types (tax-attributes creation, tax-attributes trading, and tax-attributes substitution) and considers the transaction types in connection with the attributes of judges and with the broader context of judicial decision making. To contextualize the empirical analysis, the authors provide a doctrinal analysis of both

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the countries’ GAAR provisions and the judicial interpretation of GAARs, along with some examples of divergence and convergence among the three countries. The statistical results provide some modest support for Edgar’s claim that the judiciary’s institutional competence is limited when it comes to identifying tax avoidance in substitution cases and that Canada’s GAAR could be improved through the incorporation of an economic substance test.

**KEYWORDS:** GAAR ■ TAX ATTRIBUTES ■ DUKE OF WESTMINSTER ■ ECONOMIC SUBSTANCE ■ STATUTORY INTERPRETATION

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A TRIBUTE TO TIM EDGAR

Tim Edgar once modestly said he had had only a few epiphanies in his life, and that one of them was his idea about the classification of general anti-avoidance rule (GAAR) cases by transaction types. As he wrote over a decade ago, GAAR cases may be classified in three categories according to whether they feature transactions that attempt to

1) create a tax attribute,
2) transfer a tax attribute, or
3) substitute a lower-taxed transactional form for a higher-taxed transactional form.1

In 2011, Tim led our first application for funding from the Canadian Tax Foundation to run empirical tests of his typology in connection with judicial decision making in a comparative international context. His view—that the project had the potential to advance knowledge in the area—informs something that he subsequently wrote, as editor of the Canadian Tax Journal:

It is probably accurate to suggest that GAAR has altered the contours of tax planning in Canada. That altered landscape may be attributable in part to the fact that the jurisprudence considering the interpretation and application of this provision does not readily yield an especially clear road map, at least in the sense of providing certainty and predictability of result.2

In this paper—made possible by the Foundation’s generous funding support and the diligent work of a number of Osgoode students—we report the empirical results of a comparative empirical study of GAAR cases in Australia, Canada, and New Zealand, and we situate the results in a doctrinal analysis of the respective countries’ GAAR provisions and judicial attitudes toward GAAR. With this paper, we pay tribute to Tim’s inspiring scholarship, dear friendship, and love of tax.

INTRODUCTION

A large body of literature exists on judicial anti-avoidance doctrines and statutory general anti-avoidance rules (GAARs). Yet very little of this literature frames the subject in terms of a general theoretical perspective that offers broad policy lessons

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for the design of GAARS. Notable exceptions are Chorvat;\(^3\) Brooks and Head;\(^4\) Ulph;\(^5\) Weisbach;\(^6\) and Edgar.\(^7\) The existing literature provides little systematic empirical evidence about judicial decision making in tax-avoidance cases and the related effectiveness of judicial anti-avoidance doctrines and statutory GAARS. This literature is primarily doctrinal in nature.

In this paper, we seek to fill this gap by building on Edgar’s conceptual framework, using insights gained from an empirical exploration into judicial decision-making in GAAR cases in Australia, Canada, and New Zealand. In our research, we developed a specific dataset that included (1) GAAR cases that were decided over a specified period (from 1989 to 2019) and (2) the attributes of judges who decided the cases. The design of this empirical study builds on some exploratory work of Li and Hwong\(^8\) that used data analysis to identify key variables in case attributes along with other potentially key explanatory variables (for example, judicial attributes) for judicial decision making in GAAR cases.

According to Edgar’s conceptual framework, tax avoidance should be viewed as a negative externality, and its consequential attributes (such as loss of revenue and efficiency) should be eliminated through appropriate policy instruments, such as GAARS. To be target-effective, tax-avoidance transactions should be classified into three types: (1) the creation of tax attributes (“creation type”); (2) the trading of tax attributes (“trading type”); and (3) the substitution of a lower-taxed transaction for a higher-taxed transaction (“substitution type”). Since different types of tax avoidance pose different identification issues, a GAAR provision should be designed to apply differently to different types of transactions. Further, the judiciary has the institutional competence to apply and enforce a GAAR in the case of creation and trading types of transactions, but it is less well equipped to address transactions of the substitution type. Instead of relying on the judiciary’s exercise of statutory interpretation to identify prohibited tax-avoidance behaviour, we should rely on the legislature to build a better GAAR on the basis of two different concepts of economic substance:

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(1) economic substance used virtually the same as a primary business purpose test (PPT) for creation and trading types of transactions; and (2) economic substance used virtually the same as a synthetic replication in substitution transactions. The judiciary’s interpretive role would thus be reduced, especially in substitution cases. Because substitution types of transactions are designed to take advantage of legislative gaps, they are more effectively addressed by the legislature’s building a rule than by the judiciary’s engaging in statutory interpretation. The judiciary’s institutional competence does not lie in policy analysis or in filling legislative gaps.9

To test Edgar’s ideas in our research, we divided the cases in the dataset10 according to transaction types. On the basis of the data, statistical analyses were performed to test for the relationships between judicial decision making and transaction types in light of the case attributes (country, and the political climate of the country when cases were decided) and the judicial attributes (the national political climate when judges were appointed, the years of experience judges had when deciding cases, and the gender of the judges). By and large, the statistical results back up Edgar’s hypothesis that judges do a better job of applying GAAR in creation and trading types of cases.

Let us provide some comparative context with respect to the GAARs in the three countries. A GAAR case in Canada begins at the Tax Court of Canada, whose decisions can be appealed to the Federal Court of Appeal (three-judge panel). The Supreme Court of Canada hears a GAAR case only with leave. In Australia and New Zealand, a taxpayer can opt for an administrative tribunal11 or a court to begin a GAAR case, and three levels of federal court are involved. In Australia, these three levels are as follows: (1) Federal Court (single judge), (2) Federal Court (full court [three-judge panel]); and (3) the High Court of Australia.12 In New Zealand, the three levels are as follows: (1) the High Court (single judge); (2) the Court of Appeal (three-judge panel); and (3) the Supreme Court of New Zealand (New Zealand’s

10 Cases were excluded from this dataset if they were decided before 1989 or were concerned with predominantly procedural matters (such as evidentiary or penalties) or non-income tax matters (such as GST or property tax). Cases heard by tribunals were included only if they provide meaningful descriptions of the facts and consideration of the GAARs. This selection policy was intended to ensure that the cases shed light on the transaction types. For some of the raw data, see the latest updated version of an online data appendix at www.yorku.ca/thwong/edgar.xlsx.
11 Administrative Appeals Tribunal or Small Taxation Claims Tribunal in Australia and Taxation Review Authority in New Zealand.
12 The Peabody case illustrates this process. The Australian Tax Office (ATO) invoked part IVA in assessing the taxpayer. The taxpayer lodged an objection to the ATO assessment, which the ATO disallowed. She then asked the ATO to refer it to the Federal Court. Justice O’Loughlin in the Federal Court agreed with the ATO (Peabody v. Commissioner of Taxation (1990)). The taxpayer appealed to the full bench of the Federal Court, which found for her (Peabody v. Commissioner of Taxation, [1993] FCA 74). The ATO appealed the decision to the High Court, which upheld the Full Court decision (Federal Commissioner of Taxation v. Peabody, [1994] HCA 43).
court of last resort, as of 2004). Like the Supreme Court of Canada, the High Court of Australia and the Supreme Court of New Zealand hear appeals by leave only. The Tax Court of Canada is the only court staffed with judges that have specialized knowledge in taxation. In all three countries, the highest court has decided a very small number of GAAR cases: four by the Supreme Court of Canada—Canada Trustco (2005), Mathew (2005), Lipson (2009), and Copthorne (2011)); five by the High Court of Australia—Peabody (1994), Spotless (1996), Consolidated Press Holdings (CPH) (1998), Hart (2004), and Mills (2011)); and two by the Supreme Court of New Zealand—Ben Nevis (2008) and Penny (2009).

In order to provide the necessary context to make sense of the results of the data analysis, the second and third sections of this paper provide an overview of the legislative features of the respective GAARs and the respective judicial attitudes toward them. Just as the GAAR provisions in the three countries differ in their technical design and historical evolution, the judicial approaches to interpreting and applying these provisions tend to differ from country to country. In the paper’s fourth section, we offer a broad comparison of the GAARs in action, with some examples of similarities and differences. Next, we present the empirical study in terms of descriptive statistics, regression results, and simulated patterns. Finally, we tease out some normative implications of the empirical research, with a view to building a better GAAR.

**LEGISLATIVE FEATURES OF THE THREE GAARs**

**History**

The Canadian GAAR is the youngest of the three GAARs. Section 245 of the Canadian Income Tax Act was enacted in 1988 and slightly amended in 2005 and 2016. In Australia, a GAAR was part of the first federal income tax law adopted in 1915. The current GAAR was introduced in 1981 as part IVA of the Income Tax Assessment...
Act 1936\(^9\) and was amended in 2013.\(^{20}\) New Zealand may have the world’s oldest GAAR: a GAAR was included in the Property Assessment Act 1879,\(^{21}\) which was carried forward into section 40 of the Land and Income Tax Act 1954.\(^{22}\) The current GAAR is found in sections BG 1, GA 1 and YA 1 of the Income Tax Act 2007.\(^{23}\)

**Objective and Effect**

GAARs are not self-executing rules. They are provisions of last resort. They empower the tax administration (the minister of national revenue in Canada, the commissioner of federal taxation in Australia, and the commissioner of inland revenue in New Zealand) to deny the taxpayer tax benefits arising from tax-avoidance transactions. The objective is to counteract unacceptable tax-avoidance arrangements that would, without a GAAR, succeed in avoiding tax by relying on legally valid transactions or forms and on the literal interpretation of tax laws.\(^{24}\)

The effect of a GAAR is to legislatively mandate a purposive construction of taxpayers’ transactions (as opposed to a construction bound by the legal form or shape of the transactions) and a purposive interpretation of tax law provisions that taxpayers rely on to obtain the desired tax benefit. The Canadian GAAR provision, for example, in defining “avoidance transaction,” explicitly refers to the primary purpose of the transaction, and the Supreme Court of Canada acknowledged in *Canada Trustco* that GAAR was “intended to negate arrangements that would be permissible under a literal interpretation of other provisions of the *Income Tax Act*, on the basis that they amount to abusive tax avoidance.”\(^{25}\) The Supreme Court of New Zealand (Elias CJ and Anderson J) captured the effect of GAAR in *Ben Nevis* by stating that the provisions of the taxing statute (that is, the specific provisions that exist in addition to GAAR) are to be purposively and contextually interpreted, the substance of an arrangement gauged, and care taken not to resurrect two “allied and dangerous

\(^{19}\) Income Tax Assessment Act 1936, No. 27, 1936 (herein referred to as “the ITAA 1936”). Part IVA includes sections 177A to 177G. For more discussion, see G.T. Pagone, *Tax Avoidance in Australia* (Toronto: Federation Press, 2010), at 22-37.

\(^{20}\) These amendments were contained in the Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Act 2013, No. 101, 2013; with effect from November 16, 2012 (herein referred to as “the 2013 amendment”).

\(^{21}\) Property Assessment Act 1879 (43 Victoriae 1879 No 17).

\(^{22}\) For further discussion, see Craig Elliffe and Andrew Smith, “New Zealand,” in Michael Lang et al., eds., *GAARs—A Key Element of Tax Systems in the Post-BEPS World* (Amsterdam: IBFD 2016), at 457-72.

\(^{23}\) Income Tax Act 2007, 2007 No. 97 (herein referred to as “the NZ-ITA”).

\(^{24}\) The Canadian GAAR authorizes the minister to deny the tax benefits resulting from an avoidance transaction by making a reasonable determination of the appropriate tax consequences. The Australian GAAR allows the commissioner to “destroy” the tax-avoidance arrangements and then “reconstruct” them in order to remove the tax benefits.

\(^{25}\) *Canada Trustco*, supra note 14, at paragraph 13.
myths”—namely (1) that “in tax cases to an extent unknown in other areas of law, form prevails over substance” and (2) that “the substance of a transaction, and the only thing to be regarded, is its legal effect.”26 An Australian jurist, writing extrajudicially, stated:

The broad thrust of the policy enacted in Part IVA [GAAR] was to incorporate into tax law a general proscription against arrangements entered into for the sole or dominant purpose of obtaining a reduction in the tax that would otherwise be payable. The intention of the provisions is to strike down schemes that can only be explained on the basis of the tax benefits sought.27

**Design Features**

The GAARs in Canada, Australia, and New Zealand define “tax benefit” and a “tax-avoidance transaction,” and they authorize the government to deny the tax benefit. The purpose of a transaction is built into the definition of “avoidance transaction.” The Canadian GAAR is unique in requiring an additional abuse test and imposing no penalties.28

**“Transaction”**

The term “transaction” is used in the Canadian GAAR, while “scheme” and “arrangement” are used in the Australian and New Zealand GAARs, respectively. The meanings of these terms are similar and defined very broadly. The Canadian GAAR defines “transaction” to include “an arrangement or event,”29 and a transaction may be part of a series that results in a tax benefit. Australia defines “scheme” to mean “(a) any agreement, arrangement, understanding, promise or undertaking, whether express or implied and whether or not enforceable, or intended to be enforceable, by legal proceedings; and (b) any scheme, plan, proposal, action, course of action or course of conduct.”30 New Zealand defines “arrangement” to mean “an agreement, contract, plan, or understanding, whether enforceable or unenforceable, including all steps and transactions by which it is carried into effect.”31

In practice, the existence of a “scheme” has been litigated in Australia and considered in Canada, but no case in New Zealand seems to turn on the meaning of

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27 *Pagone*, supra note 19, at 22.
28 The Australia GAAR exposes the taxpayer to a penalty of 25 percent (for lack of reasonable care) to 75 percent (for intentional disregard) of the tax shortfall amount (section 177F of ITAA 1936). New Zealand GAAR exposes the taxpayer to 100 percent shortfall penalties (section 141D of the Tax Administration Act (NZ) 1994, 1994 No. 166).
29 ITA section 245(1).
30 ITAA 1936 section 177A.
31 NZ-ITA section YA 1.
“arrangement.” In *Peabody*, the Australian Full Federal Court held that where a scheme consists of a series of steps, or a course of action, the commissioner cannot merely isolate one step in the course of action and classify that one step as a scheme. Since the commissioner has the discretion to cancel the tax benefit resulting from a tax-avoidance scheme, the commissioner’s formulation of the scheme is important. In the *Canadian Pacific* case, the Federal Court of Appeal said that “the definition of transaction is extended to include circumstances that would not strictly be considered to be a transaction within the normal meaning of that term,” but “that extended definition cannot be interpreted to justify taking apart a transaction in order to isolate its business and tax purposes.” The court rejected the minister’s argument that the denominating of the Australian currency of a borrowing transaction was a separate transaction: “[T]he Australian dollar borrowing was one complete transaction and cannot be separated into two transactions by labelling the designation in Australian dollars as a separate transaction.”

The notion of a “series” of transactions is explicitly relevant to the definition of “avoidance transaction” in the Canadian GAAR. Canadian courts have interpreted “series” broadly, and their interpretation involves a common-law test as to whether “each transaction in the series [is] pre-ordained to produce a final result” and a statutory deeming rule under subsection 248(10) regarding any related transaction that is completed in contemplation of a series.

**Tax Benefit, Tax Avoidance, and Counterfactual**

The term “tax benefit” is used in Australia and Canada, while “tax avoidance” is used in New Zealand. Canada and New Zealand define these terms broadly, while Australia has a statutory counterfactual requirement.

Canada defines “tax benefit” to mean “a reduction, avoidance or deferral of tax or other amount payable,” “an increase in a refund of tax,” or “a reduction, avoidance or deferral of tax.” New Zealand defines “tax avoidance” to mean “altering the incidence of any income tax,” “relieving a person from liability to pay income tax or from a potential or prospective liability to future income tax,” or “avoiding, postponing, or reducing any liability to income tax or any potential or prospective liability to future income tax.” There is no explicit requirement to identify a hypothetical comparative arrangement.

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32 The leading case on the meaning of series is *Copthorne*, supra note 14.
33 Supra note 12.
34 *The Queen v. Canadian Pacific Ltd.*, 2001 FCA 398.
35 Ibid., at paragraph 24.
36 Ibid., at paragraph 26.
37 For example, *Copthorne*, supra note 14, at paragraph 43.
38 ITA subsection 245(1), definition of “tax benefit.”
39 NZ-ITA section YA 1.
In contrast, Australia defines “tax benefit” in more detail and builds in a counterfactual (analogy or hypothetical alternative) element. Specific types of tax benefits include an amount not being included in assessable income; a deduction being allowed; a capital loss being incurred; and a foreign income tax offset being allowed. The counterfactual element is stated as follows:

[T]he obtaining by a taxpayer of a tax benefit in connection with a scheme shall be read as a reference to:

(a) an amount not being included in the assessable income of the taxpayer of a year of income where that amount would have been included, or might reasonably be expected to have been included, in the assessable income of the taxpayer of that year of income if the scheme had not been entered into or carried out.\(^{41}\)

Accordingly, the counterfactual refers to the action with which the taxpayer’s actions are compared. The concept is controversial and was much litigated between 2009 and 2012;\(^{42}\) it was the focus of a spate of cases, each of which involved complex commercial structures and transactions. The nature of GAAR proceedings became highly contingent on the outcomes of these cases, because the application of GAAR hinges on the determination of the relevant counterfactual—that is, the determination of what might have happened but didn’t. Taxation according to a GAAR became “taxation by analogy.”\(^{43}\) Australia had what was called a “part IVA outbreak,”\(^{44}\) and taxpayers won the majority of the cases. In response to this outbreak, constraints on the use of counterfactuals were introduced in Australia in 2013. New section 177CB(2) and section 177CB(3) state, respectively:

(2) A decision that a tax effect would have occurred if the scheme had not been entered into or carried out must be based on a postulate that comprises only the events or circumstances that actually happened or existed (other than those that form part of the scheme).

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40 ITAA 1936 section 177CB.
41 Ibid., section 177C(1)(a) (emphasis added).
(3) A decision that a tax effect might reasonably be expected to have occurred if the scheme had not been entered into or carried out must be based on a postulate that is a reasonable alternative to entering into or carrying out the scheme.

There are, thus, two limbs to the counterfactual determination: the “would have” limb and the “might reasonably be expected to have” limb. The “would have” limb involves a comparison of the tax outcomes of the impugned scheme with the outcomes of an alternative, postulated scheme that entirely replaces the impugned scheme. The “might reasonably be expected to have” limb involves comparing the tax outcomes of the impugned scheme with the outcomes of an alternative postulate involving a substituted set of arrangements (this is a recharacterization approach). The commissioner identifies the counterfactual, and the onus is on the taxpayer to rebut it.\(^45\) Counterfactuals are relevant to determining the existence of a tax benefit and a predominant purpose.\(^46\)

**Primary (Dominant) Purpose of Transactions**

GAARs apply only to avoidance transactions, which are, generally, transactions entered into for the primary purpose of avoiding tax. The three countries differ in their legislative approaches to identifying tax avoidance. Canada uses a reasonable primary non-tax purpose (commercial or family) test to determine whether a transaction should be excluded from consideration as an avoidance transaction.\(^47\)

New Zealand uses the purpose test to positively identify tax-avoidance arrangements. Section YA 1 of the NZ-ITA defines “tax avoidance arrangement” to mean an arrangement, whether entered into by the person affected by the arrangement or by another person, that directly or indirectly—(a) has tax avoidance as its purpose or effect; or (b) has tax avoidance as 1 of its purposes or effects, whether or not any other purpose or effect is referable to ordinary business or family dealings, if the tax avoidance purpose or effect is not merely incidental.

Thus, if an arrangement has tax avoidance as its sole or dominant purpose or effect, it would be considered a tax-avoidance arrangement.

Australia has the most elaborate legislation on this point. The purpose test is couched in section 177D, which identifies the tax-avoidance schemes to which

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\(^{45}\) In practice, it may be difficult for the commissioner to obtain evidence to support the counterfactual (that is, the reconstructed version of events). See Australian Taxation Office, *Law Administration Practice Statement* PS LA 2005/24, “Application of General Anti-Avoidance Rules,” December 13, 2005, at paragraph 112.

\(^{46}\) Ibid., at paragraphs 130-31.

\(^{47}\) ITA subsection 245(3) defines an avoidance transaction to mean any transaction (or any transaction that is part of a series of transactions) that, but for the GAAR provision, would result, directly or indirectly, in a tax benefit, “unless the transaction may reasonably be considered to have been undertaken or arranged primarily for bona fide purposes other than to obtain the tax benefit.”
part IVA applies. It refers to the purpose of a person, as opposed to an arrangement. Under section 177D(1), tax-avoidance schemes are those of which it may be concluded that the person, or one of the persons who entered into or carried out the scheme or any part of the scheme, did so for the purpose of enabling the relevant taxpayer to obtain a tax benefit in connection with the scheme or enabling the relevant taxpayer and other taxpayers each to obtain a tax benefit in connection with the scheme. Section 177D(2) lists eight factors that are to be considered in applying the purpose test:

(a) the manner in which the scheme was entered into or carried out;
(b) the form and substance of the scheme;
(c) the time at which the scheme was entered into and the length of the period during which the scheme was carried out;
(d) the result in relation to the operation of this Act that, but for this Part, would be achieved by the scheme;
(e) any change in the financial position of the relevant taxpayer that has resulted, will result, or may reasonably be expected to result, from the scheme;
(f) any change in the financial position of any person who has, or has had, any connection (whether of a business, family or other nature) with the relevant taxpayer, being a change that has resulted, will result or may reasonably be expected to result, from the scheme;
(g) any other consequence for the relevant taxpayer, or for any person referred to in paragraph (f), of the scheme having been entered into or carried out;
(h) the nature of any connection (whether of a business, family or other nature) between the relevant taxpayer and any person referred to in paragraph (f).

These factors are considered in an attempt to isolate observable facts and circumstances—for example, what was done under the scheme; how it was done; when it was done; how long it took; whether any of the persons involved are related; and what the economic substance is with respect to the change in financial position. In the case of mixed tax-avoidance and business or family purposes, the tax-avoidance purpose must be the dominant one if the application of the Australian GAAR is to be triggered. These factors can be viewed as creating a codified economic substance test.

The Australian and Canadian GAAR provisions make it clear that the purpose test is based on facts, not on the intent of the taxpayer. The NZ provision refers to the purpose of the arrangement as opposed to the taxpayer’s purpose. In all three countries, it was contemplated that tax avoidance may be one of two or more purposes that the taxpayer has in entering into or carrying out a scheme, and that

48 ITAA 1936 section 177A(5).
49 The wording is “it would be concluded (having regard to the matters [listed in the eight factors])” in section 177D(1) of ITAA 1936, and “it may reasonably be considered” in section 245(3) of the ITA.
GAAR is triggered only if tax avoidance is the taxpayer’s primary, dominant, or non-incidental purpose.

**Purpose of Statutory Provisions**

As a measure of last resort, GAAR functions as a shield to protect (1) the tax base as defined by the charging provisions; (2) the integrity of tax expenditures provisions that grant tax benefits to taxpayers with specific preconditions; and (3) the effectiveness of specific anti-avoidance rules (SAARs). The provisions thus protected can be viewed as “specific” or “primary” provisions in relation to the GAAR provision. If a tax benefit desired by the taxpayer is explicitly sanctioned by a primary provision, the GAAR provision clearly would not apply. The GAAR provision is invoked in the absence of such explicit sanction. A critical question is whether the tax benefit should be denied through a purposive interpretation of the primary provision. Discerning legislative intent is an exercise in statutory interpretation.

The courts in Canada, Australia, and New Zealand all seem to apply their respective GAARs to transactions designed to obtain a tax benefit in an “artificial” or “contrived” way, and they do so on the grounds that the use of the primary provisions to gain such a tax benefit is not within Parliament’s purpose. Examples are the Supreme Court of Canada decision in *Mathew*, the High Court of Australia decision in *Hart*, and the Supreme Court of New Zealand decision in *Ben Nevis*. As a matter of statutory interpretation, however, a conceptual difficulty arises with respect to statutory interpretation when it comes to the GAAR provisions relative to a purposive construction of primary provisions. Justice Pagone, writing extrajudicially, pinpoints the difficulty this way: “[H]ow can the [GAAR] provisions ever apply when the primary taxing provisions have failed to achieve their proper and intended purpose when they have been construed and applied according to their purpose?”

The Canadian GAAR has a “misuse and abuse” test, which the Supreme Court of Canada has interpreted as involving a two-step inquiry: (1) to determine the purpose or rationale of the primary provisions with respect to the scheme of the ITA, the

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50 “Blatant,” “artificial,” or “contrived” are, in legal terms, inexact. That inexactness also provides fertile ground for differences of opinion as to whether a particular arrangement is blatant, artificial, or contrived. See Richard Edmonds, “Part IVA & Anti-Avoidance—Where Are We Now?” (2003) 6:3 Tax Specialist 96-103.

51 *Mathew*, supra note 14.

52 *Hart*, supra note 15.

53 *Ben Nevis*, supra note 16.

54 Pagone, supra note 19, at 16. See also Brian J. Arnold, “Policy Forum: Some Thoughts on the Supreme Court’s Approach to the Determination of Abuse under the General Anti-Avoidance Rule” (2014) 62:1 Canadian Tax Journal 113-27, noting at 125: “[I]n my view, there is no other reasonable basis for the distinction that . . . between the ordinary textual, contextual, and purposive approach and the textual, contextual, and purposive approach applied to subsection 245(4).”
relevant provisions, and permissible extrinsic aids; and (2) to determine whether the avoidance transaction defeated or frustrated the legislative purpose or rationale.\(^{55}\)

The concept of abuse is absent in the New Zealand GAAR provision, but the Supreme Court of New Zealand has adopted a parliamentary contemplation test, which is akin to the Canadian abuse test.\(^{56}\) In \textit{Ben Nevis}, Tipping, McGrath, and Gault JJ said:

When, as here, a case involves reliance by the taxpayer on specific provisions, the first enquiry concerns the application of those provisions. The taxpayer must satisfy the court that the use made of the specific provision is within its intended scope. If that is shown, a further question arises based on the taxpayer’s use of the specific provision viewed in the light of the arrangement as a whole. If, when viewed in that light, it is apparent that the taxpayer has used the specific provision, and thereby altered the incidence of income tax, in a way which cannot have been within the contemplation and purpose of Parliament when it enacted the provision, the arrangement will be a tax avoidance arrangement.\(^{57}\)

The notion of abuse is largely irrelevant in Australian GAAR cases. The judicial focus is mostly on determining the dominant purpose of a scheme through a consideration of the eight factors.

**JUDICIAL ATTITUDE**

When GAAR is drafted as a broadly worded standard as opposed to a specific rule, its effect depends on judicial interpretation. GAAR in action can be much narrower than GAAR on paper, depending on the judicial attitude toward the \textit{Duke of Westminster}\(^{58}\) principle—that is, the principle that taxpayers have the right to minimize taxation. This principle is grounded in (1) a more literal interpretation of the primary provisions of taxing statutes and (2) respect for the legal form and shape of transactions.

**Decisions of the Highest Court**

The GAAR decisions of the highest courts in Canada, Australia, and New Zealand have not been overruled or modified through legislative amendment.\(^{59}\) Judicial attitude can thus be gleaned from these decisions.

\(^{55}\) See \textit{Canada Trustco}, supra note 14. In that case the court concluded that capital cost allowance (CCA) deductions claimed by the taxpayer from a sale and leaseback transaction were consistent with the object and spirit of the CCA provisions relied upon by the taxpayer notwithstanding that it was an avoidance transaction and that there may not have been real financial risk or economic cost.

\(^{56}\) See \textit{Ben Nevis}, supra note 16, at paragraph 45.

\(^{57}\) Ibid., at paragraph 107.


\(^{59}\) In Australia, part IVA was significantly amended in 2013 in response to the lower courts’ interpretation of “tax benefit” and the use of counterfactuals, which was perceived to be
The Supreme Court of Canada applied GAAR in Mathew, Lipson and Copthorne, but not in Canada Trustco. The court found the transactions in Canada Trustco to be “not so dissimilar from an ordinary sale-leaseback.” In Mathew, the loss-shifting transactions carried out through the use of partnerships were found to be abusive, because the purpose of one partnership was “simply to realize and allocate the tax losses, without any other significant partnership activity” and the “abusive nature of the transactions is confirmed by the vacuity and artificiality of the non-arm’s length aspect of the initial relationship” between the initial partnership and the loss-making company. In the transactions in Lipson, the taxpayer’s wife borrowed money to buy from the taxpayer shares in the family corporations so that, in effect, the taxpayer could deduct interest on the couple’s home mortgage loan by taking advantage of an attribution rule (a SAAR to prevent income splitting). The majority of the court found the transactions abusive, because their effect was to use an anti-avoidance rule to achieve tax avoidance. In Copthorne, the taxpayer sought to increase the paid-up capital by restructuring the vertical parent-subsidiary relationship of two Canadian corporations into a horizontal sister-sister relationship in order to avoid the cancellation of paid-up capital in the subsidiary upon a vertical amalgamation. The higher paid-up capital would be paid to the non-resident shareholder tax-free as opposed to being paid as a dividend that is subject to withholding tax. The court found the step in the series of transactions that led to the restructuring to be abusive because it was “primarily for a tax purpose and . . . done in a manner found to circumvent a provision of the Income Tax Act.”

According to the Supreme Court of Canada, GAAR “is a legal mechanism whereby Parliament has conferred on the court the unusual duty of going behind the words of the legislation to determine the object, spirit or purpose of the provision or provisions relied upon by the taxpayer.” An avoidance transaction is subject to GAAR if it achieves an outcome that the provision was intended to prevent or it defeats the underlying rationale of the provision. The minister, according to the court, “must clearly demonstrate that the transaction is an abuse of the Act, and the benefit of the doubt is given to the taxpayer.”

limiting the scope of GAAR and creating unwarranted uncertainties; see the 2013 amendment, supra note 20. In Canada, GAAR was amended in 2004 to overrule a Tax Court of Canada decision, in Fredette v. The Queen, 2001 DTC 621, that the GAAR did not apply to tax regulations.

60 Canada Trustco, supra note 14, at paragraphs 78 and 80.
61 Mathew, supra note 14, at paragraph 61.
62 Ibid., at paragraph 62.
63 Lipson, supra note 14, at paragraph 42.
64 Copthorne, supra note 14, at paragraph 121.
65 Ibid., at paragraph 66.
66 Ibid., at paragraph 72.
New Zealand

The Supreme Court of New Zealand applied GAAR in both of its decisions. *Ben Nevis* concerned a complex 50-year forestry investment tax-shelter scheme under which investors (the taxpayers) sought to claim from the outset significant annual tax deductions for amortized licence fees and insurance premiums that, in theory, were not actually payable until near the maturation of the scheme and that, in practice, were unlikely to be payable even then. The taxpayers argued that the deductions were permitted by the specific provisions in the NZ-ITA and that the scheme was thus consistent with Parliament’s purpose (not “beyond Parliamentary contemplation”) and therefore not subject to GAAR. In applying GAAR, the majority explained:

The ultimate question is whether the impugned arrangement, viewed in a commercially and economically realistic way, makes use of the specific provision in a manner that is consistent with Parliament’s purpose. If that is so, the arrangement will not, by reason of that use, be a tax avoidance arrangement. If the use of the specific provision is beyond Parliamentary contemplation, its use in that way will result in the arrangement being a tax avoidance arrangement.\(^{67}\)

*Ben Nevis* established the “Parliamentary contemplation” test. The arrangement adopted by the taxpayer in *Ben Nevis* was not of a kind that Parliamentary contemplated when it enacted the specific provisions upon which the taxpayers had relied. In addition, the arrangement was contrived.

*Penny* applied the same test to the ordinary use, by taxpayers, of the corporate form or trust form in order to benefit from the lower corporate tax rate. This case concerned taxpayers (surgeons) who transferred their medical practice to a company owned by a trust and paid themselves a salary of less than 20 percent of the profits generated by the practice. As a result, the professional income was taxed at the corporate rate rather than the top personal tax rate. The court confirmed that the taxpayers were free to use the corporate or trust structure. The court also found, however, that the use of this structure, when it is combined with the payment of an “artificially” low salary for the purpose of obtaining a tax advantage, is “beyond parliamentary contemplation” and thus subject to GAAR.\(^{68}\)

The *Penny* case has no counterpart in Canada. The Canada Revenue Agency (CRA) has not invoked GAAR to deny the tax benefits of using private corporations. The decisions in *Ben Nevis* and *Canada Trustco* hinge on the meaning of “cost.” The Supreme Court of Canada was of the view that “cost” in the relevant provisions should not be reread as “money at risk” and should have a legal meaning.\(^{69}\) The Supreme Court of New Zealand took an economic approach: when “there was no

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\(^{67}\) *Ben Nevis*, supra note 16, at paragraph 109 (emphasis added).

\(^{68}\) *Penny*, supra note 16, at paragraph 33.

\(^{69}\) *Canada Trustco*, supra note 14, at paragraphs 74-75 and 81.
real risk in the whole thing,” the deduction “cannot have been within the contemplation of Parliament when it enacted” the specific provision.\(^\text{70}\) Further, the court stated that “[w]hile the law treats the relevant costs as incurred, . . . the Court is permitted, when considering the question of tax avoidance, to examine the commercial nature of the incurred cost and any factors that might indicate that the expenditure will never be truly incurred.”\(^\text{71}\)

**Australia**

The High Court of Australia applied GAAR in *Spotless, CPH*, and *Hart*, but not in *Peabody* and *Mills*. *Peabody*\(^\text{72}\) concerned a series of transactions designed to float the shares of an operating company after a minority shareholder’s interest was bought by the majority shareholder. The taxpayer was a beneficiary of a family trust that was the majority shareholder. To lower the cost of financing, a shell company was used to purchase the shares from the minority shareholder with Aus$8.6 million raised through issuing redeemable preference shares to a bank. These preference shares were redeemed (and capital returned to the bank) when the trust loaned Aus$8.6 million to the shell company with proceeds from the public float. This loan was subsequently forgiven by the trust. Among the purposes of this structuring were (1) the avoidance of a capital gains tax if the trust bought the shares from the minority shareholder and then sold them at a higher price to the public; (2) lower cost of financing through the payment of “dividends” to the bank instead of interest; and (3) respecting the minority shareholder’s desire for confidentiality. The commissioner assessed the taxpayer for the capital gains tax. The court found that GAAR did not apply because the decision to finance the purchase of the minority shares through the shell company was a rational commercial decision.

The transactions in *Mills*,\(^\text{73}\) which were described as “stapled securities,” consisted of a stapled unsecured note issued by the NZ branch of the Commonwealth Bank of Australia and preference shares issued by the bank. The NZ branch paid distributions on the securities without the bank’s paying Australian income tax on the source of funding. The question was whether the security holders, such as Mr. Mills, could obtain an imputation credit (which is akin to the Canadian dividend tax credit). The answer hinged on the characterization of the security as equity. The commissioner denied the imputation credits on the grounds that the dominant purpose in using stapled securities was to generate an imputation credit while the bank did not pay Australian income tax on the source of funding. On consideration of all relevant factors and circumstances, the court held that, although it could be concluded that the bank had a purpose of enabling security holders to obtain an imputation benefit, that purpose was incidental to the bank’s purpose of

\(^{70}\) *Ben Nevis*, supra note 16, at paragraph 148.

\(^{71}\) Ibid., at paragraph 128.

\(^{72}\) Supra note 12.

\(^{73}\) *Mills*, supra note 15.
raising tier 1 capital to meet the regulatory requirement. Since tax avoidance was not the dominant purpose, GAAR did not apply.

In Spotless, the taxpayer deposited Aus$40 million of surplus funds in the Cook Islands, earning a rate of interest that was about 4 percent lower than the interest rate that could have been obtained by investing the funds in Australia. The taxpayer claimed that the interest income was exempt from Australian tax pursuant to a specific provision of the ITAA, the basis for the claim being that the interest had been subject to withholding tax in the Cook Islands. The majority of the High Court of Australia found that the dominant purpose of the transaction was to obtain the tax exemption—the commercially unattractive interest rate was more than offset by the tax exemption. The mere fact that a transaction can be justified as a rational commercial decision will not of itself be sufficient to avoid the operation of GAAR. A broader commercial objective apart from tax will not prevent the operation of GAAR. The court rejected a dichotomy between rational commercial decisions and tax planning. In consequence, part IVA was upheld by the court as applicable in cases where tax objectives explain the structure of what is otherwise a wholly commercial, and otherwise fiscally permissible, outcome.

In CPH, the taxpayer took preparatory steps to avoid the application of a deduction-quarantining provision under which the domestic interest deduction on funds borrowed to make foreign investment is limited to the amount of foreign-source income. The consolidated group of companies considered a takeover of a UK target, using borrowed funds. To avoid the quarantining rule, CPH borrowed Aus$450 million in Australia and lent the money to an Australian subsidiary (Sub1), incurring interest expense. Sub1 used the money to subscribe for redeemable preference shares in another Australian subsidiary (Sub2). Sub2 used the funds to subscribe for shares in a UK subsidiary, which then lent the money to a Singapore company that would then invest in the ultimate vehicle to be used for the takeover bid. The takeover did not actually take place. The commissioner invoked GAAR to deny CPH the interest deduction, arguing that steps involving Sub1 and Sub2 were inserted for tax reasons. The court agreed with the commissioner and applied GAAR.

The Hart case concerned the application of GAAR to a so-called “split loan” facility. The taxpayers borrowed from a bank to acquire their principal residence, and interest was not deductible. Later, they decided to buy a new residence and rent out the first residence. The change of use of the first residence enabled the interest to be deductible. To refinance their existing home and borrow money for the new property, the taxpayers took a split loan. Under the terms of the split loan, a loan (Aus$298,000) was notionally divided into two “accounts”—the investment loan account and the home loan account. The taxpayers had the option of directing

74 Spotless, supra note 15.
75 Ibid. (Brennan CJ, Dawson, Toohey, Gaudron, Gummow, and Kirby JJ).
76 CPH, supra note 15.
77 Hart, supra note 15.
that all monthly payments be applied toward the home loan account, that interest unpaid on the investment loan account be capitalized, and that compound interest be debited to that account. The split-loan facility had the twin effects of (1) paying off the home loan faster and at a lower total interest cost and (2) deferring and thus increasing the interest cost on the investment loan account. The commissioner disallowed the taxpayers’ deduction of the interest that was accruing but unpaid on the original amount of the investment loan account. The court agreed with the commissioner and held that the manner in which the scheme was entered into strongly suggested that the taxpayers entered into that scheme for the dominant purpose of obtaining a tax benefit.78

The Legacy of the Duke

The GAAR provisions of Canada, Australia, and New Zealand can be said to use the Duke of Westminster principle as a foil. This is most obvious in the case of the Australian GAAR, which, as Morse and Deutsch have observed, “pushes against the formal choice principle . . . and invalidates transactions where a taxpayer chooses a contrived ‘Plan B’ approach over a more natural ‘Plan A’ course of action.”79

The highest courts in the three countries have displayed somewhat different attitudes toward the role of the Duke of Westminster principle. The Supreme Court of Canada regards the principle as “a legitimate and accepted part of Canadian tax law” that is attenuated only by GAAR,80 and even Justices Binnie and Deschamps of the Supreme Court have expressed concern about “how healthy is the Duke of Westminster.”81

In contrast, the High Court of Australia and the Supreme Court of New Zealand regard the Duke of Westminster as largely irrelevant. For example, the High Court of Australia stated in Spotless:

Part IVA [GAAR] is to be construed and applied according to its terms, not under the influence of “muffled echoes of old arguments” concerning other legislation. In this Court, counsel for the taxpayers referred to the repetition by the Privy Council in Commissioner of Inland Revenue v Challenge Corporation of the statement by Lord Tomlin in Inland Revenue Commissioners v Duke of Westminster that “(e)very man is entitled if he can to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be.” Lord Tomlin spoke in the course of rejecting a submission that in assessing surtax under the Income Tax Act 1918 (UK) the Revenue might disregard legal form in favour of “the substance of the matter.” His remarks have no significance for the present appeal. Part IVA is as much a part of the statute under

78 Ibid., at paragraph 68.
80 Canada Trustco, supra note 14, at paragraphs 31 and 13.
81 Lipson, supra note 14, at paragraph 54.
which liability to income tax is assessed as any other provision thereof. In circumstances
where s 177D applies, regard is to be had to both form and substance (s 177D(b)(ii)).

The Supreme Court of New Zealand has made no reference to the Duke of West-
minster in its GAAR decisions and has stated that “English decisions provide limited
direct assistance” in interpreting a statutory GAAR.83 The court emphasized that
“there must be a weapon able to thwart technically correct but contrived trans-
actions set up as a means of exploiting the Act for tax advantages.”84

Relevance of Economic Substance

With respect to the relevance of economic substance in GAAR cases, the Supreme
Court of Canada has taken the narrowest approach. In Canada Trustco, for example,
the court stated that the explanatory notes to the GAAR provision elaborate that the
provisions of the ITA “are intended to apply to transactions with real economic
substance”85 but that “s. 245(4) does not consider a transaction to result in abusive
tax avoidance merely because an economic or commercial purpose is not evident.”86

In contrast, the High Court of Australia accepted that GAAR was intended to be
an “effective general measure against those tax avoidance arrangements that . . . are
blatant, artificial or contrived”87 as evidenced by, among other factors, a lack of eco-
nomic substance. The Supreme Court of New Zealand firmly endorses the
economic substance approach and stated in Ben Nevis:

In considering these matters, the courts are not limited to purely legal considerations.
They should also consider the use made of the specific provision in the light of the
commercial reality and the economic effect of that use. The ultimate question is
whether the impugned arrangement, viewed in a commercially and economically re-
alistic way, makes use of the specific provision in a manner that is consistent with
Parliament’s purpose.88

The “purposive interpretation” doctrine also emboldens courts in New Zealand
to look through the legal form of the arrangements for the economic substance:

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82 Spotless, supra note 15, at paragraph 9.
83 Ben Nevis, supra note 16, at paragraph 110.
84 Penny, supra note 16, at paragraph 47.
85 Canada Trustco, supra note 14, at paragraphs 48-49 and 56.
86 Ibid., at paragraph 57. The Supreme Court of Canada, ibid., was clear that “the GAAR was
not intended to outlaw all tax benefits; Parliament intended for many to endure” and that the
“central inquiry is focussed on whether the transaction was consistent with the purpose of
the provisions of the Income Tax Act that are relied upon by the taxpayer.”
87 Hart, supra note 15, at paragraph 86, per Callinan J.
As Parliament’s purpose in enacting specific provisions is axiomatically targeted at the most commonplace and conventional issues which arise, anything that indicates an unusual or contrived application of a provision is also likely to indicate that the provision was not used in the way Parliament thought it would be. If enough of these abnormalities are present, and are also accompanied by tax advantages, then it is a fair conclusion that the use is outside Parliamentary contemplation and the GAAR applies.\textsuperscript{89}

\textbf{Morality}

The three countries’ highest courts are unanimous on the irrelevance of morality, and they make it clear that applying GAAR is an exercise in statutory interpretation. Accordingly, the courts’ role is to interpret both the broad wording of the GAAR provisions and the technically detailed primary provisions. The High Court of Australia has made no reference to morality in its GAAR decisions. The Supreme Court of Canada has said that “determining the rationale of the relevant provisions of the Act should not be conflated with a value judgment of what is right or wrong nor with theories about what tax law ought to be or ought to do.”\textsuperscript{90} The Supreme Court of New Zealand has stated that judges should not be distracted by “intuitive subjective impressions of the morality” of certain arrangements.\textsuperscript{91}

\textbf{DOCTRINAL COMPARISON}

The substantial similarities among the three countries’ common-law traditions and GAAR provisions would seem to suggest that ample room exists for convergence in their high courts’ GAAR decisions. However, the judicial approaches to interpreting and applying GAAR are not exactly the same, which leaves room for divergence in the courts’ decisions. On the basis of the decisions canvassed above and certain decisions from the lower courts in the three countries, we offer below some examples of convergence and divergence. We have chosen these examples on the basis of a broad consideration only, given that many other factors may well explain the case outcomes.

\textbf{Examples of Convergence}

One area of convergence is the courts’ concern about taxpayers’ using contrived and artificial, albeit legal, means to achieve an economic outcome, thus avoiding tax liability and thereby shifting the economic burden to other taxpayers. Among the four types of arrangements mentioned below, sales and lease-back transactions were found to be not subject to GAAR, presumably because these transactions do no more than shift the benefit of a tax consequence from one taxpayer to another in


\textsuperscript{90} Copthorne, supra note 14, at paragraph 70.

\textsuperscript{91} Ben Nevis, supra note 16, at paragraph 102.
the arrangement, and are therefore revenue-neutral from a tax policy perspective. The other three types of transactions resulted in revenue losses.

Loss-generating cases have been found to be subject to GAAR. In Canada, the Federal Court of Appeal applied GAAR in three separate loss-generating cases: 1207192 Ontario Limited, Triad Gestco, and Global Equity. These cases involved stock dividends that shifted value from common shares to preferred shares and thereby gave rise to a loss on the common shares. The losses were capital in nature in the first two cases, and business losses in the third case. The courts found that the object, spirit, and purpose of the relevant provisions were to allow only the recognition of “true capital losses incurred outside the same economic unit” or of business losses that “must be grounded in some form of economic or business reality.” In Australian cases such as Howland-Rose, Vincent, Puzey, and Calder, the natural counterfactual is that a loss-generating transaction would not take place. For example, Puzey concerned a so-called tax-effective investment in a sandalwood project. The taxpayer combined an amount of his own funds with an amount borrowed through the scheme, and he secured, by participation in the scheme, a tax deduction sufficient to cover the amount invested. In effect, the tax deduction was the source of the investment. The government has won numerous cases related to tax shelters wholly unrelated to the businesses of Australian taxpayers. The Supreme Court of New Zealand decision in Ben Nevis is a loss-generating case.

Loss-trading cases have also produced some convergence in the decisions of the three countries’ courts. Canadian cases such as Mathew, Birchcliff Energy Ltd.,

94 Triad Gestco Ltd. v. Canada, 2012 FCA 258; aff’g 2011 TCC 259.
96 Triad Gestco, supra note 94, at paragraph 55 (TCC).
97 Global Equity, supra note 95, at paragraph 62.
98 Howland-Rose v. Commissioner of Taxation, [2002] FCA 246 (expenditure on research into the development of products made from tea tree oil was not deductible as the expenditure was not capable of being identified with the derivation of any assessable income).
101 Calder v. Commissioner of Taxation, [2005] FCAFC 254 (holding part IVA applicable to excessive deductions for advance fee and interest payments made out of borrowed round-robin funds).
102 Significantly, however, this transaction was found to involve full-recourse loans—in other words, the taxpayer could be called upon to repay the loan in the future.
103 Mathew, supra note 14.
Oxford Properties\textsuperscript{105} and 594710 British Columbia\textsuperscript{106} suggest that tax-avoidance transactions aimed at trading losses (or profit) are abusive and subject to GAAR. An NZ example is the Miller\textsuperscript{107} case, in which business profits were shifted to companies with existing losses through a scheme that was found to be “highly artificial.”

Another issue giving rise to convergence among the courts is the issue of deductibility of interest on money borrowed to purchase a principal residence. It is not surprising that the top courts in both Canada and Australia applied GAAR to transactions designed to obtain the tax deduction through tax-avoidance arrangements. The Lipson case involved transactions known as “Singleton with a spousal twist.”\textsuperscript{108} Although the Singleton type of financing (that is, using borrowed money to replace equity in a law firm’s capital account and purchasing a home with the equity amount) was found unanimously not to be subject to GAAR, the spousal twist was found by the majority in the Supreme Court of Canada to be abusive because the attribution rules were intended to prevent income shifting between spouses, and that intention was frustrated. In Hart, the split loan arrangement for a mortgage to finance a rental property and a residence was found to be subject to GAAR. These cases do not mean, however, that there is convergence among the three countries’ courts with respect to interest deductibility in general.

The GAAR has not applied to cases involving sale and lease-back arrangements: Eastern Nitrogen\textsuperscript{109} and Metal Manufactures,\textsuperscript{110} in Australia; and Canada Trustco, in Canada. The highly leveraged cross-border transactions in Canada Trustco were found to be not dissimilar to standard sale and lease-back transactions and thus immune from GAAR. In the Australian cases, after considering the eight criteria for determining the dominant tax-avoidance purpose, the courts held that the most influential purpose of the taxpayer (which sold the assets and leased them back) was not to obtain a tax benefit but, rather, to obtain “a very large financial facility on the best terms reasonably available.”\textsuperscript{111} These decisions were regarded as providing “authority for the proposition that Part IVA should not apply in circumstances

\textsuperscript{106} Canada v. 594710 British Columbia Ltd., 2018 FCA 166.
\textsuperscript{107} Miller v. Commissioner of Inland Revenue, [2001] 3 NZLR 316 (PC).
\textsuperscript{108} Lipson, supra note 14, at paragraph 59. In this case, Mrs. Lipson took a loan from a bank on the condition that she would repay the loan the next day. She used the borrowed money to purchase shares of the family corporation from Mr. Lipson, who used the proceeds to purchase a family home. The Lipsons obtained a mortgage on the house, and Mrs. Lipson used the proceeds of the mortgage to repay the loan. Mrs. Lipson incurred interest expenses at an amount greater than the dividends received from the family corporation. Mr. Lipson, taking advantage of attribution rules, deducted the interest, in effect.
\textsuperscript{110} Commissioner of Taxation v. Metal Manufactures Ltd, [2001] FCA 365.
\textsuperscript{111} Eastern Nitrogen, supra note 109, at paragraph 119.
where a tax benefit has been obtained through a form where the form itself serves commercial objectives other than the tax benefit.”

Examples of Divergence

On a number of GAAR-related questions, the courts in the three countries diverge. The use of “do-nothing” counterfactuals (that is, how would the taxpayer have been taxed if it had “done nothing,” or had not engaged in the avoidance transaction) is quite important in Australia, but not in Canada or New Zealand. Some Australian cases, especially those that predate the 2013 amendment, denied GAAR applications based on do-nothing counterfactuals on the grounds that the alternative transaction (higher-tax option) was so unlikely that it would not possibly have occurred. One example is the *RCI Pty* case. In this case, an Australian taxpayer corporation was a member of a group that undertook an internal restructuring intended to, among other goals, establish a central group finance company in the Netherlands. As part of the restructuring, RCI received a dividend from a US subsidiary, which reduced the value of the shares of the US subsidiary. After receiving the dividend, RCI transferred those shares to a related company in Malta, resulting in no taxable gains for Australian tax purposes. The commissioner contended that the capital gain that RCI would have realized from the transfer of the shares in the absence of the dividend was a tax benefit. But the taxpayer prevailed in the courts with its argument that no tax benefit existed because, if the taxpayer had faced a tax liability of Aus$172 million, it would not have entered into the internal restructuring transaction in the first place.

Canadian and NZ cases do not contain specific counterfactual analysis. However, the notion of the do-nothing alternative was considered by Canadian courts in cases such as *Univar Canada* and *Copthorne*. In *Copthorne*, which involved a vertical amalgamation, the court’s consideration of the do-nothing counterfactual supported the finding that the transaction had produced a tax benefit. In *Univar Canada*, the Tax Court of Canada found, through consideration of the do-nothing alternative,

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112 Pagone, supra note 92, at 785.

113 *RCI Pty*, supra note 42.

114 Ibid., at paragraph 150: “[I]n our view, if the scheme in either of its manifestations had not been entered into or carried out, the reasonable expectation is that the relevant parties would have either abandoned the proposal, indefinitely deferred it, altered it so that it did not involve the transfer by RCI of its shares in JHH(O) [US subsidiary] to RCI Malta or pursued one or more of the other alternatives referred to in the Information Memorandum; but they would not have proceeded to have RCI transfer its shares in JHH(O) to RCI Malta at a tax cost of $172 million. On this view, RCI did not obtain the tax benefit it was alleged by the Commissioner to have obtained in connection with the scheme.”

115 *Univar Canada Ltd. v. The Queen*, 2005 TCC 723; rev’d 2017 FCA 207.

116 *Copthorne*, supra note 14, at paragraph 35.
that no tax benefit existed. The Federal Court of Appeal suggested in *Univar Canada* that alternative transactions may be relevant in the abuse analysis.

Another example of a GAAR issue on which the three countries diverge is the use of private corporations or trusts to divert income. In Australia and New Zealand, where an individual assigns income to an entity, GAAR has applied unless the “tax advantages are subordinate to other commercial reasons for channeling personal services income through an intermediary” or the individual receives a reasonable level of salary. In Canada, SAARs such as the indirect payment rules under subsection 56(2) were invoked in cases such as *McClurg* and *Neuman*, and there are no GAAR cases in which the tax benefit of using private corporations or trusts has been denied.

Treaty-shopping cases are found only in Canada. The minister invoked GAAR, without success, to deny treaty benefits in *MIL Investments* and *Alta Energy*. In *Alta Energy*, after establishing the rationale of the relevant treaty provisions of the Luxembourg Convention on the basis of the provisions’ textual meaning, the Federal Court of Appeal held that the treaty-shopping structure was not abusive. The court remarked that “the rationale for the relevant provisions of the Luxembourg Convention can be found in the text of these provisions” and that, “[s]ince the provisions operated as they were intended to operate, there was no abuse.”

**EMPIRICAL STUDY**

**Exploring Transaction Types in the Context of Judicial Decision Making**

**Transaction Types**

The dataset contains the attributes of the cases as well as the judges who decided them. The size of the dataset is very modest: 99 Canadian cases decided by 65 judges

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117 *Univar Canada*, supra note 115, at paragraph 43 (TCC): “[T]he only alternate arrangement that can be considered is the possibility of the alleged avoidance transaction not having occurred. Had the shares of Barbadosco not been acquired by the Appellant, there would be no tax otherwise payable which could be avoided, reduced or deferred. The acquisition of such shares by the Appellant does not change that.”

118 Ibid., at paragraph 19 (FCA).

119 See Morse and Deutsch, supra note 79, at 126, note 144; and *Federal Commissioner of Taxation v. Mochkin*, [2003] FCAFC 15.

120 *Penny*, supra note 16.


123 *Canada v. MIL (Investments) SA*, 2007 FCA 236.


125 Ibid., at paragraph 69.

126 Ibid., at paragraph 80.
(48 male and 17 female); 96 Australian cases decided by 70 judges (62 male and 8 female); and 28 New Zealand cases decided by 50 judges (43 male and 7 female).

Each case is classified, according to Edgar’s typology, as a creation type, a trading type, or a substitution type. The classification of a case is not always clear-cut. Some cases may fall into two categories. For example, the transactions in Lipson could equally be the creation type or the substitution type. We opted for the latter categorization because a viable higher-tax alternative existed for that type. Overall, the substitution type accounts for over 50 percent of total cases (see table 1).

Judicial Attributes and Regression Variables

To empirically explore the question whether identification of the transaction type helps predict how judges will decide GAAR cases, the dataset includes information about the judges who decided them, so that the data about the cases and the data about the judges can be linked. An exploratory research approach grounded in logistic regression analysis was adopted.

The unit of analysis was the votes cast by the judges, coded as either “for the government” or “not for the government.” The binary variable of votes was used as the dependent variable. Transaction type was used as the independent variable. In addition, four categorical variables and one continuous variable were used as the covariates. In setting up the independent variable and the covariates, one category of each categorical variable was designated as the base category serving as the basis of comparison for other categories of the same variable. These five categorical variables were set up as follows:

1. the transaction type in each case (the substitution type as the base category versus the creation type and the trading type);\(^\text{127}\)
2. the jurisdiction in which each case was decided (New Zealand as the base category versus Australia and Canada);
3. a rough proxy of the country’s national political climate at the time each case was decided (times when conservatives were in power as the base category versus times when liberals were in power);\(^\text{128}\)

\(^{127}\) The classification of a case as a creation, trading, or substitution decision was not always clear-cut. Some cases may fall into two categories. For example, the transactions in Lipson, supra note 14, could be a creation type and a substitution type. We opted for the latter because of a viable higher-tax alternative existed.

\(^{128}\) Because the dataset includes only GAARs decided by the federal courts in Canada and Australia, and because New Zealand is a unitary state, the government in power refers to the national level only. The conservatives refer to the Progressive Conservative Party of Canada; its subsequent incarnation, the Conservative Party of Canada in Canada; The Liberal Party of Australia, in Australia; and The New Zealand National Party in New Zealand; the liberals refer to The Liberal Party of Canada in Canada, The Australian Labor Party in Australia, and The New Zealand Labour Party in New Zealand.
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<td>31%</td>
<td>55</td>
<td>57%</td>
</tr>
<tr>
<td>In favour of government</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>New Zealand</td>
<td>25</td>
<td>89%</td>
<td>11</td>
<td>44%</td>
<td>14</td>
<td>56%</td>
</tr>
<tr>
<td>Canada</td>
<td>48</td>
<td>48%</td>
<td>16</td>
<td>33%</td>
<td>17</td>
<td>35%</td>
</tr>
<tr>
<td>Australia</td>
<td>55</td>
<td>57%</td>
<td>23</td>
<td>42%</td>
<td>24</td>
<td>44%</td>
</tr>
</tbody>
</table>
4. a rough proxy of the country’s national political climate at the time when each judge was appointed (judges appointed when conservatives were in power as the base category versus judges appointed when liberals were in power); and
5. the gender of each judge (male judges as the base category versus female judges (given the nature of the raw data available, only male and female gender categories were coded).

The continuous covariate was the judicial experience of each judge, as represented by the number of years that the judge had accumulated on the bench at the time when a case was decided. Judicial experience is measured from when the judge was first appointed as a judge.

The Variables Coded

A total of 455 votes were cast in the three groups of cases, of which 252 (55 percent) were in substitution cases, 135 (30 percent) in creation cases, and 68 (15 percent) in trading cases. The distribution reflects the dominance of votes in substitution cases in Australia and Canada. The New Zealand dataset, which records no vote in a trading case, shows a 51-49 split between votes in creation and substitution cases.

In terms of the gender of judges, in New Zealand, male judges cast 63 (88 percent) of the total votes, as table 2 shows.

Table 2 also shows that 66 of 72 votes (92 percent) were cast for the government. Of the 66 votes, 33 (or 50 percent) were cast by judges appointed when conservatives were in power, and 23 (or 35 percent) were cast by male judges who cast their votes in substitution cases that were decided when conservatives were in power.

In Canadian cases, 94 (50 percent) of 187 votes were cast in substitution cases, while the rest of the votes were split between 45 trading cases (24 percent), and 48 creation cases (26 percent). Male judges cast 132 (71 percent) of the 187 votes. As shown in table 3, 105 (or 56 percent) of 187 votes were cast for the government. Of 94 votes in the substitution cases, 66 (70 percent) were cast not for the government, while most votes in trading cases (39 of 45: 87 percent) and creation cases (38 of 48: 79 percent) were cast for the government. Among the votes cast not for the government in substitution cases, male judges who decided cases when liberals were in power in the federal government accounted for 30 of 66 votes (46 percent). Among the votes cast for the government in trading cases, male judges who decided cases when liberals were in power in the federal government accounted for 23 of 39 (59 percent). Among the votes cast for the government in creation cases, male judges who decided cases when conservatives were in power accounted for 20 of 28 (53 percent).

In Australian cases, 123 of 196 votes (62.8 percent) were cast in substitution cases, while 50 of the 196 (25.5 percent) were cast in creation cases, and 23 (11.7 percent) in trading cases. Male judges cast 169 the 196 votes (86 percent). As shown in table 4, 110 of 196 votes (56 percent) were cast for the government.

Of the 123 votes in the substitution cases, 66 (54 percent) were cast not for the government, and that is the opposite of votes in other cases—39 of 50 (78 percent)
<table>
<thead>
<tr>
<th>Transaction type</th>
<th>Appointed when _____ were in power in the federal government</th>
<th>Votes cast when _____ were in power in the federal government</th>
<th>Votes cast not for the government</th>
<th>Votes cast for the government</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Conservatives</td>
<td>Liberals</td>
<td>Male</td>
<td>Female</td>
</tr>
<tr>
<td>Substitution</td>
<td>Conservatives</td>
<td>Liberals</td>
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<td>1</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>19</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>Liberals</td>
<td>Conservatives</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Liberals</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Total</td>
<td>1</td>
<td>1</td>
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<tr>
<td></td>
<td>Total</td>
<td></td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Creation</td>
<td>Conservatives</td>
<td>Liberals</td>
<td>3</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>11</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td>Liberals</td>
<td>Conservatives</td>
<td>9</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Liberals</td>
<td>18</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Total</td>
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<td>1</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td>4</td>
<td>2</td>
</tr>
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</table>
TABLE 3  Votes Cast by Canadian Judges by Transaction Types, Politics, and Gender

<table>
<thead>
<tr>
<th>Transaction type</th>
<th>Appointed when _____ were in power in the federal government</th>
<th>Votes cast when _____ were in power in the federal government</th>
<th>Votes cast not for the government</th>
<th>Votes cast for the government</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Conservative(s)</td>
<td>Liberal(s)</td>
<td>Male</td>
<td>Female</td>
</tr>
<tr>
<td>Substitution</td>
<td>Conservatives</td>
<td>Liberals</td>
<td>9</td>
<td>6</td>
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<tr>
<td></td>
<td>Total</td>
<td></td>
<td>25</td>
<td>10</td>
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<tr>
<td></td>
<td>Conservatives</td>
<td>Liberal(s)</td>
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<td>2</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td></td>
<td>20</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td></td>
<td>42</td>
<td>12</td>
</tr>
<tr>
<td>Creation</td>
<td>Conservative(s)</td>
<td>Liberal(s)</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td></td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td>Conservative(s)</td>
<td>Liberal(s)</td>
<td>0</td>
<td>0</td>
</tr>
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<td>Total</td>
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<tr>
<td></td>
<td>Total</td>
<td></td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Trading</td>
<td>Conservative(s)</td>
<td>Liberal(s)</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td></td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td></td>
<td>Conservative(s)</td>
<td>Liberal(s)</td>
<td>0</td>
<td>0</td>
</tr>
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<td>Total</td>
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<td>0</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td>58</td>
<td>24</td>
</tr>
</tbody>
</table>
### TABLE 4  Votes Cast by Australian Judges by Transaction Types, Politics, and Gender

<table>
<thead>
<tr>
<th>Transaction type</th>
<th>Appointed when _____ were in power in the federal government</th>
<th>Votes cast when _____ were in power in the federal government</th>
<th>Votes cast not for the government</th>
<th>Votes cast for the government</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Male</td>
<td>Female</td>
<td>Total</td>
</tr>
<tr>
<td>Substitution</td>
<td>Conservatives</td>
<td>6</td>
<td>2</td>
<td>8</td>
</tr>
<tr>
<td></td>
<td>Liberals</td>
<td>24</td>
<td>10</td>
<td>34</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>30</td>
<td>12</td>
<td>42</td>
</tr>
<tr>
<td></td>
<td>Conservatives</td>
<td>11</td>
<td>1</td>
<td>12</td>
</tr>
<tr>
<td></td>
<td>Liberals</td>
<td>11</td>
<td>1</td>
<td>12</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>22</td>
<td>2</td>
<td>24</td>
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<tr>
<td></td>
<td>Total</td>
<td>52</td>
<td>14</td>
<td>66</td>
</tr>
<tr>
<td>Creation</td>
<td>Conservatives</td>
<td>1</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td>Liberals</td>
<td>3</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>4</td>
<td>1</td>
<td>5</td>
</tr>
<tr>
<td></td>
<td>Conservatives</td>
<td>5</td>
<td>5</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Liberals</td>
<td>1</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>6</td>
<td>6</td>
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<tr>
<td></td>
<td>Total</td>
<td>10</td>
<td>1</td>
<td>11</td>
</tr>
<tr>
<td>Trading</td>
<td>Conservatives</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>Liberals</td>
<td>1</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>1</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td>Conservatives</td>
<td>3</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Liberals</td>
<td>3</td>
<td>1</td>
<td>4</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>6</td>
<td>1</td>
<td>7</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>7</td>
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<tr>
<td></td>
<td>Total</td>
<td>69</td>
<td>17</td>
<td>86</td>
</tr>
</tbody>
</table>
were cast for the government in creation cases; and 14 of 23 (61 percent) for the government in trading cases. Among the votes cast not for the government in the substitution cases, male judges who decided cases when liberals were in power accounted for 35 of the 66 votes (53 percent). Among the votes cast for the government in the creation cases, male judges who decided cases when conservatives were in power accounted for 26 of the 39 votes (67 percent). Among the votes cast for the government in the trading cases, male judges who decided cases when conservatives were in power accounted for 10 of the 14 votes (71 percent).

The votes in the cases were cast by 185 judges of varying years of experience on the bench when they decided a case, ranging from six who had just been appointed and one who had had 35 years on the bench. Figure 1 displays the distribution of judicial experience in box plots.

In total, the median experience of the 185 judges when they decided the cases was about 11 years. Half of them—from the 25th percentile to the 75th percentile—had been on the bench from 6 to 16 years. The experience of the 50 NZ judges ranged from newly appointed to 33 years on the bench, with a median of 14 years of experience. Half of these NZ judges had been on the bench from 8 to 18 years. The 65 Canadian judges’ experience on the bench ranged from newly appointed to 35 years on the bench, with a median of 12 years’ experience. Half of these judges had been on the bench from 8 to 17 years. The experience of the 70 Australian judges ranged from newly appointed to 26 years, with a median of 9 years. Half of these Australian judges had been on the bench from 4.5 to 15 years.

In sum, although judges of the three countries, considered as three different groups, appeared to share a similar profile of experiences when cases were decided, and although most of them were male, they appeared to decide cases of different transaction types (according to the Edgar typology) differently. In particular, the NZ picture appears to look quite different from the Canadian and Australian pictures. In New Zealand, for example, most of the votes cast in substitution cases were for the government, while in Canada and Australia, most of the votes cast in substitution cases were not for the government. That said, the Canadian and Australian pictures look different from each other, too, although the difference is of a more nuanced nature. For example, most of the votes cast for the government in trading cases in Canada were cast when liberals were in power in the federal government, while most of the votes cast for the government in trading cases in Australia were cast when conservatives were in power.

Exploring Influences of the Edgar Typology in Judicial Decision Making

Given that the unit of analysis was the votes cast by the judges and that the analytical approach was to examine judicial voting patterns according to transaction types, we ran three different logistic regression models regressing judicial votes on transaction with robust standard errors. The objective was to compare the influences of transaction types on judicial decision making in three different settings. The results are shown in table 5.
Model 1 compared (1) the influence of the creation type of transaction on judicial decision making with the influence of the substitution type (creation versus substitution) and (2) the influence of the trading type of transaction with the influence of the substitution type (trading versus substitution). Compared with votes in substitution cases, votes in creation and trading cases were more likely to be cast for the government, with creation votes more likely to be cast for the government than trading votes. Model 1 did not take into consideration that the votes were cast in different countries and that some judges voted in multiple cases.

Building on model 1, model 2 compared, in different countries, (1) the influences of the creation type with those of the substitution type and (2) the influences of the trading type with those of the substitution type. Compared with votes in substitution cases, votes in trading and creation cases were more likely to be cast for the government, with trading votes more likely to be cast for the government than were creation votes. Model 2 did not take into consideration that some judges voted in multiple cases.

The change in the degree of the influences of trading type and creation type in model 2 relative to model 1 can be attributed to the fact that model 2 took into account that the votes were cast in different countries.

Wider in scope than model 1, model 2 took into consideration the impact of different countries in its examination of the influences of transaction types, and it
did so by comparing the jurisdiction of Canada with that of New Zealand (Canada versus New Zealand) and the jurisdiction of Australia with that of New Zealand (Australia versus New Zealand). Compared with votes in NZ cases, votes in Canada and Australia were less likely to be cast for the government, with votes in Canadian cases less likely to be cast for the government than votes in Australian cases.

In considering the differences between countries in a comparison of the influences of transaction types, a rough proxy of the national political climate when cases were decided was included in model 2. In comparing how votes were cast when liberals were in power with how they were cast when conservatives were in power (liberals versus conservatives in power when a case was decided), it was found that votes cast when liberals were in power were less likely to be for the government than votes cast when conservatives were in power.

Building on model 2, model 3 compared the influences of the creation transaction type with those of the substitution type, and the influences of the trading type with those of the substitution type, in different countries with different judges.

| TABLE 5 Comparing Influences of Transaction Types in Different Settings |
|---------------------------------|-----------------|-----------------|-----------------|
|                                 | Model 1         | Model 2         | Model 3         |
| Creation versus substitution    | 1.609***        | 1.403***        | 1.448***        |
|                                 | [0.255]         | [0.273]         | [0.257]         |
| Trading versus substitution     | 1.389***        | 1.892***        | 1.849***        |
|                                 | [0.319]         | [0.371]         | [0.367]         |
| Canada versus New Zealand       | -2.274***       | -2.195***       | -2.195***       |
|                                 | [0.485]         | [0.493]         | [0.493]         |
| Australia versus New Zealand    | -2.053***       | -1.923***       | -1.923***       |
|                                 | [0.478]         | [0.483]         | [0.483]         |
| Liberals versus conservatives in power when a case was decided | -0.936***       | -1.092***       | -1.092***       |
|                                 | [0.229]         | [0.315]         | [0.315]         |
| Liberals versus conservatives in power when a judge was appointed | -0.139          | -0.139          | -0.139          |
|                                 | [0.287]         | [0.287]         | [0.287]         |
| Liberals in power when a case was decided by a judge appointed when liberals in power versus other scenarios | 0.355           | 0.355           | 0.355           |
|                                 | [0.444]         | [0.444]         | [0.444]         |
| Female versus male              | -0.452          | -0.452          | -0.452          |
|                                 | [0.274]         | [0.274]         | [0.274]         |
| Years on the bench              | 0.0366*         | 0.0366*         | 0.0366*         |
|                                 | [0.0180]        | [0.0180]        | [0.0180]        |
| Number of votes                 | 455             | 455             | 455             |

Standard errors in brackets.

* $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$. 
As in model 2, votes in trading and creation cases were more likely than votes in substitution cases to be cast for the government, with trading votes more likely than creation votes to be cast for the government. Also in model 3, as in model 2, national factors were considered, and the national results in model 3 were similar to those in model 2. Votes in Canada and Australia were less likely than votes in New Zealand to be cast for the government, with votes in Canadian cases less likely to be cast for the government than votes in Australian cases. Votes in cases decided when liberals were in power were less likely to be cast for the government than votes in cases decided when conservatives were in power.

Unlike model 2, model 3 considered four judicial attributes. The first of these was the national political climate of the country when a judge was first appointed. A rough proxy (liberals versus conservatives in power when a judge was appointed) was used. Votes cast by judges appointed when liberals were in power were less likely to be cast for the government than votes cast by judges appointed when conservatives were in power, but model 3 finds that sheer chance could have been a factor in this pattern.

The second judicial attribute considered was a combination of the national political climate when a case was decided and the national political climate when a judge was appointed. A special scenario—liberals in power when a case was decided by a judge appointed when liberals were in power versus other scenarios—was considered. Votes cast by liberal-appointed judges deciding cases when liberals were in power in the federal government were more likely to be cast for the government, relative to other scenarios, but model 3 finds that sheer chance could have been a factor in this pattern.

The third attribute considered was the gender of judges. Votes cast by female judges were less likely than votes cast by male judges to be for the government, but model 3 finds that sheer chance may have been a factor in this pattern. The influence of gender could become more prominent when more female judges are appointed. Male judges dominated the judiciary in each country. Female judges seem to have voted just like their male counterparts insofar as more of them voted for the government than not for the government, except in Australia. In Australia, 100 of the 169 votes cast by male judges were cast for the government, while 69 were cast not for the government. But of the 27 votes cast by female judges, only 10 were cast for the government, with 17 cast not for the government. Because of the small number of votes cast by female judges in this comparative context, the fact that more votes by female judges were cast not for the government in such a case could not have changed any general voting patterns. But if there had been more female judges, at least in Australia, the general voting patterns could have looked quite different.

129 The analysis in model 3 was set up to recognize that some judges cast more than one vote, and each vote she or he cast was cast by the same judge. In other words, this full model clustered on individual judges, taking into the repeated-measures consideration of the fact that a judge who cast more than one vote was the same individual who cast those votes.
The fourth judicial attribute considered was the judges’ years on the bench. Votes cast by judges with more years on the bench were more likely to be for the government than were votes cast by judges with fewer years on the bench, and model 3 finds that the influence of judicial experience is not random.

The modelling in our study, culminating in the full model shown in model 3, illustrates the essence of Edgar’s typology of transaction types. The selected data show that judges in different countries appeared to have decided tax-avoidance cases of different transaction types differently. Female and male judges with different numbers of years on the bench deciding cases in environments with different political undercurrents might have decided cases differently, but such patterns could be owing to chance. The focus of the above exposition is not on the details, such as the actual magnitude of the effects in the logistic regressions; the focus, rather, is the hints the typology can offer as to the direction of judicial decision making. Such hints can be expanded and transformed into a visualization of what judicial decision making might look like in different hypothetical settings.

Using model 3, simulations were performed to sketch out hypothetical judicial voting patterns. Figure 2 shows the simulated patterns in substitution, creation, and trading cases, in different countries under different national political climates, decided by judges whose judicial experience varied in length.

Three conjectures are visualized according to the simulated voting patterns based on model 3. First, in all three countries, judges with differing degrees of judicial experience are expected to be more likely to vote for the government in trading cases than in creation cases, and the judges are expected to be more likely to vote for the government in creation cases than in substitution cases. Second, across all transaction types, judges in some countries, such as New Zealand, are expected to be more likely to vote for the government than judges in other countries (such as Australia) with the same number of years on the bench, and judges in countries such as Australia are expected to be more likely to vote for the government than judges in countries like Canada who have the same number of years on the bench. Third, the two conjectures above are expected to hold even in the context of different political undercurrents—for example, regardless of whether liberals or conservatives are in power in the federal government when a case is decided. One extrapolation from these conjectures could be stated as follows: judges from the three countries that are at the same point in their respective judicial careers may be expected to be more likely to vote for the government in trading cases than in creation cases, and to be more likely to vote for the government in creation cases than in substitution cases.

**NORMATIVE IMPLICATIONS FOR BUILDING A BETTER GAAR**

The statistical results offer some modest insights that might be of use in advancing Edgar’s conceptual framework for building a better GAAR. Considered together with the doctrinal analysis in the foregoing sections of this paper, these insights have some normative implications.
Transaction Types and Institutional Competencies of the Judiciary

The GAAR provisions in Canada, Australia, and New Zealand do not identify tax avoidance by transactional types. They are drafted as a standard to be used in overriding the application of primary provisions relied on by the taxpayer in obtaining a tax benefit. In applying the standard, the judiciary must (1) characterize the legal relationships created by the parties to the relevant transactions, (2) characterize the purpose of the transaction(s) as primarily tax-driven or not, and (3) finally interpret and apply the relevant statutory provisions that supposedly provide the tax benefit accessed by the tax-driven transaction(s). The history of the GAAR provisions in these three countries suggests that they were enacted primarily to force a reluctant judiciary to engage in “what is a more explicitly policy-based approach to the statutory interpretation exercise in a tax-avoidance context.”

Our empirical results show that judges in Canada and Australia applied GAAR (votes cast for the government) in more cases involving tax-attributes creation and tax-attributes trading than in transactional substitutional cases: Canada—16/22 in creation cases, 15/21 in trading cases, but 17/56 in substitution cases; Australia—23/30 in creation cases, 8/11 in trading cases, but 24/55 in substitution.

130 Edgar, “Building a Better GAAR,” supra note 1, at 878.
cases. The result in New Zealand shows that judges mostly rule for the government in creation cases (11/13) and substitution cases (14/15). There were no NZ trading cases in the dataset.

Although this evidence does not directly speak to the institutional competency of the judiciary in identifying tax avoidance in tax-attributes creation and tax-attributes trading cases, it suggests that a greater proportion of the cases brought forward by the government were validated by the courts. The institutional competency of the judiciary in characterizing the fact pattern presented by a particular transaction and applying the appropriate tax consequences of such characterization does not seem to be affected by gender. In other words, GAAR was more effective in these two types of transactions. One possible explanation for this result is that more “perfect” information is available to judges when they are deciding whether a tax attribute is created or traded, and this is the case because the impugned statutory provisions are more susceptible to general statutory interpretation (that is, the type of statutory interpretation the judiciary is charged to do in other areas of the law). The same is not true of substitution cases, in which the taxpayer takes advantage of gaps or legislative deficiencies. The judges in these cases, in order to apply GAAR, must perform some policy-making functions through the exercise of statutory interpretation.

The statistical result seems to lend support to Edgar’s claim that the legislature and executive branches have more institutional competency than the judiciary when it comes to responding to the transactional substitution type of cases and should provide “a legislative means to identify (relatively easily) the range of problematic tax-avoidance transactions without relying on the courts to perform this necessary function in an interpretative role.”

Role of Statutory Interpretation

GAAR was meant to force the judiciary to interpret tax law provisions in such a manner as to balance (1) taxpayers’ right to choose transactional forms and shape to minimize taxation under the Duke of Westminster principle and (2) the government’s right to protect the public interest by neutralizing the negative externalities of tax avoidance.

The empirical evidence suggests that the judiciary in New Zealand was more willing to apply GAAR than the judiciary in Australia and Canada, which seems to suggest that GAAR can be effective through reliance on the judiciary’s “unshackled” exercise of statutory interpretation. The difference between the Canadian approach, which requires both a taxpayer’s tax-avoidance purpose and Parliament’s purpose, and the Australian approach, which emphasizes the taxpayer’s purpose, may explain why judges in Canada were less likely to apply GAAR. In other words, the statutory requirement that judges characterize both the taxpayer’s purpose and Parliament’s

131 It is a mystery to us, though, why the judges in New Zealand appeared to have behaved differently in applying the GAAR in substitution cases.

purpose makes it more difficult for GAAR to apply in Canada than in Australia. The required twinning of legislative purpose and taxpayer’s purpose in the triggering of the Canadian GAAR may give the Supreme Court of Canada reason to say that the Duke of Westminster principle co-exists with GAAR, in spite of the fact that the traditional judicial doctrines that underlie the principle (that is, characterizing transactions and interpreting statutory provisions without consideration of the business purpose of the taxpayer and the purpose of Parliament) were the very reasons for the enactment of GAAR.

To make the Canadian GAAR more effective, especially in respect of transactional substitution cases, Canada can consider following the NZ model, by dropping the abuse test; or the Australian model, by adopting a statutory economic substance test. The GAAR’s success rate was 25/28 in New Zealand, 55/96 in Australia, and 48/99 in Canada. However, the Australian experience demonstrates the challenges of applying the economic substance test in substitution cases. By requiring the identification of a counterfactual and the eight factors in substitution cases, the Australian GAAR ignores the fact that such transactions may not have counterfactuals because these transactions tend to be innovative, involving hybrid transactions or synthetic replication of higher-taxed transactions. There is some validity in Tim Edgar’s claim that it is “utterly hopeless to leave it to the judiciary to articulate a behavioral prohibition . . . in its identification of prohibited transactions” because “trained as lawyers, and not public policy analysts, judges (and the lawyers appearing before them) simply do not have the institutional competence to execute this important task.”

Incorporating Economic Substance into the Canadian GAAR

Given the history of GAAR and judicial behaviour, it is unlikely that Canada will remove the statutory abuse test and adopt the NZ model. To make the Canadian GAAR more effective in targeting transactional substitution cases, we second Edgar’s idea of incorporating an economic substance test and making it easier for judges to apply GAAR. In essence, the idea was to use the economic substance test in two nuanced ways: (1) as a primary business purpose test for the creation and trading transactions; and (2) as tantamount to a synthetic replication of a higher-taxed transaction in substitution cases. The primary business purpose test would be similar to the eight-factor test in the Australian GAAR. The synthetic replication notion was apparently akin to the Australian counterfactual approach.

The building of statutory economic substance tests into GAAR would be consistent with the notion that tax laws are meant to apply to transactions with economic and commercial substance, and with the judicial consensus that the vacuity and artificiality of transactions attract the application of GAAR. Such a GAAR would be more like a SAAR in specifically prescribing the prohibited transactions and reducing the need for judicial exercise in statutory interpretation.

133 Ibid., at 837.
Statutory interpretation would still play a role in characterizing the type of avoidance transactions and applying the economic substance test. In the context of creation and trading cases, if a transaction’s primary purpose is found to be obtaining a tax benefit, the next step for the courts is to determine whether that benefit is explicitly sanctioned by the specific provisions relied on by the taxpayer in obtaining the tax benefit. Typically, such provisions would be tax expenditure provisions that set out eligible conditions for the tax relief in the form of deductions, exemptions, or deferrals. In substitution cases, the absence of economic substance alone is sufficient to trigger GAAR, and there is no need for the courts to use GAAR to fill the legislative gaps through the exercise of statutory interpretation. However, if a substitution transaction involves the creation or transfer of a tax attribute, statutory interpretation is required to establish whether such creation or transfer of tax attributes is intended to be a means of providing a tax relief.

Applying the statutory economic substance tests to the four Supreme Court GAAR cases would result in no change to the outcomes of Mathew, Lipson, and Copthorne. In Mathew, the tax-attribute trading transaction lacked economic substance, and the benefit of loss deduction by the taxpayer was not explicitly sanctioned by any provisions of the ITA. In Lipson and Copthorne, a higher-taxed alternative (non-deduction of the mortgage interest in Lipson and elimination of the paid-up capital in a subsidiary upon a vertical amalgamation in Copthorne) would be the counterfactual and used to deny the tax benefit arising from the substituted transactions. On the other hand, the outcome of Canada Trustco might have been different if the economic substance tests had been applied. The transactions in Canada Trustco are substitution transactions involving the creation of a tax attribute—that is, deduction of the capital cost allowance (CCA). Because of the specified leasing property rules that treat, in effect, a sale-leaseback transaction as a financing transaction, with the exception of several types of property, such as trailers, the transactions in Canada Trustco substituted a lending transaction for tax purposes with a sale-leaseback transaction, thus qualifying for the CCA. Accordingly, the CCA tax attribute can be considered to be the result of the avoidance transaction. 134

In conclusion, our doctrinal and empirical analysis of the GAAR provisions in action in Canada, Australia, and New Zealand provides some modest support for Tim Edgar’s conceptual framework. If GAAR could be amended to incorporate specific economic substance tests to target different types of avoidance transactions, greater certainty and predictability in the application of the rule would result.

134 Specified leasing rules in section 1100(1.1)-(1.13) of the regulations.