GAAR: Observations on the Concept of Abuse

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Abstract

Canada’s general anti-avoidance rule (GAAR) establishes a norm. The concept of abuse evolved to be central to that norm. But does this concept make GAAR a precise and inflexible norm, or an unpredictable and adaptable one? When GAAR was adopted in 1988, we knew very little about how the concept of abuse would be applied. The Department of Finance technical notes indicated that the concept related to respect for the object and spirit of the provisions of the Income Tax Act, but were otherwise quite vague as to its application. Twenty-five years and four Supreme Court judgments later, it cannot be said that the criteria to determine the existence of abuse in a particular case are any more precise. It is true that the first two judgments offered a structured analytical framework; however, the third decision reveals a profound division within the court, and the fourth—although it purports to rely on the first two—results in more questions than answers. Thus, it appears that the concept of abuse hinges mainly on a judge’s personal appreciation of the fiscal morality of a transaction. This approach provides greater flexibility in the application of GAAR and potentially increases the number of situations where the provision may be invoked; however, it creates a climate of significant uncertainty.

Keywords: GAAR ■ GENERAL ANTI-AVOIDANCE RULE ■ ABUSES ■ STATUTORY INTERPRETATION

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INTRODUCTION

It was 25 years ago, in June 1987, that the government announced a proposed amendment to the Income Tax Act\(^1\) introducing a general anti-avoidance rule (GAAR).\(^2\) The new provision, section 245, came into effect on September 13, 1988.

GAAR brought about a new dynamic in the application and interpretation of the Act: it is a provision that may be used to thwart the application of all other provisions. The effect is not negligible. GAAR is a legal provision that establishes a norm or standard, and sets out the criteria under which a tax benefit may be kept or denied.

A norm can be very precise, in which case it will offer certainty and predictability, but little flexibility. A norm can also be more general, in which case it will be more flexible and adaptable, but of uncertain application. A norm created by a legal provision may initially be very broad in scope but eventually become subject to court decisions giving it a narrower application; however, this is not always the case.

With respect to the application of GAAR, the courts have made it clear that the concept of abuse in subsection 245(4) is central to the GAAR analysis. While some decisions have necessarily considered the definition of an avoidance transaction, in the vast majority of cases it is the question of abuse that determines the result of the dispute. In short, in the GAAR context, the norm is abuse. The concept of abuse—in particular, its interpretation, its evolution, and its iterations as a more general or a more precise rule—is the subject of this article.

I will start by taking a look back to appreciate the context that gave rise to the adoption of GAAR and make an attempt to understand its genesis. What was the meaning originally intended for the concept of abuse? I will then fast-forward to the present: 25 years and four Supreme Court decisions later, do we have a high definition image of abuse, or are the contours of the concept still blurred? This is a question of concern across the tax community. GAAR is omnipresent: it affects not only taxpayers but also tax advisers, in the way they offer their services, and tax authorities, in the way they administer the Act. Since GAAR is here to stay, it must have some versatility in order to do its role justice; on the other hand, too much vagueness would create a climate of inappropriate uncertainty.

THE ADOPTION OF GAAR

In 1984, the Supreme Court of Canada’s decision in \(^3\) put to rest the hopes of the tax authorities for judicial recognition of a business purpose test. Today, the business purpose rule is incorporated in the statutory scheme of GAAR, specifically in the definition of “avoidance transaction” in subsection 245(3). At the time of

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1 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.

2 Canada, Department of Finance, \(\text{Tax Reform 1987: Income Tax Reform}\) (Ottawa: Department of Finance, June 18, 1987), at 130.

3 \(\text{Stubart Investments Ltd. v. The Queen, [1984]}\) 1 SCR 536.
*Stubart,* there was neither a statutory general anti-avoidance provision nor a rule of interpretation that enjoyed general application. In fact, the old section 245 (which was repealed with the adoption of GAAR) had very limited application, covering, notably, the deduction of certain expenses that artificially reduced income. Furthermore, the rules of judicial construction as expressed, for example, in the sham or ineffective transaction doctrine had limited reach.

In this context, taxpayers were free to execute tax plans the validity of which depended only upon their compliance with technical provisions of the Act. That is not to say that the Act was interpreted only in a literal sense. In fact, in *Stubart,* the Supreme Court officially rejected a textual interpretive approach in favour of the modern approach proposed by Driedger—that the words of a statute should be read in their entire context. However, an interpretive approach has its limits; in particular, it does not permit one to ignore or change the very text of the law if the words used are unambiguous when read on their own or in a given context.

Authors have suggested that in response to the criticism levelled against the tax authorities following the *Stubart* decision, the Canada Revenue Agency (CRA) adopted a permissive interpretation of the Act:

> There followed a significant change in Revenue Canada’s attitude concerning the interpretation and application of the tax law. Revenue Canada began to seek refuge from taxpayers’ complaints by adopting a strict, literal interpretation of the Income Tax Act. Tax officials ceased to refuse to give rulings on transactions that lacked a business purpose or that were designed for improper tax avoidance; in fact, they considered whether or not they had legal authority to refuse to give rulings at all.

It was a time when the minister of finance had to regularly intervene to modify the Act and implement anti-avoidance measures aimed at countering specific tax plans. A notable example is the rule on acquisition of control, which aims to limit the trading of tax losses; as the Act now reads, this set of provisions applies to acquisitions of control after January 15, 1987. Other examples include the rules governing the at-risk amount, applicable after February 26, 1986. Certain tax plans had become so widespread that they had a negative impact on the government’s tax revenues. These piecemeal adjustments allowed the prospective closing of the larger loopholes, but their reach remained limited.

The party ended in June 1987, when Finance Minister Michael Wilson published the white paper on tax reform, which included the proposal to introduce a GAAR. The white paper let it be known that the first objective of the new rule

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5 In this article, predecessors of the CRA are referred to by this name.


7 *Tax Reform 1987,* supra note 2, at 130 and 137-44.
would be to counteract large-scale tax plans of the type mentioned above. The document recognized that a GAAR must strike a balance between the taxpayer’s need for predictability and the responsibility of the government to protect its tax base and equitably administer the tax system. Nevertheless, the document added that the introduction of such a measure would inevitably bring about a level of uncertainty that must be resolved by the courts.

As initially proposed, GAAR was essentially a statutory iteration of the business purpose test; a transaction could be ignored if it was not primarily carried out for a business purpose. The doctrine of step transaction was also taken into account. In addition, the proposal included an interpretive rule providing that GAAR aimed to counteract abusive tax avoidance.

The June 1987 version of GAAR was fiercely criticized, not only by practitioners but equally by the permanent committees of the House of Commons and the Senate that had the task of analyzing the proposed legislation. In December 1987, the government published additional information on tax reform that contained a new version of GAAR. This version substantially corresponds to the text that was ultimately adopted. The business purpose test was replaced by a bona fide purpose test. Most importantly, the new version contained the exception that we find today in subsection 245(4), underlining the exclusion of transactions that do not result in a misuse of the provisions of the Act or an abuse in the application of the provisions of the Act read as a whole.

The December 1987 document took note of concerns about the uncertainty that would arise from a business purpose test and the courts’ findings in favour of an approach founded on the object and spirit of the law. With regard to the exception relating to abuse, the document pointed out that GAAR is not aimed at bona fide transactions that have economic substance and are coherent with the object and spirit of the law.

The technical notes accompanying the bill that enacted GAAR pointed out that transactions that respect the object and spirit of the provisions of the Act, when read in context, are not attacked by GAAR. The technical notes gave the example of a transaction carried out by means of a tax-free rollover under a specific provision of the Act, in conformity not only with a textual interpretation of the Act but also with the purpose of the Act considered as a whole. The technical notes also pointed out that when a transaction takes place as part of a series of transactions with the aim of producing a tax benefit and abusing the rollover provision, GAAR may apply. The accompanying example described a situation where a taxpayer tried to convert income to a capital gain by first transferring the asset to a corporation through a tax-free

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8 Canada, Department of Finance, *Supplementary Information Relating to Tax Reform Measures* (Ottawa: Department of Finance, December 16, 1987), at 146-51.

rollover in exchange for shares of that corporation, in a situation where section 54.2 did not apply, and then selling those shares.

More specifically, with regard to subsection 245(4), the technical notes provided the following guidelines:

Subsection 245(4) recognizes that the provisions of the Act are intended to apply to transactions with real economic substance, not to transactions intended to exploit, misuse or frustrate the Act to avoid tax. . . . [A] number of provisions of the Act either contemplate or encourage transactions that may seem to be primarily tax-motivated. The so-called “butterfly” reorganization is a good example of such transactions. . . .

Subsection 245(4) draws on the doctrine of “abuse of rights” which applies in some jurisdictions to defeat schemes intended to abuse the tax legislation. . . .

[T]he application of [GAAR] must be determined by reference to the facts in a particular case in the context of the scheme of the Act. For example, the . . . attribution rules are not intended to apply to gifts to adult children. . . . Thus a straightforward gift from a parent to his adult child will not be within the scope of section 245 either because it is made primarily for non-tax purposes or because it may reasonably be regarded as not being an abuse of the provisions of the Act. If, however, the gift is made so that the adult child acquires an investment and, through a series of transactions, disposes of it and subsequently transfers the proceeds . . . to the parent, proposed section 245 should apply where the purpose of the transaction is the reduction, avoidance or deferral of tax. . . .

“[E]state freezing” transactions . . . do not ordinarily result in a misuse or abuse given the scheme of the Act and the recent enactment of subsection 74.4(4) . . . to accommodate estate freezes. . . .

[In the case of a] transfer of income or deductions within a related group of corporations . . . the corporate loss limitation rules . . . clearly permit such transactions between related corporations where these transactions are otherwise legally effective and comply with the letter and spirit of these exceptions. . . .

[GAAR may nevertheless apply to some] inter-company transactions within a related corporate group[;] for example:

—where the transaction results in the deduction of the same amount twice,
—where the transactions are entered into to make two or more corporations related only for the purpose of avoiding a loss limitation, or
—where the transaction otherwise attempts to abuse the loss limitation rules.10

The day after the entry into force of GAAR, what did we know about what was required to trigger the application of a disposition that had precedence over all other legal provisions and that required the determination of tax attributes “as is reasonable in the circumstances in order to deny a tax benefit”?11

First, GAAR incorporates the concept of abuse into the Act. In the context of Canadian tax law, it is a completely novel concept, the meaning of which may be very

10 Ibid.
11 Subsection 245(2).
elastic. To define abuse, we need a reference, a standard. If the term is used as meaning excess, we must establish the limits that are not to be exceeded. If the idea of wrongful use is the intention, we must first determine what is meant by proper use.

Second, the technical notes led to the conclusion that the proper approach is to determine the object and spirit of the legal provisions, independently and with regard to the Act as a whole. The notes were silent on the methodology for determining object and spirit. However, they appeared to suggest that the object and spirit must be found in the Act, even though we can have recourse to other documents to interpret specific provisions. In other words, object and spirit must be gathered from the text itself and not from an external source.

Third, the technical notes did not set any parameters with respect to the degree of certainty required for identifying object and spirit. There are, in fact, situations in which it is not easy to ascertain the object and spirit of a technical provision. This also raises the question of who is charged with the burden of proof when a court is considering the question of abuse: the answer to this question was completely unknown at the time. What happened if object and spirit could not be identified with sufficient precision? What was sufficient precision? Must the object and spirit be established one way or the other, even if one had to guess at what Parliament may have intended?

Fourth, in the white paper, the minister of finance admitted outright that GAAR would add an element of uncertainty to the Act. However, he suggested that this consequence was justified, given the perceived necessity to include in the Act an anti-avoidance rule with general application. He pointed out that such uncertainty would be mitigated by accompanying technical notes and by information circulars to be published by the CRA. The technical notes have definitely proved to be useful, at least for demonstrating the link between abuse and the determination of object and spirit. However, the examples given were self-evident, and did not in any way foresee the complexity of situations where the application of GAAR would have to be considered. For example, while it was comforting to know that GAAR would not apply to a butterfly transaction or to income splitting with adult offspring, the technical notes gave no indication of the standard to be used for the analysis. As to information circulars provided by the CRA, they could be helpful in setting out the tax authorities’ position regarding certain situations; but unless the intention was to give the CRA the power to make law by way of such published statements—which was obviously not the case—they did no more than that. In fact, as the future was to show, the CRA’s position on a given issue has often been at odds with that of the courts.

Fifth, the technical notes stated at the outset that GAAR aims to prevent abusive tax plans. The implication is that if GAAR was intended to act as a deterrent, a degree of uncertainty may not be a bad thing.

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12 Tax Reform 1987, supra note 2, at 130.
To summarize, immediately after the adoption of GAAR, we may have had a general idea of what it intended to bring about—namely, respect for the object and spirit of the law—but we knew very little about the measure and scale of this legal rule. It was therefore the courts that were tasked with considering its application and perhaps defining its operation.

TWENTY-FIVE YEARS LATER

Twenty-five years and four Supreme Court judgments later, do we have a better understanding of the criteria for the application of GAAR? Notably, one of the four decisions—that in the Lipson case—revealed profound divisions between the justices of the Supreme Court, such that it hardly contributed to defining how GAAR functions. I will come back to that case later.

The first two decisions, Canada Trustco and Mathew, decided together in 2005, provided an analytical framework for applying GAAR that was repeated in Lipson in 2008 and in Copthorne in 2011.

Specifically on the topic of abuse, the approach set out in Canada Trustco describes the procedure to be followed in carrying out the GAAR analysis. It is a two-step process: (1) the object and spirit of the provisions in question must be determined in accordance with the unified textual, contextual, and purposive approach to statutory interpretation; and (2) that object and spirit are then applied to the facts of the case at issue. The court pointed out that abusive tax avoidance may be found where the relationships and transactions as expressed in the relevant documentation lack a proper basis relative to the object, spirit or purpose of the provisions that are purported to confer the tax benefit, or where they are wholly dissimilar to the relationships or transactions that are contemplated by the provisions.

This statement, which is elaborated in paragraphs 44 to 62 of the decision, repeats the general idea behind GAAR mentioned in the technical notes, and as an explanation of the circumstances in which GAAR may apply, it remains quite vague. As Arnold has observed with respect to this passage, “[t]he court’s test fails to provide any clear guidance to taxpayers, tax officials, and the courts.” But what else does the decision tell us about the calibration of GAAR’s application? To what extent should the object and spirit of the relevant provisions be demonstrated? To what

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14 Canada Trustco Mortgage Co. v. Canada, 2005 SCC 54.
16 Copthorne Holdings Ltd. v. Canada, 2011 SCC 63.
17 Canada Trustco, supra note 14, at paragraph 60.
extent should the transactions be void of a proper basis? The court twice pointed out that GAAR should be applied only where the transaction in question is clearly abusive.\(^{19}\) In the summary provided at paragraph 66, the court underlined that “[i]f the existence of abusive tax avoidance is unclear, the benefit of the doubt goes to the taxpayer.” This suggests that there is a high standard to be met. It is important to note that the decision also charged the Crown with the burden of proof when it comes to abuse.\(^{20}\)

The court specifically cautioned the judiciary against engaging in a “search for an overriding policy of the Act that is not based on a unified, textual, contextual and purposive interpretation.”\(^{21}\) It is not the role of judges to take part in “the formulation of taxation policy” and then use that policy as the basis for applying GAAR.\(^{22}\) Rather, the analysis must be carried out with an understanding of the object and spirit of the provisions themselves, with the help of other admissible documents.

In *Canada Trustco*, the taxpayer had claimed capital cost allowance (CCA) in respect of property acquired in the context of a series of transactions where the financial positions of the parties were closed, such that the taxpayer bore no financial risk. It was clear that the property in question qualified for the CCA deduction with reference to the language of the applicable provisions. The issue was whether the taxpayer qualified for a legally defined cost without having incurred an economic cost, since it did not take on any financial risk. After analyzing the provisions using the unified approach, the court concluded that the object and spirit of these provisions referred to a legal concept of cost. Since the court refused to incorporate a substance-over-form doctrine into GAAR, a clearly abusive character was not established.

In *Mathew*, the taxpayer had claimed partnership losses in the context of a series of transactions. At the time, subsection 18(13) disallowed the recognition of a loss in the context of a disposition between non-arm’s-length parties. The taxpayer was dealing at arm’s length with the person who made the initial disposition. The court found that the object and spirit of the provision was to prevent the crystallization of a loss by a disposition to a non-arm’s-length person, making it similar to a superficial loss. Thus, the court held:

> Interpreted textually, contextually and purposively, s. 18(13) and s. 96 do not permit arm’s length parties to purchase the tax losses preserved by s. 18(13) and claim them as their own. The purpose of s. 18(13) is to transfer a loss to a non-arm’s length party in

\(^{19}\) *Canada Trustco*, supra note 14, at paragraphs 50 and 62.

\(^{20}\) Ibid., at paragraphs 63-65.

\(^{21}\) Ibid., at paragraph 41.

\(^{22}\) Ibid. Arnold, supra note 18, at 189, sees this statement as a rejection of the approach proposed by Rothstein J in *OSFC Holdings Ltd. v. Canada*, 2001 FCA 260, at paragraphs 67-69, which would require a court, in considering the application of GAAR, to first identify the “clear and unambiguous” underlying policy of the relevant provisions or of the Act as a whole. *OSFC* involved the same series of transactions that was at issue in *Mathew* (see Arnold, supra note 18, at 171-72).
order to prevent a taxpayer who carries on a business of lending money from realizing a superficial loss.23

This conclusion appears to be in conformity with the approach proposed by the court. The object and spirit of subsection 18(13) are relatively clear.

Up to this point, even if the court’s decisions are not beyond criticism,24 we can generally reconcile the approach proposed by the courts and the decisions.

Lipson is similar to Singleton,25 but with the twist that it involved an attribution rule. In Lipson, the spouses structured a loan so that the interest would be deductible. The cost of interest was deducted by the spouse with the higher income, as a result of the attribution provisions. Three sets of reasons were provided in the court’s decision, one written by LeBel J for the majority and two minority judgments, by Binnie and Rothstein JJ.

The majority decision took up the analysis proposed in Canada Trustco and added very little new commentary, except to point out that an abuse must be identified for each tax benefit and that to this end, it is appropriate to take into account the overall effect of a series of transactions. The majority was of the opinion that

- the attribution rules are meant to prevent spouses from reducing their tax burden by taking advantage of their relationship at the time of transfer;
- these rules constitute an anti-avoidance provision;
- allowing the taxpayer to take advantage of these rules to obtain a tax benefit would be contrary to their object; and
- GAAR should apply.

Binnie J, however, held in dissent that

- the attribution rules expressly foresee the possibility that losses be attributed;
- given the facts of the case, the application of these rules was in conformity with their object and spirit; and
- the Crown did not demonstrate the clearly abusive character of the transaction.

The decision in Lipson brought considerable uncertainty to the application of GAAR. Was the finding with respect to the object and spirit of the attribution rule put forward by the minority not arguably as credible as the conclusion of the majority? Were the reasons set out in the dissenting judgment not sufficient to conclude that the object and spirit were not clear, and there was therefore no clear abuse? We have the impression that the majority’s judgment was largely influenced by a subjective

23 Mathew, supra note 15, at paragraph 58.
24 Arnold, supra note 18, criticizes in particular the Canada Trustco decision for giving little weight to the economic substance criterion, despite the comments on this aspect in the technical notes.
appreciation of the result of the series of transactions. Lipson annihilated the few indicia provided by Canada Trustco regarding the threshold that triggers GAAR.

In Copthorne, an investment gave rise to the recognition of paid-up capital (PUC) at two levels: the parent corporation benefited from the original investment, and the subsidiary benefited from the parent’s investment of proceeds from the original investment. A vertical amalgamation would have eliminated the PUC of the subsidiary. Therefore, the taxpayer made sure that the two corporations became sister corporations before the merger. The PUC of the amalgamated corporation was thus equal to the sum of the PUC of the two amalgamated corporations. Later on, a redemption of shares gave rise to a deemed dividend reduced by the preserved PUC.

Rothstein J, who wrote the court’s unanimous judgment, began the abuse analysis with the following comment:

The most difficult issue in this case is whether the avoidance transaction was an abuse or misuse of the Act. The terms “abuse” or “misuse” might be viewed as implying moral opprobrium regarding the actions of a taxpayer to minimize tax liability utilizing the provisions of the Income Tax Act in a creative way. That would be inappropriate. Taxpayers are entitled to select courses of action or enter into transactions that will minimize their tax liability (see Duke of Westminster). He reiterated the principles enunciated in Canada Trustco stating that “the GAAR can only be applied to deny a tax benefit when the abusive nature of the transaction is clear,” and that the object and spirit of the provision must be determined having an eye to the scheme of the Act, to relevant provisions, and to other admissible means. He added:

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.

Rothstein J then went on to analyze the relevant provisions, particularly the exception set out in parentheses in paragraph 87(3)(a), which provides that the PUC of the shares of a merging entity that are held by another merging entity is cancelled. To this end, he gave great importance to the legislative context: the definition of “paid-up capital” refers to certain sections of the Act besides subsection 87(3), such as sections 84.1 and 212.1, which are specific anti-avoidance provisions. Somehow by association, Rothstein J gave subsection 87(3) an anti-avoidance character:

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26 Copthorne, supra note 16, at paragraph 65.
27 Canada Trustco, supra note 14, at paragraph 50.
28 Copthorne, supra note 16, at paragraph 68.
29 Ibid., at paragraph 70.
Because s. 87(3) is one provision within this series of grinds, it is reasonable to conclude that it shares the same purpose of precluding the preservation of PUC where such preservation would allow for a withdrawal, without liability for tax, of an amount in excess of the investment made with tax-paid funds.30

We see that he also created a relationship between the notions of PUC and tax-paid contributions made by the taxpayer.

Rothstein J concluded that the object and spirit of the exception are to “preclude preservation of PUC of the shares”31 in the case of a vertical amalgamation where such preservation would permit shareholders, on a redemption of shares by the amalgamated corporation, to be paid amounts as a return of capital without liability for tax, in excess of the amounts invested in the amalgamating corporations with tax-paid funds.32

Finally, he found that the transfer of shares that made the horizontal amalgamation possible was an abusive avoidance transaction, since it was contrary to the purpose of subsection 87(3) and “would enable payment, without liability for tax by the shareholders, of amounts well in excess of the investment of tax-paid funds.”33

In Copthorne, the Supreme Court confirmed the principles enunciated in Canada Trustco, a result that is welcomed. However, certain observations are necessary.

First, as noted, the court drew a close link between the concepts of PUC and investments of tax-paid funds. However, unlike adjusted cost base, PUC is not a shareholder-specific concept; it is often the case that the PUC of shares held by a shareholder does not correspond to tax-paid funds invested to acquire the shares.

Second, the parenthetical portion of subsection 87(3) is a rather trite rule that merely stipulates that the PUC of cancelled shares must be eliminated. However, associating subsection 87(3) with sections 84.1 and 212.1 to give it an anti-avoidance character, solely by virtue of the fact that those sections appear in a list of provisions referred to in the Act, necessitates giving great importance to legislative context. As Darmo and Fournier have observed,

[the fundamental difficulty with the Copthorne decision is that the Supreme Court does not provide a principled basis for its conclusion that the transactions in question constituted abusive tax avoidance. The artifice of using the definition of PUC in subsection 89(1) as a bridge to link the underlying rationale of subsection 87(3) with that of sections 84.1 and 212.1 does not seem to even work on its own terms, and in the

30 Ibid., at paragraph 96.
31 Ibid., at paragraph 122.
32 Ibid.
33 Ibid., at paragraph 127.
end, it is apparent that the Supreme Court is merely paying lip service to its own restrictions against conducting a search for an overriding policy in the Act—in this case, a broadly stated policy against surplus stripping—while in fact doing just that.34

Third, as a corollary of the previous point, what is the appropriate scope for this decision? At one end of the spectrum, we may think that the case stands for the principle that surplus stripping is abusive. At the other end, we can conclude that the reach of the decision must be limited to the facts of the case—a situation where two corporations are first poised for a vertical amalgamation but a transaction is undertaken to enable a horizontal amalgamation. What would have been the decision in *Copthorne* if the two corporations had been sister corporations for a longer period of time? What if there had never been a merger?

Fourth, the fact that the Crown had the burden of proving abuse did not seem to be a pertinent element in the decision. The court did not set out the evidence provided by the Crown and did not ask whether the burden of proof had been met. We can therefore ask whether this rule about the burden of proof is still applicable, and if so, to what extent?

Where are we after four decisions of the highest court of the land when it comes to fine-tuning GAAR? To attach an image to this question, does the fuse that triggers the application of GAAR require 15 amps, 20 amps, or 25 amps? Is it even possible to specify such precise limits to its application?

What we see is the following: even though the Supreme Court sought to establish, in *Canada Trustco*, a clear analytical framework for the application of GAAR, that framework has been liberally applied to deny a tax benefit that the court considered abusive. Let me be clear: I am not saying that the court’s decision reaches the wrong conclusion. For instance, some are readily of the opinion that it was not acceptable for the taxpayer in *Copthorne* to be able to benefit from preserved PUC, and no one can qualify this opinion as frivolous. However, the approach that the Supreme Court initially established had the very objective to shield the analysis from personal opinions, particularly those of members of the bench.

In 2009, in a panel discussion on GAAR, Meghji phrased the basic abuse question in the following terms:

> The concern was whether we are really going to have this test apply a legal standard, consistent from case to case, where similarly situated taxpayers are treated similarly. Could this standard be crafted by the courts into a legal standard rather than something perhaps far more subjective?35

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A little later, he acknowledged that

judges have striven in a principled way to resolve these disputes and bring coherence to the issues, and I must confess that I think that they have done a pretty good job overall. But I don’t want to overstate it; I think fundamentally the misuse or abuse test is, to speak candidly, about appealing to a judge’s fiscal morality.36

Former Chief Justice of the Tax Court Donald Bowman, participating in the same discussion panel, showed characteristic candour in his reaction to this remark:

So Al has been very complimentary to the Tax Court in saying that it has formulated a judicial test. On the same basis, though, I think that there continues to be a certain visceral element—people inelegantly call it the smell test, the olfactory factor, the gut reaction. Al put it very well when he said, “does this offend a judge’s fiscal morality?” And if something does, then I think you are going to lose.37

It appears reasonable to conclude that even though there is a structured approach to GAAR (which itself carries its own share of uncertainty), the courts do not hesitate to stretch the analysis to block an avoidance transaction that is against a certain fiscal morality, even though there are decisions in which the structured approach has been applied with great rigour. As a result, GAAR as a legal norm remains unclear.

In this context, tax authorities may rightfully consider invoking GAAR as soon as a transaction goes against a certain fiscal morality, in the belief that the courts will agree with the basis of this fiscal morality, even though this is not always the case. Already the relative distance from a structured approach adopted by the courts in order to include fiscal morality has increased the range of situations where GAAR is applicable; the application of GAAR by tax authorities to transactions that they judge contrary to fiscal morality broadens the range even more, since the courts will agree with them in some, though not all, cases (not to mention cases that are not litigated before the courts).

CONCLUSION

On the ground, we see that GAAR is more and more often invoked by tax authorities. For the year ending September 30, 2012, the CRA’s GAAR Committee recommended the application of GAAR in 96 percent of the cases brought to its attention. This trend will undoubtedly contribute to an escalation in litigation in tax files, if this is not already the case, especially in those files where the financial consequences are sufficiently significant for the taxpayer to bring the case to court.

36 Ibid., at 2:15.
37 Ibid., at 2:16.
This situation has its advantages. It allows a stringent control of tax avoidance. It also enables the realization of the objectives set when GAAR was adopted, especially when it comes to the integrity of the tax system.

However, there are also inconveniences. A judicial approach that is open to fiscal morality necessarily comes with a degree of uncertainty and unpredictability for the taxpayer. It becomes extremely difficult for advisers to give opinions to their clients without reserve; taxpayers sometimes hold back on certain transactions that would have been acceptable if they had gone forward. Finally, the increase in the number of litigated files represents a significant cost for individual taxpayers and the public purse alike.

If we weigh the advantages and inconveniences, does GAAR currently bring the Canadian tax system to the point of equilibrium for both taxpayers and the government?