
Justice Bowman on Substance over Form

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INTRODUCTION

The proposition that tax should be imposed on the basis of the substance of a transaction rather than its form is deceptively appealing. “Substance” suggests something tangible, concrete, and real. On the other hand, “form,” which is often accompanied by the qualifier “mere,” suggests something ephemeral and insignificant that hides something else—namely, the substance of the thing. These popular connotations of the meanings of form and substance are, of course, misleading in the context of Canadian tax law. To quote Linden J of the Federal Court of Appeal, “In tax law, form matters.”¹ In fact, form matters a lot. The real question is whether or not there is any significant role for substance in Canadian tax law. An important preliminary question is: What does “substance” mean in reference to a transaction or a series of transactions—legal substance or economic substance? And what precisely is the economic substance of a transaction?

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1 *The Queen v. Friedberg*, 92 DTC 6031, at 6032; [1992] 1 CTC 1, at 2 (FCA).

This article deals with the decisions concerning form and substance made by Donald Bowman as a judge and later chief justice of the Tax Court of Canada. Between his appointment to the Tax Court in 1991 and his retirement in 2008, Bowman J decided many important cases involving tax avoidance. The article begins with an overview of the current law involving form and substance. This review covers statutory provisions,² case law under the general anti-avoidance rule (GAAR), and other case law. Against this background we consider the decisions of Bowman J in cases involving matters of form and substance. We consider not only his statements about form and substance in tax law, but also the results in the cases, to see how he actually applied these concepts.

FORM AND SUBSTANCE IN CANADIAN TAX LAW

The Duke of Westminster Principle

The *Duke of Westminster* principle that a taxpayer is entitled to arrange his affairs so as to minimize tax³ is deeply entrenched in Canadian tax law—so deeply entrenched that the principle is invariably applied by the courts without any analysis of its origin and scope or of its continuing validity or viability.

The *Duke of Westminster* principle is derived from the strict or literal approach to statutory interpretation, which continued to apply to taxing statutes long after it had been rejected for other statutes. According to strict interpretation, tax could be imposed only if a taxpayer's situation was covered by a literal reading of the words of a charging provision.⁴ A taxpayer's situation was determined by reference to the legal rights and obligations created by the taxpayer, not the economic substance of the transaction or arrangement. If, therefore, a taxpayer arranged the legal rights and obligations so that the statute did not apply on a literal reading of its provisions, tax was avoided, even though the arrangement—especially if construed in accordance with its economic substance—might have been within the spirit of the statute.

Literal interpretation and taxation on the basis of legal form created a potent combination that allowed tax-avoidance transactions to flourish. The only obstacle for taxpayers was to ensure that the legal form and the legal substance of their arrangements were identical. As the House of Lords stated in the *Duke of Westminster* case, courts were entitled to disregard “mere nomenclature” and consider the actual

2 Unless otherwise stated, statutory references in this article are to the Income Tax Act, RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as “the Act”).

3 *Inland Revenue Commissioners v. Westminster (Duke)*, [1936] AC 1, at 19 (HL).

4 The classic statement of this principle is found in *Partington v. The Attorney General* (1869), LR 4 HL 100, at 122: “As I understand the principle of all fiscal legislation, it is this: If the person sought to be taxed comes within the letter of the law he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be.”

legal rights and obligations created.⁵ It was on this basis that Lord Atkin dissented. In his view, the legal substance of the arrangements in the *Duke of Westminster* case was that the duke's gardener continued to receive his full wages even after the settlement of an annuity on his behalf.⁶ It is difficult to discern any difference between taxing on the basis of legal substance and disregarding sham transactions.

Virtual Irrelevance of Economic Substance

The Supreme Court of Canada has reaffirmed the *Duke of Westminster* principle many times, especially in a series of cases in the late 1990s involving blatant tax-avoidance schemes. For example, in *Shell Canada Ltd. v. The Queen*, the court unanimously stated:

This Court has repeatedly held that courts must be sensitive to the economic realities of a particular transaction, rather than being bound to what first appears to be its legal form. . . . But there are at least two caveats to this rule. First, this Court has never held that the economic realities of a situation can be used to recharacterize a taxpayer's *bona fide* legal relationships. To the contrary, we have held that, absent a specific provision of the Act to the contrary or a finding that they are a sham, the taxpayer's legal relationships must be respected in tax cases. Recharacterization is only permissible if the label attached by the taxpayer to the particular transaction does not properly reflect its actual legal effect: *Continental Bank Leasing Corp. v. Canada*, [1998] 2 SCR 298, at para. 21, per Bastarache J.⁷

In the *Shell* case, the court rejected any significant scope for taxing on the basis of the economic realities⁸ of an arrangement—though 10 years earlier, in *The Queen v. Bronfman Trust*, the court had described that approach as “a laudable trend.”⁹ Moreover, although the court did not explicitly reject any consideration of economic realities, it stated that economic realities could not be used to recharacterize bona fide legal relationships (except where the label used by the taxpayer does not reflect the actual legal effects) or to alter the application of an unambiguous statutory provision.¹⁰ If, however, economic substance is not relevant in characterizing transactions (that is, in determining the facts), it is difficult to see how it could ever

5 *Duke of Westminster*, supra note 3, at 19-21, 24-25, and 30-31.

6 *Ibid.*, at 14-15. As Lord Templeman stated in *Ensign Tankers (Leasing) Ltd. v. Stokes (Inspector of Taxes)*, [1992] 2 All ER 275, at 285 (HL): “I agree with Lord Atkin [in the *Duke of Westminster* case]. Gardeners do not work for Dukes on half wages.”

7 [1999] 3 SCR 622; [1999] 4 CTC 313, at paragraph 39.

8 In our view, the expressions “economic realities” and “economic substance” are synonymous, and in this article we use the two terms interchangeably.

9 [1987] 1 CTC 117, at 128 (SCC).

10 In the *Shell* case, the court said that paragraph 20(1)(c) was clear and unambiguous and therefore there was no role for economic realities. However, in an earlier case, *Tennant v. The Queen*, [1996] 1 CTC 290 (SCC), also involving paragraph 20(1)(c), the court applied the economic realities doctrine in favour of the taxpayer.

be relevant unless an applicable statutory provision referred explicitly to economic substance. Very few provisions do.¹¹

Despite our reading of the decision in *Shell*, at least two justices of the Supreme Court did not consider *Shell* to require complete rejection of the economic realities doctrine. In *The Queen v. Singleton*¹² in 2001, LeBel and Bastarache JJ dissented on the basis that the economic realities of the situation could, and indeed should, have been taken into account for the purposes of paragraph 20(1)(c).

In the first GAAR cases decided by the Supreme Court in 2005,¹³ the court virtually eliminated any significant role for economic substance in determining whether an avoidance transaction is abusive under subsection 245(4). Although the court referred to the explanatory notes to GAAR, which state clearly that “the provisions of the Act are intended to apply to transactions with real economic substance,”¹⁴ the court interpreted this statement to mean that transactions have economic substance if they are executed within “the object, spirit and purpose of the provisions that are relied upon for the tax benefit.”¹⁵ The court rejected any consideration of economic substance unless the statutory provision in question refers to or contemplates economic substance. Even then, according to the court, the absence of economic substance is not sufficient in itself to justify a finding of abuse, but is simply one factor to be considered. Moreover, the court seems to have equated the economic substance doctrine and the business purpose test:

Whether the transactions were motivated by any economic, commercial, family or other non-tax purpose may form part of the factual context that the courts may consider in the analysis of abusive tax avoidance allegations under s. 245(4).¹⁶

Not surprisingly, economic substance has not been an important issue in any subsequent GAAR cases. Even in the recent decision in *Lipson v. Canada*,¹⁷ involving

11 Sections 16 and 76 are examples of provisions that, arguably at least, authorize a court to consider economic realities. Sections 16 and 76 apply “notwithstanding the form or legal effect” of the transaction or arrangement. In *Ford Credit Canada Limited v. The Queen*, 2006 DTC 3424; [2006] 5 CTC 2300 (TCC), Bowman CJ held that where the Act specifically incorporates generally accepted accounting principles, it allows the court to use economic substance as opposed to legal form.

12 2001 DTC 5533; [2002] 1 CTC 121 (SCC).

13 *Canada Trustco Mortgage Co. v. Canada*, 2005 DTC 5523; [2005] 5 CTC 215 (SCC); *Mathew v. The Queen*, 2005 DTC 5538; [2005] 5 CTC 244 (SCC).

14 Canada, Department of Finance, *Explanatory Notes to Legislation Relating to Income Tax* (Ottawa: Department of Finance, June 1998), clause 186.

15 *Canada Trustco*, supra note 13, at paragraph 56.

16 *Ibid.*, at paragraph 66. This interpretation represents a fundamental misreading of GAAR. The purpose of a transaction is relevant under subsection 245(3) for determining whether a transaction is an avoidance transaction. As a result, it seems that Parliament intended something other than that purpose to be considered under subsection 245(4) in determining abuse.

17 2009 SCC 1.

transactions nicknamed “Singleton with a spousal twist,” LeBel J, writing for the majority, did not adhere to his position in *Singleton*. He merely reiterated that “[m]otivation, purpose and economic substance are relevant under s. 245(4) only to the extent that they establish whether the transaction frustrates the purpose of the relevant provisions.”¹⁸

Legal Substance over Legal Form

Economic substance plays almost no role in Canadian income taxation.¹⁹ When the courts refer to the doctrine of substance over form, they mean that legal substance prevails over legal form; and the legal substance of a transaction, going right back to the *Duke of Westminster* case, is the legal rights and obligations created by the parties. The label or nomenclature attached to a document or transaction must be disregarded in favour of its legal substance, but the underlying economic substance is irrelevant.

The legal substance of a transaction is not the same as its economic effects. Thus, a taxpayer is entitled to choose between different transactions that have the same economic results. This principle is simply a restatement of the *Duke of Westminster* principle that a taxpayer is entitled to arrange his affairs to minimize tax.

The doctrine of legal substance over legal form is probably the same as the sham transaction doctrine, although courts have sometimes tried to differentiate between them. Taxing on the basis of legal substance requires courts to ignore labels and determine liability for tax on the basis of the real legal rights and obligations created. Similarly, the sham transaction doctrine requires courts to ignore transactions that give the appearance of creating legal rights and obligations different from the actual legal rights and obligations created. If the two doctrines are different, there are, nevertheless, substantial overlaps between them.

Legal substance is equally binding on taxpayers and the tax authorities.

APPLICATION OF THE DOCTRINE OF SUBSTANCE OVER FORM IN THE DECISIONS OF BOWMAN J

Introduction

Bowman J was known to be both knowledgeable about and respectful of the law. As we illustrate below, throughout his career on the bench, he accepted and applied the law on substance over form consistently and correctly. However, he was also known to be creative, in the sense that he did not treat the law as a collection of inflexible

¹⁸ *Ibid.*, at paragraph 38.

¹⁹ For a comprehensive analysis of the Canadian jurisprudence, see Brian A. Felesky and Sandra E. Jack, “Is There Substance to ‘Substance over Form’ in Canada?” in *Report of Proceedings of the Forty-Fourth Tax Conference*, 1992 Conference Report (Toronto: Canadian Tax Foundation, 1993), 50:1-63.

rules but rather stretched and bent the rules—and occasionally created new ones²⁰—in order to reach what he considered to be the right result. These two strains in Bowman J’s judicial approach also find expression in his decisions concerning substance over form. In the discussion that follows, we show, by reference to his own words, that Bowman J understood that substance over form meant legal substance over legal form. He consistently applied the doctrine in that way, especially in cases involving genuine economic transactions that could be completed by using alternative legal structures. We also examine several decisions in which Bowman J applied a pragmatic approach, considering the overall economic result of the transactions in question. These cases involve transactions that lack an ultimate economic purpose or result other than tax savings. Arguably at least, this approach might be described as an economic substance approach.

“Legal Substance”—General Characterization Principle

Bowman J was cautious about using what he termed the “elusive expression ‘substance over form.’”²¹ In his view, the legal effects of a transaction could not be disregarded and the substance of a transaction could not be equated to its economic effect. In *Continental Bank*, he described the doctrine as follows:

The principle to be deduced from the authorities is this: the essential nature of a transaction cannot be altered for income tax purposes by calling it by a different name. It is the true legal relationship, not the nomenclature that governs.²²

This statement was repeated in several other cases.²³ It is essentially a restatement of the fundamental principle established in the *Duke of Westminster* case that tax is imposed on the basis of the legal rights and obligations created by the parties.

Bowman J found “true legal relationships” to be binding legal relationships entered into by arm’s-length parties,²⁴ such as agreements that were “formal” and “carefully drafted.”²⁵ In the *Continental Bank* case, he quoted Lord Wright in *Duke of Westminster*:

20 See, for example, the creation of the “humane and compassionate” approach to the interpretation of the disability tax credit adopted in *Radage v. R.*, [1996] 3 CTC 2510 (TCC), and subsequently approved by the Federal Court of Appeal in *Jobnston v. R.*, [1998] 2 CTC 262 (FCA).

21 *Continental Bank of Canada et al. v. The Queen*, 94 DTC 1858, at 1869; [1995] 1 CTC 2135, at 2153 (TCC); upheld 98 DTC 6505; [1998] 4 CTC 119 (SCC).

22 *Ibid.*, at 1871; 2158 (TCC).

23 See, for example, *Sussex Square Apartments Limited v. The Queen*, 99 DTC 443; [1999] 2 CTC 2143, at paragraph 28 (TCC); *Farm Business Consultants Inc. v. The Queen*, 95 DTC 200; [1994] 2 CTC 2450 (TCC); *Martin v. The Queen*, 2000 DTC 2615 (TCC); and *RMM Canadian Enterprises Inc. v. R.*, [1998] 1 CTC 2300, at paragraph 18 (TCC).

24 *Carma Developers Ltd. v. The Queen*, 96 DTC 1798, at 1801; [1996] 3 CTC 2029, at 2034 (TCC).

25 *Molinaro v. The Queen*, 98 DTC 1636; [1998] 2 CTC 2871, at paragraph 13 (TCC).

And once it is admitted that the deed is a genuine document, there is in my opinion no room for the phrase “in substance.” Or, more correctly, the true nature of the legal obligation and nothing else is “the substance.”²⁶

To Bowman J, “substance” meant “legal substance”—that is, the “substance . . . which results from the legal rights and obligations of the parties ascertained upon ordinary legal principles.”²⁷ He could see no reason for applying some vague principle of “economic substance” over form,²⁸ except, to some extent, in the context of GAAR.²⁹

Bowman J consistently applied this concept of legal substance in his decisions. In *Continental Bank*, the broad issue was the validity of a transaction by which Central Capital Leasing (“CC”) ultimately became the owner of the leasing assets formerly held by the Continental Bank (“CB”) (which was being wound up) and its subsidiary. The transaction involved the formation of a partnership into which a subsidiary of CB transferred its leasing assets in return for a 99 percent interest in the partnership. The subsidiary transferred that partnership interest to CB, which subsequently sold it to CC. These transactions ultimately permitted CB to treat the gains from the sale as capital gains as opposed to recapture of capital cost allowance, which would have resulted from a direct asset sale. Bowman J found that the legal relationships between CB and CC, which were dealing at arm’s length, were real. Although the relationships were brief, they were not illusory and not shams:

They did not involve calling one legal relationship by another name. Their ultimate purpose was, of course, to transfer the leasing assets from CB’s corporate umbrella to that of CC. That does not, however, warrant a disregard of the legal relations effected to achieve that purpose.³⁰

In *Sussex Square Apartments*, Bowman J rejected the Crown’s argument that the taxpayer’s transactions were in substance sales rather than leasing transactions.

26 *Continental Bank*, supra note 21 (TCC), at 1871; 2157-58, quoting from *Duke of Westminster*, supra note 3, at 31.

27 Bowman J considered the *Duke of Westminster* case to be “firmly entrenched in our law” and quoted the words of Lord Tomlin, Lord Russell of Killowen, and Lord Wright in his decision in *Continental Bank*, supra note 21 (TCC), at 1870-71; 2156-58.

28 *Sussex Square Apartments*, supra note 23, at paragraph 27.

29 For example, in *Evans v. The Queen*, 2005 DTC 1762; [2006] 2 CTC 2009, at paragraph 35 (TCC), Bowman J stated: “The transactions do not lack economic substance. The transactions were real and legally effective. They were not shams. By economic substance I do not intend to import into this criterion a business purpose test. The Supreme Court of Canada did not do so [in *Canada Trustco*]. Rather, I think what was meant was that a genuine change in legal and economic relations took place as the result of the transactions.” In *XCO Investments Ltd. et al. v. The Queen*, 2005 DTC 1731; [2006] 1 CTC 2220, at paragraph 35 (TCC), he stated: “I am aware that economic reality is a concept that under recent jurisprudence is not in favour. Nonetheless it is an important ingredient in a determination of what is reasonable.”

30 *Continental Bank*, supra note 21 (TCC), at 1871. This approach was upheld by the Supreme Court of Canada, supra note 21.

The taxpayer carried on the business of leasing real property. It leased property and then subleased the property for a term that ended on the day before the expiry of the head lease. The transactions were advertised as sales of freehold interests. The taxpayer's financial statements treated the profit as a gain on the sale of leasehold interests. For tax purposes, the taxpayer treated the transactions as leasing transactions, giving rise to prepaid rent, eligible for a reserve deduction under paragraph 20(1)(m). Bowman J, after quoting his reasons in *Continental Bank*, stated:

Once it is determined that the legal relationships are what they purport to be the court must give effect to them. I find that the legal relationships in this case are valid, binding and real. . . . It is trite law that there is a fundamental legal difference between an assignment of a lease, where the assignor retains no reversion, and a sublease where the lessee sublets a portion of the term to a sublessee and retains a reversionary interest.³¹

He continued:

The legal difference between an assignment and a sublease results as well in a difference for income tax purposes.³²

In *Carma Developers Ltd. v. The Queen*,³³ the taxpayer ("CDL") was a wholly owned subsidiary of Carma Corporation ("CL"). CL's shares were publicly traded. CDL was CL's "principal operating arm" in Canada, and its business consisted of the development and sale of residential and commercial real estate. In the early 1980s, CDL was heavily indebted to several classes of creditors and was suffering severe financial difficulties. CDL, CL, and the creditors worked out a plan and sought protection under the Companies' Creditors Arrangement Act.³⁴ According to the plan, three classes of creditors assigned to CL the unsecured portion of the indebtedness owed to them by CDL in exchange for shares of CL. After this transaction, the creditors owned about 75 percent of the shares of CL, which in turn owned the debts of CDL assigned to it by the creditors. The minister considered the debts to be "extinguished" in substance. Bowman J disagreed:

Here we have arm's length parties entering into binding legal relationships and I cannot conclude that these legal relationships, under which the debts were legally assigned and the obligations of CDL continued to exist, as contemplated by a plan approved by the Court of Queen's Bench of Alberta, were simply a masquerade for a forgiveness of debt. Indeed the assignment of the debts, the issuance of shares and the continued

31 *Sussex Square Apartments*, supra note 23, at paragraphs 29 and 31.

32 *Ibid.*, at paragraph 32.

33 *Supra* note 24.

34 RSC 1985, c. C-36.

enforceability of the debts by CL against CDL were integral and essential components in the efficacy of the plan and in its acceptability to the creditors.³⁵

Similarly, in *Martin v. The Queen*,³⁶ Bowman J held that the taxpayers, who were skilled craftsmen, were entitled to incorporate their services and to be treated as employees of the company. In the absence of sham, the corporate form could not be ignored.

Bowman J consistently held that the doctrine of legal substance over legal form applied equally to the taxpayer and the minister. In *Molinaro*, for example, he rejected the taxpayer's argument that the tax consequences of his transactions should be based on their "substance" (consulting fees) rather than their "form" (salary):

[I]f one makes one's bed in a particular way one should—particularly if one has had help from professional accountants and lawyers in making the bed—be prepared to lie in it.³⁷

By the same token, the minister must take the legal relations between the parties as he finds them.³⁸

Bowman J did not specifically address the relationship between substance over form and sham; nor did he, in any case, ever apply the sham doctrine. However, in *Continental Bank*, he referred to the sham doctrine in the following words:

When something is a sham the necessary corollary is that there is behind the legal façade a different real legal relationship. If the legal reality that underlies the ostensible legal relationship is the same as that which appears on the surface, there is no sham.³⁹

This description of sham is almost identical to the description of the legal substance principle discussed above.

In summary, for Bowman J, terms such as "substance over form" and "sham" were merely rhetorical devices that did not assist in drawing the difficult distinction between legitimate tax planning and abusive tax avoidance. Using characteristically colourful language, in *Continental Bank*, he wrote:

In cases of this type expressions such as sham, cloak, alias, artificiality, incomplete transaction, simulacrum, unreasonableness, object and spirit, substance over form, *bona fide* business purpose, step transaction, tax avoidance scheme and, no doubt, other emotive and, in some cases, pejorative terms are bandied about with a certain abandon.

35 Supra note 24, at paragraph 18.

36 *Martin*, supra note 23.

37 *Molinaro*, supra note 25, at paragraph 27. See also *Farm Business Consultants*, supra note 23.

38 See *Farm Business Consultants*, supra note 23, at paragraph 33; and *Continental Bank*, supra note 21 (TCC), at 1866, 2149: "If they [binding legal relations] are legally effective as between the parties they bind the Minister."

39 Supra note 21 (TCC), at 1868; 2152.

Whatever they may add, if anything, to a rational analysis of the problem, apart from a touch of colour in an otherwise desiccated landscape, they do not exist in separate watertight compartments. They are all merely aspects of an attempt to articulate and to determine where “acceptable” tax planning stops and fiscal gimmickry starts.⁴⁰

Pragmatic Approach in Tax-Avoidance Cases

While Bowman J generally saw no reason to ignore binding legal relationships or the legal substance of a transaction, he was not prepared to allow a legal “masquerade” or “fiscal gimmickry” to defeat the purpose of the legislation. To borrow the language used in a 2004 Hong Kong decision, Bowman J often “viewed [transactions] realistically” and applied to them “the relevant statutory provisions construed purposively.”⁴¹

A good example of this approach is the second GAAR case decided by the Tax Court, *RMM Canadian Enterprises Inc. v. R.*⁴² In that case, Bowman J dealt with a cross-border surplus-stripping transaction. To avoid withholding tax on a deemed dividend from the liquidation of its Canadian subsidiary (“EL”), a US parent corporation (“EC”) sold the shares of the subsidiary to a Canadian corporation (“RMM”) set up for that sole purpose. The shares of RMM were owned by a partnership of three individuals who were unrelated to EC; however, one of the individuals was a partner in EC’s law firm and a friend of its general counsel. EC guaranteed that the lease receivables of EL would be equal to a minimum amount and reimbursed half of RMM’s legal costs. Lease receivables received by EL in excess of the minimum guaranteed amount were paid to EC.

The effect of the transactions was to convert a deemed dividend into a capital gain, which the taxpayers argued was not subject to Canadian tax because of the provisions of the Canada-US tax treaty.⁴³ The Crown argued that there was a deemed

40 Ibid., at 1866-67; 2150.

41 Ribeiro PJ in *Collector of Stamp Revenue v. Arrowtown Assets Ltd.*, [2004] 1 HKLRD 77, at paragraph 35 (Hong Kong CA): “The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically.” This sentence was quoted with approval by Lord Nichols in *Barclays Mercantile Business Finance Limited v. Mawson*, [2004] UKHL 51, at paragraph 36 (HL).

42 *RMM Canadian*, supra note 23. Note, however, that in *Evans*, supra note 29 (a later GAAR case), Bowman J held that a series of transactions designed to transfer corporate profits to the shareholders was not subject to GAAR. He remarked that his decision in *RMM Canadian* was an early GAAR case, and at that time he did not have the benefit of the Supreme Court’s guidance in *Canada Trustco*: “If we had had the benefit of the Supreme Court of Canada’s views, our analysis might have been quite different” (at paragraph 34). In *Evans*, he seemed to regard surplus stripping transactions as having economic substance. Nevertheless, his pragmatic approach in *RMM Canadian* was consistently applied in other cases discussed in this section; consequently, the *Evans* decision should probably be considered an aberration.

43 The Convention Between Canada and the United States of America with Respect to Taxes on Income and on Capital, signed at Washington, DC on September 26, 1980, as amended by the protocols signed on June 14, 1983, March 28, 1984, March 17, 1995, and July 27, 1997 (herein referred to as “the treaty”).

dividend under either subsection 84(2) or section 212.1 of the Act, or alternatively that GAAR applied. Bowman J found for the minister on all three issues.

Under subsection 84(2), if property is distributed or appropriated “in any manner whatever” for the benefit of shareholders on the liquidation, discontinuance, or reorganization of the business of a corporation, a deemed dividend is considered to arise to the extent that the amount distributed exceeds the paid-up capital of the shares. Bowman J did not ignore the legal form of the transaction, which was a sale of shares, or treat the transaction as a sham. It is worthwhile to quote him at length on this point:

What of the fact that there was a sale of shares? Of course there was a sale. It was not a sham. “Sale of shares” is a precise description of the legal relationship. Nor do I suggest that the doctrine of “substance over form” should dictate that I ignore the sale in favour of some other legal relationship. That is not what the doctrine is all about. Rather, it is that the essential nature of a transaction cannot be altered for income tax purposes by calling it by a different name. It is the true legal relationship, not the nomenclature, that governs. The Minister, conversely, may not say to the taxpayer, “You used one legal structure but you achieved the same economic result as that which you would have had if you used a different one. Therefore I shall ignore the structure you used and treat you as if you had used the other one.”⁴⁴

Instead, Bowman J insisted that the sale of shares should be put “in its proper perspective in the transaction as a whole.”⁴⁵ He gave the words “in any manner whatever” in subsection 84(2) a broad meaning to ensure that the provision had some integrity:

I do not think that the brief detour of the funds through RMM stamps them with a different character from that which they had as funds of EL [the Canadian subsidiary] distributed or appropriated to or for the benefit of EC [the US parent].⁴⁶

In terms of section 212.1, the crucial issue was whether the US parent corporation and RMM Canadian were dealing at arm’s length. Although they were not related, Bowman J found that they were not dealing at arm’s length, except for the purpose of determining RMM’s fee, because RMM was merely an instrumentality or facilitator in the series of transactions.

Further, Bowman J took the same type of pragmatic approach to the interpretation of GAAR. Although he did not ignore the sale of shares for the purposes of the treaty, he held that article XIII of the treaty applied only to “a genuine alienation, and not one that is made to an accommodation party as an integral part of a distribution of surplus.”⁴⁷ He also held that the definition of “dividends” in article X of

44 *RMM Canadian*, supra note 23, at paragraph 18.

45 *Ibid.*, at paragraph 19.

46 *Ibid.*

47 *Ibid.*, at paragraph 63.

the treaty, which, according to the commentary on the OECD model convention,⁴⁸ could include disguised distributions, was broad enough to include the payments received by EC.

The same type of approach—viewing transactions realistically and interpreting statutory provisions purposively—can also be seen in several decisions of Bowman J in cases involving the deductibility of interest. In *Mark Resources Inc. v. Canada*,⁴⁹ the taxpayer, a Canadian corporation, engaged in a series of transactions with the effect of allowing it to deduct the losses of its US subsidiary. The US subsidiary had accumulated losses and had ceased to carry on business. The taxpayer borrowed money from a Canadian bank and used the funds to make a contribution to the capital of the US subsidiary. The US subsidiary in turn used the funds to acquire a term deposit with the same bank that had made the initial loan to the taxpayer. The taxpayer claimed that the interest on the loan was deductible because the borrowed money was used for the purpose of earning income in the form of increased dividends from its US subsidiary. The Crown argued that the direct use of the funds—to contribute capital to the US subsidiary—did not produce any income, and that the effect on dividends was too remote.

The key issue was the proper interpretation of the purpose test in paragraph 20(1)(c), which refers to “borrowed money used for the purpose of earning income from a business or property.” Bowman J rejected the positions of both parties because they adopted a narrow interpretation of the term “purpose”:

[Both positions are] based on a logical fallacy in that they attribute to one event in the series a purpose based upon the immediately subsequent event. The true purpose is a broader one that subsumes all of the subordinate and incidental links in the chain. The overriding ultimate economic purpose for which the borrowed funds were used was to permit the U.S. losses of PDI [the US subsidiary] to be, in effect, imported into Canada and deducted in computing PDL's [the Canadian corporation's] income.⁵⁰

He went on:

The earning of dividend income cannot, however, in my opinion, be said to be the real purpose of the use of the borrowed funds. Theoretically one might, in a connected series of events leading to a predetermined conclusion, postulate as the purpose of each event in the sequence the achievement of the result that immediately follows but in determining the “purpose” of the use of borrowed funds within the meaning of paragraph 20(1)(c) the court is faced with practical considerations with which the pure theorist is not concerned. That purpose—and it is a practical and real one, and in no way remote, fanciful or indirect—is the importation of the losses from the U.S.⁵¹

48 Organisation for Economic Co-operation and Development, *Model Tax Convention on Income and on Capital* (Paris: OECD) (looseleaf), commentary on article 10, paragraph 28.

49 [1993] 2 CTC 2259 (TCC).

50 *Ibid.*, at 2268.

51 *Ibid.*, at 2270.

Two aspects of Bowman J's analysis are worth noting. First, he considered the entire series of transactions in order to determine the purpose of the use of the borrowed funds. Second, he understood the commercial and tax effects of the series. His approach reflects a purposive approach to the interpretation of paragraph 20(1)(c). Parliament did not intend that taxpayers should be able to misuse paragraph 20(1)(c) to manufacture tax savings in circumstances where there is no reasonable prospect of any pre-tax profit. As Bowman J stated,

[i]t is true that the overall economic result, if all of the elements of the plan work, is a net gain to the appellant, but this type of gain is not from the production of income but from a reduction of taxes otherwise payable in Canada.⁵²

CONCLUSION

Bowman J's decisions on substance over form shaped the development of Canadian law on this subject. His articulation of the legal substance principle in the *Continental Bank* case was adopted by the Supreme Court. His other decisions dealing with substance over form⁵³ were universally upheld by the Federal Court of Appeal. In cases involving commercial transactions that can be undertaken in alternative legal forms, Bowman J consistently applied the doctrine of legal substance over legal form. In cases involving transactions that lacked an underlying economic purpose or result other than tax savings, he often looked beyond the mere legal substance of the transactions if the language of the relevant statutory provisions allowed him to do so. In *Mark Resources*, for example, he considered the entire series of transactions for the purposes of determining the overall economic effect or result. The Supreme Court has since rejected Bowman J's approach in that case. In *Singleton*⁵⁴ and *Ludmer c. Ministre du Revenu national*,⁵⁵ the Supreme Court adopted a narrow, blinkered, literal approach to the interpretation of paragraph 20(1)(c) that defies common sense. According to the Supreme Court, any purpose, even an ancillary purpose, to earn gross revenue is sufficient to satisfy the purpose test in paragraph 20(1)(c); moreover, the fact that the use of the borrowed funds is part of a series cannot be considered in determining the purpose of the use of the borrowed funds. Although in the recent *Lipson*⁵⁶ case the Supreme Court adopted an "overall result" test in applying subsection 245(4), it did not overrule or limit the result in *Singleton*. In our view, Bowman J's realistic appreciation of the transactions, coupled with a purposive interpretation of the statute, is far preferable to the Supreme Court's approach to the interpretation of paragraph 20(1)(c), and of the Act generally.

52 Ibid.

53 See *Carma Developers*, supra note 24; *Farm Business Consultants*, supra note 23; *Molinaro*, supra note 25; and *Sussex Square Apartments*, supra note 23.

54 Supra note 12.

55 [2002] 1 CTC 95 (SCC).

56 Supra note 17.

