GAAR at 25: A Trip Down Memory Lane and Charting an Uncertain Future

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ABSTRACT

Canada’s general anti-avoidance rule (GAAR) was born of official frustration with the failure of legislative drafting to keep pace with perceived abuses that enabled taxpayers to achieve tax outcomes considered unacceptable or abusive by the tax administration. The countermeasure was GAAR, which allowed the administration to change the tax consequences to those considered “reasonable.” The results of GAAR and of the interpretations, often subjective, of the courts have been to create even greater uncertainty in the application of an already immensely complex statute, and to embolden the tax administration to invoke GAAR whenever it does not like the tax outcome of a particular situation.

KEYWORDS: GAAR ■ ABUSES ■ TAX BENEFITS ■ AVOIDANCE ■ SERIES OF TRANSACTIONS

CONTENTS

Introduction 355
Arms Race 356
Weapons Design 356
New Battlefields 359
Decided Cases or Legal Essays? 361
The World According to GAAR 362

INTRODUCTION

One is seldom invited to write an article for the Canadian Tax Journal with the specific request that it be neither technical nor burdened with many footnotes. On this occasion, there is a dual quarter-century commemoration involved: the opening of an office of the Canadian Tax Foundation in Quebec and the coming into effect of the general anti-avoidance rule (GAAR). Only one of those events caused the Earth to

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1 Section 245 of the Income Tax Act, RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as “the Act”). Unless otherwise stated, statutory references in this article are to the Act.
move for Canada’s tax community. The opportunity to reflect on GAAR, as a practitioner affected by it, is all but irresistible.

ARMS RACE

Twenty-five years ago, an obviously frustrated Canada Revenue Agency (CRA) persuaded the Department of Finance that a tactical nuclear weapon was required to deal with the undeniable fact that taxpayers were proving more adept than the government in the cat-and-mouse game of drafting and manipulating the provisions of an increasingly specific and technical Income Tax Act. The intricate style of the “tax reform” Act, which contributed to the move and countermove contest, had been a deliberate governmental choice, under the direction of Don Thorson, who became deputy minister of justice in 1973. In addition, the CRA was not faring particularly well before the courts; an additional impetus in the direction of a GAAR included the 1984 Supreme Court of Canada decision in *Stubart*.

Much of the statutory complexity of the Act had resulted from reforms recommended by the Carter commission, including the introduction of a tax on capital gains, a general philosophy that the tax burden on investment income should be roughly the same whether it was earned directly by an individual taxpayer or through a corporation, and a number of specific anti-avoidance rules. To its credit, the government of the day did balk at acceptance of the full “a buck is a buck is a buck” package advocated by the Carter commission, which had concluded that there should be no conceptual (or tax rate) difference between a capital gain realized by a risk-taking investor or entrepreneur and Canada savings bond interest.

The government, as the initiator of the statutory concepts and language, appeared to be unable to draft the legislation with the specificity necessary to avoid unintended results, or results that reflected something different from what the government might have thought if it had considered the possible outcomes. There was, at the time, a political reluctance to engage in wholesale retrospective legislation. Such a solution would not only be seen as a public acknowledgment of failure to draft adequate legislation; it would also have broader reputational implications for a country hoping to attract capital and investment.

WEAPONS DESIGN

The technique approved by the Department of Finance and enacted by Parliament was, instead, to provide for a GAAR that would permit the CRA to attack what it considered to be abusive tax avoidance: in such cases, taxpayers would be denied

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2 Referred to at that time as the Canada Customs and Revenue Agency, or Revenue Canada. It would serve little purpose to follow the various nomenclatures that emerged over the years as Canada’s revenue authority changed its name more often than most forgers. Accordingly, in this article, the current name is used throughout.

3 *Stubart Investments Ltd. v. The Queen*, [1984] 1 SCR 536.

a tax benefit otherwise resulting from a transaction or series of transactions, and the taxpayer’s outcome would be replaced with one that was “reasonable.” The latter expression was clearly euphemistic. Such a measure implicitly acknowledged that, whatever the transaction or transactions may have been, the legal results could be supported on a construction of the particular provisions of the Act, whether those provisions were relied upon or avoided. The structure of GAAR was relatively straightforward: there had to be a tax benefit, there had to be an avoidance transaction, and there had to be a misuse of a statutory provision or an abuse of the Act as a whole. Only the minister was able to invoke GAAR; taxpayers could not.

The statutory language used to enact the rule was, predictably, obtuse. Taxpayers, the CRA, and the courts were left to determine how GAAR was to be applied. It is probably fair to suggest that the courts were initially concerned about the degree of administrative power now in the hands of the CRA and that judges with tax experience may have considered the provision to be on the draconian side of reasonable. Judges—especially those who were imbued with the interpretive approach exemplified by the Duke of Westminster decision5—were not likely to simply accept the proposition that taxpayers could not take advantage of opportunities provided within the scope of the statutory language of the Act. The classic approach at the time was that before a taxpayer’s property could be taken from him by way of tax, the confiscation had to be supported by clear and unambiguous statutory language. The corollary was that a taxpayer was entitled to arrange his affairs in a manner that would minimize the taxes he paid. Taxing statutes were seemingly subjected to more intensive interpretation in support of those principles, and the minister had mixed success in cases brought before the courts.

This approach began to be watered down by the time of Stubart and was all but buried as a result of Notre-Dame de Bon-Secours,6 despite occasional pockets of judicial resistance in cases like Shell,7 Ludco,8 and Singleton.9 Taxing statutes are now considered to be like any other statutes, with no special attributes that would lead to the application of a different standard of analysis. The expanded Driedger approach10 (the “modern” approach) has been generally approved and is constantly being massaged. The following excerpts from three judgments of the Supreme Court of Canada in GAAR appeals to date show some of the evolution.

Canada Trustco

The Income Tax Act remains an instrument dominated by explicit provisions dictating specific consequences, inviting a largely textual interpretation. Onto this compendium

5 Commissioners of Inland Revenue v. Westminster (Duke), [1936] AC 1 (HL).
7 Shell Canada Ltd. v. Canada, [1999] 3 SCR 622.
of detailed stipulations, Parliament has engrafted quite a different sort of provision, the GAA. This is a broadly drafted provision, 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. To the extent that the GAAR constitutes a “provision to the contrary” as discussed in Shell (at para. 45), the Duke of Westminster principle and the emphasis on textual interpretation may be attenuated. Ultimately, as affirmed in Shell, “[t]he courts’ role is to interpret and apply the Act as it was adopted by Parliament” (para. 45). The court must to the extent possible contemporaneously give effect to both the GAAR and the other provisions of the Income Tax Act relevant to a particular transaction.\footnote{2005 SCC 54, at paragraph 13.}

The first part of the inquiry under s. 245(4) requires the court to look beyond the mere text of the provisions and undertake a contextual and purposive approach to interpretation in order to find meaning that harmonizes the wording, object, spirit and purpose of the provisions of the Income Tax Act. There is nothing novel in this. Even where the meaning of particular provisions may not appear to be ambiguous at first glance, statutory context and purpose may reveal or resolve latent ambiguities. “After all, language can never be interpreted independently of its context, and legislative purpose is part of the context. It would seem to follow that consideration of legislative purpose may not only resolve patent ambiguity, but may, on occasion, reveal ambiguity in apparently plain language.” See P.W. Hogg and J.E. Magee, Principles of Canadian Income Tax Law (4th ed. 2002), at p. 563. In order to reveal and resolve any latent ambiguities in the meaning of provisions of the Income Tax Act, the courts must undertake a unified textual, contextual and purposive approach to statutory interpretation.\footnote{2009 SCC 1, at paragraph 26.}

**Lipson**

In determining the purpose of the relevant provision(s) of the Act, a court must take a unified textual, contextual and purposive approach to statutory interpretation (Canada Trustco, at para. 47). This approach is, of course, not unique to the GAAR. As this Court confirmed in Kaulius, the approach to statutory interpretation is the same for provisions of the ITA as for those of any other statute: it is necessary “to determine the intention of the legislator by considering the text, context and purpose of the provisions at issue” (Kaulius, at para. 42; see also Placer Dome Canada Ltd. v. Ontario (Minister of Finance), 2006 SCC 20, [2006] 1 S.C.R. 715, at paras. 21-23).\footnote{2005 SCC 54, at paragraph 13.}

**Copithorne**

The object, spirit or purpose can be identified by applying the same interpretive approach employed by this Court in all questions of statutory interpretation—a “unified textual, contextual and purposive approach” (Trustco, at para. 47; Lipson v. Canada, 2009 SCC 1, [2009] 1 S.C.R. 3, at para. 26). While the approach is the same as in all statutory interpretation, the analysis seeks to determine a different aspect of the statute

\footnote{2005 SCC 54, at paragraph 13.}{
\footnote{2009 SCC 1, at paragraph 26.}
than in other cases. In a traditional statutory interpretation approach the court applies the textual, contextual and purposive analysis to determine what the words of the statute mean. In a GAAR analysis the textual, contextual and purposive analysis is employed to determine the object, spirit or purpose of a provision. Here the meaning of the words of the statute may be clear enough. The search is for the rationale that underlies the words that may not be captured by the bare meaning of the words themselves. However, 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.  

From resolution of latent ambiguities, to discerning the intention of the legislator, to a search for the rationale underlying the meaning of clear words is an interesting progression. Despite the concluding sentence in the Copthorne extract, possibly the biggest risk in relation to GAAR litigation is that, since legislative guidelines do not exist, personal opinions regarding what constitutes misuse or abuse will add to the general uncertainty arising from the provision. This subjective factor (personal opinion) is compounded by the fact that the Act is “a compendium of highly detailed and often complex provisions,” which, on traditional interpretive principles, function as a coherent whole. However, the reality is closer to a chaotic system in which highly detailed amendments do not always mesh well with other provisions. The basic premise of statutory interpretation (that the statute constitutes a coherent whole) is most often false. In the context of GAAR, this leaves considerable and potentially troubling latitude to decide on the basis of personal opinion.

NEW BATTLEFIELDS

Be all this as it may, GAAR provided the CRA with a powerful weapon that changed the normal rules of play within the tax system and created a great deal of uncertainty within the tax community. For tax practitioners, one of the key questions posed by clients was whether or not a particular transaction or series was “GAARable,” a particularly difficult opinion to provide. It frequently led, as practitioners will recall, to lengthy and largely inconclusive language in tax opinions, since it was uncertain what might be the flavour-of-the-day hot button issues within the CRA. In addition, it is almost impossible to know what CRA auditors might be submitting to the internal GAAR Committee in support of any opinion sought to be used as the basis for an assessment invoking GAAR. Little, if any, meaningful discussion can be held with anyone in authority before an assessing decision is reached.

If, however, it was fair to say that there was initial reluctance to give the CRA free rein in the application of GAAR, it is equally fair to say that much of that reluctance has been overcome. GAAR, even as a tool of last resort, has become much stronger

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14 Copthorne Holdings Ltd. v. Canada, 2011 SCC 63, at paragraph 70.
15 Canada Trustco, supra note 11, at paragraph 41.
than was expected even a few years ago. The tax administration has moved farther
to the right, often wrapped in the dogma that everyone should assume a fair share
of the overall tax burden and that any reduction of that burden on the part of one
taxpayer has to be made up by other taxpayers.

The issue of what constitutes a “tax benefit” has not received much judicial atten-
tion, especially since most taxpayers in GAAR appeals have been willing to concede
that a tax benefit has been realized. “Tax benefit” is, however, a defined term in a very
aggressive taxing provision,16 and the definition deserves careful consideration. A tax
benefit for the purposes of GAAR does not mean (or should not mean) simply that
the taxpayer may be better off than he would otherwise have been but for the trans-
actions under review. The notion of tax deferral has troubling aspects. Assume that
a taxpayer has a property that he has decided to sell. He learns that tax rates are to
decline in future years, so he decides to wait until the new rates are in effect. Has he
realized a GAARable tax benefit?

In many respects, the same is true of “avoidance transaction,” also an element
more often than not conceded by taxpayers in GAAR litigation. The courts, espe-
cially the Supreme Court of Canada, have struggled particularly with the notion of
a “series” of transactions. The common-law notion of series has been expanded by
the addition of subsection 248(10) of the Act, adding little clarity and more com-
plexity to the expression. The most recent interpretations by the Supreme Court of
Canada have brought the meaning of “series” perilously close to “sequence.” The
fallout from this jurisprudence in relation to other provisions of the Act remains to
be seen, but it now seems clear that any transaction that has the effect of preserving
a tax attribute commences a series of transactions, the implications of which may
not be known for years. The difficulties for tax practitioners in giving opinions on
whether a series of transactions has commenced and what the impact may be have
suddenly multiplied beyond imagination.

There is also a domino effect in relation to the concept of avoidance transaction.
Despite what the court implied in Copthorne about the protection afforded by the
avoidance transaction test,17 this test is nothing more than a formality. Because only
one transaction in a series is sufficient to taint the series, the test is meaningless, and
all the analysis about the application of GAAR must be done at the abusive tax avoid-
ance stage (which is the most subjective). The Canada Trustco decision was very clear
that “[i]f at least one transaction in a series of transactions is an ‘avoidance trans-
action,’ then the tax benefit that results from the series may be denied under the
GAAR.”18

16 The definition is contained in subsection 245(1).
17 Copthorne, supra note 14, at paragraph 119.
18 Canada Trustco, supra note 11, at paragraph 34.
DECIDED CASES OR LEGAL ESSAYS?

Despite the admonitions of the Supreme Court of Canada in *Canada Trustco*19 and *Copthorne*,20 one of the key considerations for the tax practitioner has become whether the courts will decide GAAR cases as pieces of litigation or treat the cases before them as platforms for reflections on tax policy.

It is easy to see how the CRA might seek to expand the application of GAAR, especially where there are perceived gaps in the legislative scheme. This could also occur where benefits are realized within the statutory scheme that the CRA perceives as unintended or inappropriate. On the other hand, certain of these outcomes may be the result of, in effect, a legislative invitation to certain courses of conduct or the regulation of certain courses of conduct. Thus far, the courts have tended to resist the expansion of GAAR in such circumstances, either rejecting the application of GAAR altogether or declaring it unnecessary to the disposition of an appeal.

More interesting, however, is the question of whether GAAR cases are dealt with differently from other tax appeals. Traditionally, the duty of a court is to render a decision on the merits of the case before it, on the basis of the case as pleaded, and on the presented evidence. If the parties have agreed on the facts, a court does not intervene to change those facts. The parties submit their arguments on the applicable points of law, and the court renders a reasoned judgment on the matter. In the accepted way of things, the judgment is often written with the intention that the losing party will understand why he or she has lost. The winner, of course, does not care why he or she has won.

It is clear that the Supreme Court of Canada regards itself as a court of judicial policy and that it uses its judgments as a platform to provide guidance for lower courts on the proper approach to dealing with certain legal issues. However, the court must balance this role with its duty as a court to decide the cases that are brought before it, whether by right or by leave, on the basis of the record before it.

It seems to be in the nature of things that the Supreme Court of Canada sometimes tries to do too much with the cases that arrive before it, especially when nine very intelligent judges have their own ideas of what is important and what messages need to be sent. It requires a great deal of coordination and goodwill to keep a judgment from looking like the proverbial camel, resulting from a group effort to design a horse.

GAAR appeals have some of the elements common to Charter21 appeals, where the courts were faced with new and difficult concepts, with very little legislated guidance, and were left on their own to design the juridical flesh for the statutory skeleton provided to them. Despite occasional complaints about the results, it is clear that legislators had no appetite for the details of the general policy enactments

19 Ibid., at paragraph 41.
20 *Copthorne*, supra note 14, at paragraph 70.
and were more than content to leave that work to the courts. Charter appeals reached the Supreme Court of Canada sooner than GAAR appeals, no doubt because of the societal importance of Charter issues in relation to the less exciting consideration of whether a particular taxpayer may have been overassessed for income tax. The first Charter appeal, *Skapinker*,22 was decided by the Supreme Court of Canada in May 1984, about two years after the Charter became law. The first GAAR appeals, *Canada Trustco* and *Kaulius*,23 were not decided by the court until October 2005, some 18 years after GAAR was adopted.

*Canada Trustco* and *Kaulius* were decisions of the full court. They contained a number of general statements of principle, including the approach to be taken when applying GAAR to a particular appeal, as well as the need for certainty in commercial transactions. *Lipson* was only a seven-judge bench, but it resulted in three different sets of reasons; it did very little to settle anything, other than to underline the fact that GAAR is not easily interpreted, even by the most senior judges in the country. The need for certainty was all but brushed aside. By the time *Copthorne* was heard, the court recognized that, whatever was decided, it had to be by the court as a whole. GAAR is too important, with too many implications, for the court to be split on what the statutory language means. I submit (admitting to a slight bias, as losing counsel in that appeal) that the court got it spectacularly wrong, on the two principal issues of abuse and series of transactions. There was also a viable argument as to whether there was even a tax benefit (as defined) in the first place.

We now enter a new period in which the lower courts will have to chew on the general statements made by the Supreme Court and the CRA will be emboldened to apply GAAR to a broadened spectrum of circumstances. Whether the eventual outcome will be a retrenchment in the direction of the principles adopted in *Canada Trustco* or expansion on the basis of *Copthorne* remains anyone’s guess.

It is probably Pollyanna-ish to hope that statutory amendments should be preferred over GAAR assessments when the CRA disagrees with the tax results of a transaction. The CRA does not have the legislative initiative, but Finance is often quite receptive to its ideas. GAAR would remain a last-resort provision for blatant schemes. It would not be a weapon used against taxpayers every time there is a disagreement. Some taxpayers might conceivably get away with tax benefits until the legislation is changed (which could be retrospective, if past conduct is a predictor of future conduct), but at least the application of the Act would be fair and predictable.

**THE WORLD ACCORDING TO GAAR**

If the past is a predictor for the future, uncertainties arising from GAAR will continue to plague the Canadian tax system. In the judicial context, the more specialized lower courts—which are exposed to a broad range of business and commercial transactions, closer to the decision-making processes on a day-to-day basis, and

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better able to determine the intentions of taxpayers—will have to initiate the changes required to make sense of some of the dicta of the Supreme Court of Canada, or to move those dicta in a different direction. We have recently seen such an outcome, in relation to the analysis applicable to farming losses, in Craig.24 There, the lower courts eventually refused to follow the Supreme Court of Canada’s Moldowan decision.25 Although the Supreme Court rebuked the lower courts for effectively overruling Moldowan, it nevertheless agreed that they had been correct as a matter of law, and dismissed the minister’s appeal.

As taxpayers adjust to the uncertain future of GAAR and the breadth of its application, some observations may be of interest:

- Think of the Duke of Westminster as dead or, at best, on life-support.
- GAAR is likely to be supported by significant disclosure requirements à la Québec and other jurisdictions, since the authorities are not capable of conducting the necessary audits of complicated business transactions. A regime of this nature is already proposed under section 237.3 of the Act, although the concept of “reportable transaction” is somewhat limited.
- The burden of having to show that a particular outcome makes sense as a matter of tax policy will, first, have to be read into the overall GAAR equation and, second, be discharged by the taxpayer.
- There will be growing pressure from tax professionals to request access to the submissions made from CRA auditors to the GAAR Committee, in order to provide necessary clarifications before assessments based on GAAR are issued.
- The burden of persuasion to demonstrate misuse or abuse, supposedly resting on the minister, is illusory.
- Anti-avoidance provisions are the minister’s toys, not taxpayers’ toys; they are not available to be used by taxpayers for their own tax planning (Lipson).
- Deliberately remaining below certain legislated thresholds may lead to the application of GAAR (Desmarais).26
- GAAR will increasingly be used to fill legislative gaps on the basis that this function is perceived to be implicit in its provisions.
- Despite the concern for certainty in financial transactions expressed by the Supreme Court of Canada in Canada Trustco, that concern is very much subordinate to all other factors in the court’s examination of particular cases.
- Examining the intention surrounding transactions will become increasingly important, and taxpayers will likely have to accept that, although unstated, there is a de facto business purpose test that must be met in order to prevent the application of GAAR.

26 Desmarais v. The Queen, 2006 TCC 44.
- Intervening events (such as unanticipated legislation) may get drawn into the analysis of whether a series of transactions has occurred, but may then be completely ignored because retrospective connections can be established.
- The initial three-stage level of analysis of GAAR is effectively now compressed into one, focused on the question of abuse.
- No strong nexus is required for the purposes of finding that transactions constitute a series.
- “In contemplation” in subsection 248(10) is not a forward-looking test, in the sense of a gift made “in contemplation of” death.
- No matter how firm the courts may be in their assertions that GAAR is not a judicial smell test, because of the lack of interpretive guidelines and the complexity of the Act, tax practitioners will not go far wrong if they completely ignore those assertions.
- Expect that the CRA will be encouraged by recent decisions to use GAAR more frequently, always remembering that abuse is in the eye of the beholder.
- Deterioration in the working relationships between taxpayers and the CRA, as well as the Department of Justice, will likely continue.
- Finally, live with it: no one, including the courts, really knows what GAAR means.