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# Policy Forum: Some Thoughts on the Supreme Court's Approach to the Determination of Abuse Under the General Anti-Avoidance Rule

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**KEYWORDS:** GENERAL ANTI-AVOIDANCE RULE ■ GAAR ■ STATUTORY INTERPRETATION ■ ABUSES ■ SUPREME COURT DECISIONS

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## INTRODUCTION: THE ISSUE

Neil Brooks has written that “[Canada’s] income tax laws are a mess” and our judges are to blame: “Generally, judges have simply done an abysmal job of interpreting tax legislation.”<sup>1</sup> Brooks’s view is that a judge’s “responsibility is to give a meaning to the statutory language that will lead to the most sensible tax policy result.”<sup>2</sup> If judges

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1 Neil Brooks, “The Responsibility of Judges in Interpreting Tax Legislation,” in Graeme S. Cooper, ed., *Tax Avoidance and the Rule of Law* (Amsterdam: IBFD Publications, 1997), 93-129, at 93.

2 *Ibid.*, at 94.

behaved as he thinks they should, there would be no need for a general anti-avoidance rule (GAAR). However, the reality is that, despite Brooks's best efforts, Canadian judges continue to see their role as a narrow one of interpreting and applying the law; they deny that they have any role in making law, which is the exclusive responsibility of Parliament. In this context, a GAAR is necessary, and given the broad nature of the Canadian GAAR,<sup>3</sup> the courts are effectively forced into performing a law-making function.

This brief article deals with the issue of statutory interpretation and tax avoidance in the context of the concept of abuse in Canada's GAAR—specifically, subsection 245(4).

The jurisprudence indicates that the application of GAAR requires three conditions to be satisfied: there must be

1. a "tax benefit,"
2. an "avoidance transaction," and
3. a "misuse" of the provisions of the Act or an "abuse" of the provisions of the Act read as a whole.

A tax benefit is broadly defined to be any reduction, deferral, or avoidance of tax or other amount payable under the Act.<sup>4</sup> An avoidance transaction is a transaction that results in a tax benefit or a transaction that is part of a series of transactions that results in a tax benefit, unless it can reasonably be considered that the primary purpose of the transaction was other than to obtain the tax benefit.<sup>5</sup> In most of the GAAR cases that have been heard by the courts, the existence of a tax benefit and an avoidance transaction is usually clear; often, in fact, these aspects of GAAR are conceded by the taxpayer. Accordingly, in most GAAR cases, the crucial issue is the concept of misuse or abuse under subsection 245(4).

Under subsection 245(4), GAAR does not apply unless an avoidance transaction results in a misuse of the provisions of the Act (or the provisions of the regulations and rules thereunder, or of a tax treaty or other enactment) or an abuse of those provisions read as a whole. The Supreme Court of Canada has clearly established that there is no meaningful distinction between the concepts of misuse and abuse under GAAR.<sup>6</sup> Moreover, the Supreme Court has held that subsection 245(4) is an interpretive

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3 Canada's general anti-avoidance rule is contained in 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.

4 Subsection 245(1), the definition of "tax benefit."

5 Subsection 245(3), defining "avoidance transaction."

6 *Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54, at paragraph 39: "Parliament could not have intended this two-step approach, which on its face raises the impossible question of how one can abuse the Act as a whole without misusing any of its provisions." In my view, the Supreme Court is incorrect on this point. If a transaction has been designed so that a specific

test, not a substantive rule. In other words, whether an avoidance transaction constitutes an abuse involves a determination of whether the transaction is consistent with or violates the object and purpose of the relevant provisions of the Act.

This article analyzes how the Supreme Court's approach to the concept of abuse under subsection 245(4) has developed and where that approach is likely to lead. The analysis presented here is not intended to be comprehensive or exhaustive. It does not deal with important aspects of the concept of abuse, such as the relevance of artificiality and economic substance; it is selective in terms of the cases that are examined, and it does not review in detail the factual context of those cases. Rather, this article presents my ideas about the Supreme Court's view of the role of subsection 245(4) in the abstract.<sup>7</sup>

### THE PURPOSE OF SUBSECTION 245(4)

Subsection 245(4) is intended to restrict or provide a safety valve against an overly broad application of GAAR. Parliament clearly intended that not all transactions whose primary purpose is to avoid or reduce tax should be considered offensive and rendered ineffective for income tax purposes. Accordingly, after casting the net of GAAR broadly in terms of the definitions of tax benefit and avoidance transaction, Parliament added an exception for avoidance transactions that do not contravene, frustrate, violate, conflict with, or abuse the purpose or policy of the Act.<sup>8</sup>

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anti-avoidance rule does not apply, one cannot reasonably consider whether the rule has been misused, since it has not been used at all. On the other hand, one can reasonably consider whether such a transaction is an abuse of the statute read as a whole. In any event, the Supreme Court's position on this issue is not important given that, in French, the distinction between misuse (« abus ») and abuse (« abus ») is non-existent, and the concept of abuse is broad enough to include the misuse of a provision of the Act.

- 7 The analysis and observations presented here expand on commentary previously published online in Brian J. Arnold, "Musings on the Supreme Court's View of the Concept of Abuse Under the GAAR," *The Arnold Report* post 041, December 2012 ([www.ctf.ca/ctfweb/EN/CTF\\_Publications/Newsletters/The\\_Arnold\\_Report/Archive/EN/Newsletters/The\\_Arnold\\_Report/BArnold\\_Archive.aspx](http://www.ctf.ca/ctfweb/EN/CTF_Publications/Newsletters/The_Arnold_Report/Archive/EN/Newsletters/The_Arnold_Report/BArnold_Archive.aspx)). For further discussion on this topic, see Marc Darro and Olivier Fournier, "Recent Developments Regarding the Application of Subsection 245(4)," in *Report of Proceedings of the Sixty-Third Tax Conference*, 2011 Conference Report (Toronto: Canadian Tax Foundation, 2012), 37:1-33.
- 8 Such an exception is common in statutory GAARs and is also found in the general test for the abuse of tax treaties. See paragraph 9.5 of the commentary on article 1 of Organisation for Economic Co-operation and Development, *Model Tax Convention on Income and on Capital: Condensed Version* (Paris: OECD, July 2010); and paragraph 23 of the commentary on article 1 of the *United Nations Model Double Taxation Convention Between Developed and Developing Countries* (New York: United Nations, 2011), which quotes paragraph 9.5 of the commentary on article 1 of the OECD model convention.

## RELEVANT CASE LAW

### OSFC Holdings

The starting point for my analysis is the Federal Court of Appeal's decision in the *OSFC Holdings* case.<sup>9</sup> I have chosen that case as my starting point because until the first Supreme Court GAAR cases, *OSFC Holdings* was the leading GAAR case and, more importantly, the decision was written by Rothstein J, who has since been elevated to the Supreme Court.

In *OSFC Holdings*, Rothstein J adopted a two-stage test, first "identifying the relevant policy of the provisions of the Act as a whole" and then assessing the facts to determine "whether the avoidance transaction constituted a misuse or abuse having regard to the identified policy."<sup>10</sup> The first stage is "a question of interpretation."<sup>11</sup> Rothstein J made it clear that he used the term "policy" to refer collectively to the various descriptions of the approach to the determination of misuse or abuse as "purposive, object and spirit, scheme or policy."<sup>12</sup> Moreover, he stated, the determination of the policy of the Act is not limited to a consideration of the words of the relevant provisions or the Act as a whole, since that would render GAAR meaningless; rather, reference may also be made to "extrinsic aids such as technical notes, writings, Hansard and enacting notes."<sup>13</sup>

Because an avoidance transaction will always comply with the letter of the relevant provisions,<sup>14</sup> according to Rothstein J, the misuse or abuse analysis under subsection 245(4)

is not an exercise of trying to divine Parliament's intention by using a purposive analysis where the words used in a statute are ambiguous. Rather, it is an invoking of a policy to override the words Parliament has used.<sup>15</sup>

Elsewhere in his reasons, he refers to "the policy behind" the relevant provisions.<sup>16</sup> Although "strict compliance with the Act" is

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9 *OSFC Holdings Ltd. v. Canada*, 2001 FCA 260.

10 *Ibid.*, at paragraph 67.

11 *Ibid.*, at paragraph 68.

12 *Ibid.*, at paragraph 66.

13 *Ibid.*, at paragraph 63.

14 If a transaction does not comply with the provisions relied on for the tax benefit, GAAR, as a provision of last resort, is irrelevant and unnecessary.

15 *OSFC Holdings*, supra note 9, at paragraph 69.

16 *Ibid.*, at paragraph 61. As noted below, Rothstein J returned to this terminology when he wrote the decision on behalf of the Supreme Court in the *Coptborne* case, infra note 27; see infra note 30 and the accompanying text.

normally . . . sufficient . . . Parliament has enacted subsection 245(4) and if any meaning is to be given to it, it must be to override the results of strict compliance when abuse of the provisions of the Act, read as a whole, is apparent.<sup>17</sup>

Rothstein J describes the court's task to find an overriding policy under subsection 245(4) as an "unusual duty"<sup>18</sup> and uses this to justify his conclusion that the policy must be clear and unambiguous; otherwise, GAAR cannot be applied.

Applying his two-stage approach, Rothstein J had "no difficulty concluding that the general policy of the *Income Tax Act* is against the trading of non-capital losses by corporations, subject to specific limited circumstances,"<sup>19</sup> and that the transactions at issue contravened that clear policy.

### Canada Trustco and Mathew

The first two GAAR cases heard by the Supreme Court were argued and decided together. *Canada Trustco*<sup>20</sup> involved a prepaid lease arrangement under which Canada Trustco effectively purchased capital cost allowance to reduce its taxable income. The companion case, *Mathew*,<sup>21</sup> was an appeal of the *OSFC Holdings* decision with a different lead taxpayer. The Supreme Court held that GAAR applied in *Mathew* but not in *Canada Trustco*, upholding the decisions of the Federal Court of Appeal in both instances. Of the two decisions, *Canada Trustco* is the leading one; in it, the Supreme Court sets out in detail its approach to the interpretation and application of GAAR. My focus here is the Supreme Court's approach to the concept of abuse in subsection 245(4).

In *Canada Trustco* and *Mathew*, the Supreme Court rejected Rothstein J's approach to establishing a misuse or an abuse, which involved a narrow textual analysis of the relevant provisions followed by a broad purposive analysis of the Act as a whole. Instead, the Supreme Court adopted what it described as "a unified, textual, contextual, and purposive approach."<sup>22</sup> The court's use of the term "unified" in this

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17 *OSFC Holdings*, supra note 9, at paragraph 117.

18 *Ibid.*, at paragraph 69. In a panel discussion at a Canadian Tax Foundation conference in 2005, Rothstein J reiterated this description of the court's task in respect of GAAR: "So we are being asked, notwithstanding compliance, whether there is a misuse or an abuse. That's different from our usual statutory interpretation exercise." Rothstein J also suggested that the courts should be cautious in carrying out the "unusual duty" imposed by GAAR because it is difficult for a court to foresee the unintended consequences of its decisions. Brian Arnold, Judith Freedman, Al Meghji, Mark Meredith, and Hon. Marshall Rothstein, "The Future of GAAR," in *Report of Proceedings of the Fifty-Seventh Tax Conference*, 2005 Conference Report (Toronto: Canadian Tax Foundation, 2006), 4:1-16, at 4:3-4.

19 *OSFC Holdings*, supra note 9, at paragraph 98.

20 *Canada Trustco*, supra note 6.

21 *Mathew v. Canada*, 2005 SCC 55 (sub nom. *Kaulius v. The Queen* in the Federal Court of Appeal, 2003 FCA 371).

22 *Canada Trustco*, supra note 6, at paragraph 40.

context is confusing, but presumably means that there is no distinction between misuse and abuse. The court rejected Rothstein J's comments about overriding policy in strong terms:

The courts cannot search for an overriding policy of the Act that is not based on a unified textual, contextual and purposive interpretation of the specific provisions at issue. . . . To send the courts on the search for some overarching policy and then to use such a policy to override the wording of the provisions of the *Income Tax Act* would inappropriately place the formulation of taxation policy in the hands of the judiciary, requiring judges to perform a task to which they are unaccustomed and for which they are not equipped. . . .

[T]o search for an overriding policy of the *Income Tax Act* that is not anchored in a textual, contextual and purposive interpretation of the specific provisions that are relied upon for the tax benefit would run counter to the overall policy of Parliament that tax law be certain, predictable and fair, so that taxpayers can intelligently order their affairs.<sup>23</sup>

It is important to recognize that the court does not prohibit entirely a search for an overriding policy, but only a search for such a policy that is “not anchored in a textual, contextual and purposive interpretation of the specific provisions that are relied upon for the tax benefit.” It is hard for me to imagine a Canadian court invoking policy to interpret the words of any statute if the policy was not derived from or based on those words. Certainly, in *OSFC Holdings* Rothstein J did not suggest any such frivolity.

Despite rejecting Rothstein J's comments about policy, the Supreme Court accepted, without any acknowledgment, the two-stage approach to the determination of abuse adopted in *OSFC Holdings*. However, the court restricted the first stage to the determination of the purpose of the provisions that conferred the tax benefit, whereas Rothstein J referred to the determination of the policy of the provisions of the Act as a whole. Rothstein J's approach is preferable to the Supreme Court's in this regard. The Supreme Court's focus on only the provisions relied on by the taxpayer for the tax benefit is too narrow. In many, if not most, cases, the tax benefit may be based on a single provision, but it will be necessary to examine several statutory provisions to determine the statutory scheme and the underlying rationale for that scheme.<sup>24</sup>

In *Mathew*, the Supreme Court decided that GAAR applied because “it is implicit that the rules [in subsection 96(1)] are applied when partners in a partnership carry on a business in common, in a non-arm's length relationship.”<sup>25</sup> Arguably, the court did precisely what it said was unacceptable: invoke an overarching policy that cannot be found in the text of the relevant provision. There is no suggestion in the

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23 Ibid., at paragraphs 41-42.

24 As a result, as Darro and Fournier suggest (*supra* note 7, at 37:3), lower courts were reluctant to find abuse on the basis of the provisions of the Act read as a whole.

25 *Mathew*, *supra* note 21, at paragraph 51.

words of subsection 96(1) that the provision is limited to partnerships in which the relationship between the partners is non-arm's-length.

### Lipson

In 2006, the plot thickened: Rothstein J, the judge who had written what was recognized as the leading GAAR decision—until the Supreme Court rejected it—was appointed to that court. Since then, Rothstein J has become known as the Supreme Court justice who is most knowledgeable about and interested in tax issues. Two questions come to mind: How has the Supreme Court's GAAR jurisprudence developed with Rothstein J playing a leading role on the court, and how will it develop in the future?

Rothstein J's first GAAR case at the Supreme Court—*Lipson*<sup>26</sup>—provides little detailed information about the court's approach to GAAR, although it is clear that its attitude had shifted significantly in the four years since *Canada Trustco* and *Mathew*. The change in the composition of the court during those years produced a serious split concerning GAAR. In *Lipson*, a case involving an arrangement to obtain interest deductibility through the use of the spousal attribution rules, Binnie J, writing for the minority, disagreed sharply and openly with LeBel J, writing for the majority. Such open disagreements between justices of the Supreme Court are rare. The disagreement in *Lipson* is perhaps the more surprising in light of the fact that the decisions in *Canada Trustco* and *Mathew* were unanimous. If the *Lipson* decision reveals little about the Supreme Court's approach to the interpretation of subsection 245(4), it reveals even less about Rothstein J's view, because he took the position that the application of GAAR was unnecessary in light of subsection 74.5(11).

### Copthorne

The decision in *Copthorne*, issued in 2011,<sup>27</sup> indicates that *Lipson* was only a way station in the evolution of the Supreme Court's approach to subsection 245(4). Rothstein J wrote the decision for a unanimous court and was instrumental in effecting that shift. My thesis is that under his influence the Supreme Court has moved away from the approach adopted in *Canada Trustco*, back to the approach adopted by the Federal Court of Appeal in *OSFC Holdings*.

In *Copthorne*, a parent and subsidiary corporations in the same corporate group became sister corporations before being amalgamated. If the parent and subsidiary corporations had been amalgamated without first becoming sister corporations, the paid-up capital of the shares of the subsidiary would have been eliminated on the amalgamation. Therefore, the effect of the preliminary step was to arbitrarily increase or duplicate the paid-up capital of the amalgamated corporation by the amount of the paid-up capital of the subsidiary.

26 *Lipson v. Canada*, 2009 SCC 1.

27 *Copthorne Holdings Ltd. v. Canada*, 2011 SCC 63.

The taxpayer argued that the conclusion that the Act precluded corporations from preserving paid-up capital on amalgamation could be based only on a general policy against surplus stripping, contrary to the Supreme Court's injunction in *Canada Trustco* against a search for an overriding policy.<sup>28</sup> The Supreme Court rejected this argument on the ground that its decision was based on an analysis of the paid-up capital provisions, not "some broad statement of policy."<sup>29</sup> Thus, it appears that the injunction against invoking an overriding policy is not a serious constraint on the application of GAAR as long as the Crown can establish to the court's satisfaction that the policy is grounded in a textual, contextual, and purposive analysis of the provisions of the Act.

What is more significant to me is how Rothstein J described the interpretive approach required for a determination of abuse under subsection 245(4). He began by saying that courts have "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."<sup>30</sup> GAAR deals with transactions that are "in strict compliance with the text" of the Act but are not necessarily in accordance "with their object, spirit or purpose."<sup>31</sup> Object, spirit, and purpose are what Rothstein J appropriately referred to in *OSFC Holdings* as "policy."<sup>32</sup> However, in *Canada Trustco* the Supreme Court expressed aversion to the use of this term. Perhaps this is because the Supreme Court has consistently rejected the idea of courts deciding cases on the basis of unexpressed notions of policy. Since the *Friesen* case in 1995,<sup>33</sup> the Supreme Court has cited the following statement of principle, originally written by Peter Hogg and subsequently reiterated by Hogg, Magee, and Li:

It would introduce intolerable uncertainty into the Income Tax Act if clear language in a detailed provision of the Act were to be qualified by unexpressed exceptions derived from a court's view of the object and purpose of the provision.<sup>34</sup>

This is not the place for a detailed critique of the Supreme Court's endorsement of this bit of indefensible hyperbole.<sup>35</sup> The important point here is that in *Coptborne*

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28 Ibid., at paragraph 117.

29 Ibid., at paragraph 118.

30 Ibid., at paragraph 66.

31 Ibid.

32 *OSFC Holdings*, supra note 9, at paragraph 66.

33 *Friesen v. Canada*, [1995] 3 SCR 103.

34 Peter W. Hogg, *Notes on Income Tax*, 3d ed. (Toronto: Carswell, 1994), at 22:12, currently found in Peter W. Hogg, Joanne E. Magee, and Jinyan Li, *Principles of Canadian Income Tax Law*, 7th ed. (Toronto: Carswell, 2010), at 584. The same wording is used in the current version except that the word "routinely" has been inserted before "qualified."

35 I have railed against this statement previously. Policy is always unexpressed in tax legislation; it must be inferred from the words of the legislation and from extrinsic aids. However, this is no

Rothstein J refers to object, spirit, and purpose not as policy, but (quoting Vern Krishna) as the “legislative rationale that underlies specific or interrelated provisions of the Act.”<sup>36</sup> Later, he refers to the “underlying rationale” of the paid-up capital provisions.<sup>37</sup>

## THE SUPREME COURT’S CURRENT VIEW OF THE CONCEPT OF ABUSE

It is appropriate to pause here briefly to focus on the language used by the Supreme Court in describing the task of a court in applying subsection 245(4). The courts cannot search for an overarching or overriding policy—at least not one that is not based on a textual, contextual, and purposive analysis of the relevant provisions of the Act. In short, the policy must be attached to or anchored in the words in some fashion. As noted above, it is difficult to imagine a court inventing a tax policy that was not based on the legislation at all. This would be a violation of the judicial function and the rule of law. Unfortunately, some lower courts have misunderstood the Supreme Court’s caution about searching for an overriding policy that is not grounded in the provisions of the Act and have simply refused to look for *any* overriding or overarching policy.

Although the courts cannot search for an overriding or overarching policy, according to the Supreme Court, they can go *behind* or *beneath* the words to find the object and spirit or underlying rationale of the relevant provisions. When the Supreme Court refers to the underlying rationale, it does not emphasize that the rationale or policy must be based in some fashion on the words of the provisions. However, such a condition must be implicit. On a metaphorical level, I understand that the term “underlying rationale” involves connotations of foundations and bedrock—something solid—whereas “overarching or overriding policy” suggests something ethereal and insubstantial—not something that judges searching for certainty, predictability, and fairness would rely on. In substance, however, there is no difference between an overriding or overarching policy and an underlying rationale, despite the Supreme Court’s comments to the contrary. Both the underlying rationale and the overriding or overarching policy of the relevant provisions of the Act must be found by means of a rigorous analysis of the provisions of the Act as a whole and any relevant extrinsic aids.

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reason for the courts to ignore tax policy considerations. See Brian J. Arnold, “Statutory Interpretation: Some Thoughts on Plain Meaning,” in *Report of Proceedings of the Fiftieth Tax Conference*, 1998 Conference Report (Toronto: Canadian Tax Foundation, 1999), 6:1-36, at 29-30; and Brian J. Arnold, “Reflections on the Relationship Between Statutory Interpretation and Tax Avoidance” (2001) 49:1 *Canadian Tax Journal* 1-39, at 27-28.

36 *Copthorne*, supra note 27, at paragraph 69, quoting Vern Krishna, *The Fundamentals of Income Tax Law* (Toronto: Carswell, 2009), at 818.

37 *Copthorne*, supra note 27, at paragraphs 87 and 109.

As I have suggested above, a close reading of *Coptborne* indicates that Rothstein J is moving the Supreme Court from its approach to GAAR in *Canada Trustco* back to his approach in *OSFC Holdings*.

First, although this is a small point, the introductory paragraphs of the decisions in *OSFC Holdings* and *Coptborne* are almost identical:

It is relatively straightforward to set out the GAAR scheme. It is much more difficult to apply it. Generally, where a transaction is an avoidance transaction (a transaction that would result in a tax benefit, and whose primary purpose was to obtain the tax benefit), the tax benefit resulting from the transaction will be denied. However, the tax benefit will not be denied if the avoidance transaction would not result in a misuse of the provisions of the Act or an abuse of the Act read as a whole [*OSFC Holdings*].<sup>38</sup>

It is relatively straightforward to set out the GAAR scheme. It is much more difficult to apply it. Where a transaction is an avoidance transaction (a transaction that would result in a tax benefit and whose primary purpose was to obtain the tax benefit), the tax benefit resulting from the transaction will be denied. However, the tax benefit will not be denied if the avoidance transaction would not result in an abuse or misuse of the *Income Tax Act* [*Coptborne*].<sup>39</sup>

The differences in wording between these two passages are insignificant. The similarity in wording is telling because it suggests that, when Rothstein J wrote his reasons for judgment in *Coptborne*, he likely went back and consulted his Federal Court of Appeal decision in *OSFC Holdings*.

In addition, in both cases Rothstein J referred to the “unusual duty” imposed on a court under subsection 245(4):

The Court will proceed cautiously in carrying out the unusual duty imposed upon it under subsection 245(4) [*OSFC Holdings*].<sup>40</sup>

And:

The 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 [*Coptborne*].<sup>41</sup>

I understand that some might argue that the decisions of the Supreme Court should not be parsed in the same rigorous way that tax legislation is construed. But in my view a close reading of the Supreme Court’s decisions is inevitable, and I

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38 *OSFC Holdings*, supra note 9, at paragraph 2.

39 *Coptborne*, supra note 27, at paragraph 32.

40 *OSFC Holdings*, supra note 9, at paragraph 69.

41 *Coptborne*, supra note 27, at paragraph 66. See also Rothstein J’s comments cited in note 18, supra.

would be very much surprised if the Supreme Court did not understand this and expect it. As a result, I think it is fair to assume that the Supreme Court chooses its words carefully.

Both *OSFC Holdings* and *Copthorne* make it clear that subsection 245(4) is an interpretive provision, not a substantive rule. In *OSFC Holdings* Rothstein J wrote:

Ascertaining the relevant policy is a question of interpretation. As such, it is ultimately the duty of the Court to make this determination.<sup>42</sup>

And in *Copthorne* he wrote:

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.”<sup>43</sup>

Thus, GAAR applies to transactions that abuse, frustrate, or defeat the object, spirit, purpose, policy, or underlying rationale of the relevant provisions. The determination of the purpose of the provisions is an interpretive exercise based on a textual, contextual, and purposive analysis of the provisions.

According to the Supreme Court, the provisions of all statutes, including taxing statutes and in particular subsection 245(4), must be interpreted in accordance with the modern rule, which, since *Canada Trustco*, has also been described by the Supreme Court as the textual, contextual, and purposive approach. The modern approach was adopted by the Supreme Court in its 1984 decision in *Stubart Investments*, where the court endorsed the following description from Driedger’s *Construction of Statutes*:

Today there is only one principle or approach, namely, the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament.<sup>44</sup>

The modern rule has been reaffirmed by the Supreme Court many times.<sup>45</sup> Although the court has never said so explicitly, lower courts and commentators have universally assumed that the modern rule and the textual, contextual, and purposive approach are identical. This conclusion seems justified because the references in the modern rule to the “grammatical and ordinary sense” of the words, the “entire context,” and

42 *OSFC Holdings*, supra note 9, at paragraph 68.

43 *Copthorne*, supra note 27, at paragraph 70.

44 E.A. Driedger, *Construction of Statutes*, 2d ed. (Toronto: Carswell, 1983), at 87, quoted in *Stubart Investments Ltd. v. The Queen*, [1984] 1 SCR 536, at 578.

45 See, for example, *Placer Dome Canada v. Ontario (Minister of Finance)*, 2006 SCC 20, and *Imperial Oil Ltd. v. Canada*, 2006 SCC 46. For some reason, however, the Supreme Court has not discussed the approach to statutory interpretation in any of its tax decisions since 2006.

“the object of the Act, and the intention of Parliament” equate to the “textual,” “contextual,” and “purposive” elements of the Supreme Court’s approach.

The question is: What does the interpretive analysis required under subsection 245(4) add to the basic interpretive approach that must first be applied to the relevant provisions of the Act? As noted in the explanatory notes and confirmed by the Supreme Court in *Canada Trustco* and *Coptborne*,<sup>46</sup> GAAR is intended to be a provision of last resort. Rothstein J dealt briefly with this issue in *OSFC Holdings*.<sup>47</sup> In effect, the analysis under subsection 245(4) is the invoking of the policy or purpose to override the words of the Act with respect to transactions that otherwise comply with the letter of the relevant provisions. Rothstein J apparently assumed that provisions of the Act are to be interpreted literally—or, perhaps more accurately, that in applying the modern approach, the literal meaning of the words plays a dominant role in the interpretive process.

In *Coptborne*, Rothstein J explained the relationship between the textual, contextual, and purposive approach that is ordinarily applied to the interpretation of statutes and the textual, contextual, and purposive approach that must be applied under subsection 245(4):

While the approach is the same as in all statutory interpretation, the analysis [under subsection 245(4)] seeks to determine a different aspect of the statute 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.<sup>48</sup>

This is a brave attempt to resolve the uneasy relationship between the ordinary approach to statutory interpretation and the interpretive approach to the determination of abuse under GAAR, but in my opinion, it is unsuccessful.<sup>49</sup> In the first place,

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46 Canada, Department of Finance, *Explanatory Notes to Legislation Relating to Income Tax* (Ottawa: Department of Finance, June 1988). *Canada Trustco*, supra note 6, at paragraph 21: “The GAAR was enacted as a provision of last resort in order to address abusive tax avoidance, it was not intended to introduce uncertainty in tax planning.” *Coptborne*, supra note 27, at paragraph 66: “Courts, however, must remember that s. 245 was enacted ‘as a provision of last resort’” (quoting *Canada Trustco*).

47 See supra note 17 and the accompanying text.

48 *Coptborne*, supra note 27, at paragraph 70.

49 Darro and Fournier, supra note 7, accept the Supreme Court’s distinction between the two interpretive exercises based on the different goals of the two exercises. They suggest that the goal of the interpretive exercise under subsection 245(4) is “to determine whether the words give an early indication of possible rationales for the provision, which would inform the ensuing contextual and purposive analysis” (ibid., at 37:7). I think their analysis reads too much into the Supreme Court’s reasons and assumes that the interpretive process is more artificial than it really is.

it relies on the assumption that there is a meaningful difference when the same thing is done for different purposes: that is, applying a textual, contextual, and purposive approach to determine the meaning of a provision is somehow different from applying a textual, contextual, and purposive approach to determine the object, spirit, or purpose of that provision. However, the object, spirit, or purpose of the provision, the determination of which is the goal of the subsection 245(4) analysis, is part of the textual, contextual, and purposive analysis that is supposed to be applied in every exercise of statutory interpretation. Therefore, in every case of statutory interpretation, a court should consider the words of the statute and any relevant extrinsic aids to determine the purpose of the provision. That task should have been completed by the time the court arrives at the first stage of the determination of abuse under subsection 245(4) (determination of the object, spirit, or purpose of the relevant provisions).

In my view, there is no other reasonable basis for the distinction that Rothstein J attempts to draw between the ordinary textual, contextual, and purposive approach and the textual, contextual, and purposive approach applied to subsection 245(4). For example, it cannot reasonably be argued that the relevant provisions for the abuse analysis under subsection 245(4) are different from the provisions that are subject to the ordinary textual, contextual, and purposive approach to interpretation. Nor can it reasonably be argued that the purpose of the relevant provisions can be different for the purpose of the ordinary interpretive exercise and for the purpose of the abuse analysis under subsection 245(4).

One possible way to make sense out of the distinction between the two interpretive exercises is that the purpose of the relevant provisions gets more weight in the abuse analysis than in the ordinary interpretive exercise. This is a plausible explanation because the Supreme Court has said many times that since tax provisions are detailed and particular, the text (the literal meaning of the words) must play a dominant role in establishing the meaning of the provisions. Indeed, in the preceding excerpt from *Coptborne*, Rothstein J suggests that this is the case when he refers to “the rationale that underlies the words that may not be captured by the bare meaning of the words themselves.” However, in *Canada Trustco*, the Supreme Court also went on to say that it is invariably necessary to consider the context and purpose of apparently clear words because such contextual and purposive analysis may reveal latent ambiguities.<sup>50</sup> Such ambiguities are then resolved by reference to all of the relevant factors: text, context, purpose, consequences of alternative interpretations, presumptions, etc.<sup>51</sup>

Therefore, this explanation is not internally consistent if it is based on an assumption that the words of the Act are to be interpreted in accordance with their literal meaning. The modern rule is clear that the interpretation of all statutory

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50 *Canada Trustco*, supra note 6, at paragraph 47.

51 Ruth Sullivan, *Sullivan on the Construction of Statutes*, 5th ed. (Markham, ON: LexisNexis Canada, 2008), at 1-21.

provisions must consider the context and purpose of the legislation as well as the ordinary meaning of the words. Moreover, the practice of the courts accords with the modern rule in this regard. Courts habitually consider all three factors, although in many cases the literal meaning of the words may be accorded more weight. Consequently, the only basis on which this explanation is plausible is if the weight to be attributed to the purpose of the relevant provisions differs in the two interpretive exercises. This rationale, however, does not withstand scrutiny. Such an approach does not and cannot tell a court how much weight to attribute to the purpose; it can only indicate that more weight should be given to purpose under subsection 245(4) than under other provisions. However, even in ordinary cases of statutory interpretation, where the literal meaning of a provision is ambiguous and the context is not helpful in unlocking the meaning, the purpose of the provision—assuming that it can be established with clarity—may be given substantial weight in applying the modern rule. It is inconceivable to me how in such circumstances a court would give more weight to the purpose of the provisions in determining whether there has been abuse under subsection 245(4).

The problem is that, in every interpretive exercise, the interpreter must balance all of the relevant information and assign weight to each factor. It is not as simple as interpreting provisions without giving any or much weight to purpose and a lot of weight or exclusive weight to the text, and then reversing the weighting under subsection 245(4). This is not how we (including judges) interpret words, although it may be how we (including judges) rationalize or justify our conclusions after the fact.

In *Canada Trustco* and *Mathew*, the Supreme Court enunciated the following test for abuse under subsection 245(4):

[A]busive 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.<sup>52</sup>

This test is tautological: a transaction will be abusive when it lacks a proper basis relevant to the policy of the provisions of the Act; and, of course, it will lack a proper basis when it is abusive. Further, the “wholly dissimilar” standard seems to have been invented by the court without any basis in the words of GAAR or the explanatory notes; and the court provides no guidance for determining when transactions or relationships are wholly dissimilar to those contemplated by the provisions relied on for the tax benefit. In particular, the reference to relationships is unjustified by anything in the wording of subsection 245(4).

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52 *Canada Trustco*, supra note 6, at paragraphs 60 and 66; and *Mathew*, supra note 21, at paragraph 31. For a more detailed criticism of this test, see Brian J. Arnold, “Policy Forum: Confusion Worse Confounded—The Supreme Court’s GAAR Decisions” (2006) 54:1 *Canadian Tax Journal* 167-209, at 193-94.

Subsequent Supreme Court cases have wisely ignored the formulation of the test for abuse in *Canada Trustco*. (Not surprisingly, in those cases, the court did not explicitly reject that test.) Instead, subsequent cases have focused on what the Supreme Court in *Canada Trustco* identified as three types of abuse and, with a little reverse engineering, have effectively turned this typology into the test of abuse.<sup>53</sup> Thus, abuse will be found where

1. the outcome is one that the relevant provisions seek to prevent,
2. the underlying rationale of the relevant provisions is defeated, and
3. the relevant provisions are circumvented in a manner that defeats their object and purpose.

The difficulty with this reformulation of the test is that it does not provide any more meaningful guidance as to when a transaction will be considered to be abusive than the former test did; it merely restates the test in three ways that overlap extensively. When is the outcome of a transaction one that the provisions seek to prevent? When does a transaction defeat the underlying rationale of the provisions or circumvent the provisions in a manner that defeats their object and purpose? The answer is, “When the transaction is abusive”—and we are back to where we started.

What we need is for the Supreme Court to articulate an objective test or tests for the determination of abuse that can be applied by taxpayers, tax officials, and the courts with some degree of certainty.<sup>54</sup>

## CONCLUSION

This article argues that the Supreme Court’s approach to the determination of abuse under subsection 245(4) is shifting under the influence of Rothstein J. The determination of the policy or purpose of the provisions of the Act that have been abused will not be restricted to the provisions that the taxpayer relied on for the tax benefit, as suggested by the Supreme Court in *Canada Trustco*, but will include the provisions of the Act read as a whole. Although the relationship between the ordinary approach to the interpretation of the provisions of the Act and the interpretive exercise under subsection 245(4) is still unclear, the court recognizes that it is necessary for the abuse analysis to go beyond the words of the Act in order for GAAR to have meaning. These are important developments; however, there are several other issues involving the determination of abuse that remain to be resolved. The most important issue, in my view, is the need for the Supreme Court to develop objective tests for abuse that can be applied by the courts so that the concept of abuse does not degenerate into a smell test.

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53 See *Canada Trustco*, supra note 6, at paragraph 45; *Lipson*, supra note 26, at paragraph 40; and *Copthorne*, supra note 27, at paragraph 72.

54 For example, one possibility might be a comparison of the quantum of the tax benefits and the commercial benefits of the transaction.

