Statutory Interpretation and the General Anti-Avoidance Rule: A Practitioner's Perspective

John R. Owen*

PRÉCIS

La disposition générale anti-évitement a reçu la sanction royale le 13 septembre 1988, mais les premières indications de la manière dont les tribunaux l'appliqueront n'ont été perçues que récemment. Selon la décision *McNicholl et al. v. The Queen*, il semble que la Cour de l'impôt privilégie une analyse subjective plutôt qu'une analyse plus objective fondée sur les dispositions contenues dans la Loi de l'impôt sur le revenu et sur le but ou l'intention qui peut raisonnablement être tiré de ces dispositions.

Dans cet article, l'auteur examine les limites de la DGAÉ, en mettant un accent particulier sur l'exception contenue dans le paragraphe 245(4). Il conclut que, bien que la définition des termes « avantage fiscal » et « évitement fiscal » soit très large, la portée de la DGAÉ est limitée par l'exception contenue dans le paragraphe 245(4). L'auteur soutient qu'afin d'obtenir un degré raisonnable de certitude quant aux cas auxquels s'applique la DGAÉ, le fait de savoir si une opération précise donne lieu à un abus d'une disposition contenue dans la Loi ou à un abus de l'ensemble des dispositions contenues dans la Loi doit être établi en appliquant aux dispositions en cause les règles d'interprétation du texte de la loi qui s'appliquent généralement aux lois fiscales.

ABSTRACT

The general anti-avoidance rule (GAAR) received royal assent on September 13, 1988, but we have only recently seen the first indications of how the courts will apply this rule. The decision in *McNichol et al. v. The Queen* suggests that the Tax Court may be favouring a subjective analysis over a more objective approach based on the provisions of the Income Tax Act and the purpose or intention that can reasonably be drawn from those provisions.

In this article, the author considers the boundaries of the GAAR with particular emphasis on the exception in subsection 245(4). He concludes that while the definitions of "tax benefit" and "tax avoidance" cast a very

* Of Thorsteinssons, Toronto.

broad net, the scope of the GAAR is limited by the exception in subsection 245(4). The author argues that in order to obtain a reasonable degree of certainty as to when the GAAR applies, the question whether a particular transaction results in a misuse of a provision of the Act or an abuse having regard to the provisions of the Act read as a whole should be determined by applying to the provisions in issue the rules of statutory interpretation generally applicable to tax statutes.

INTRODUCTION

The introduction of the general anti-avoidance rule[1] (GAAR) in September 1988 was preceded and followed by a flurry of analysis of the new rule.[2] However, since 1989, relatively little has been written on the GAAR.[3] The GAAR effectively prevents a taxpayer from enjoying a benefit resulting from an avoidance transaction unless the taxpayer can demonstrate that the transaction did not result in a misuse of a provision of the Act or an abuse of the Act read as a whole. The fundamental difficulty with the application of the rule lies in determining first what constitutes an avoidance transaction and then whether the transaction is a misuse or abuse. In this article, I will consider the possible approaches to the application of the GAAR with particular emphasis on the "misuse or abuse" concept contained in subsection 245(4) of the Act.

I will come to the conclusion that the GAAR casts a very wide net with respect to transactions that qualify as "avoidance transactions." Despite

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[1] Section 245 of the Income Tax Act, RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as "the Act"). Unless otherwise stated, statutory references in this article are to the Act and the regulations thereunder (herein referred to as "the Regulations") as amended to January 5, 1998.

[2] See, for example, Brian J. Arnold and James R. Wilson, "The General Anti-Avoidance Rule—Part 1" (1988), vol. 36, no. 4 *Canadian Tax Journal* 829-87, ". . . Part 2" (1988), vol. 36, no. 5 *Canadian Tax Journal* 1123-85, ". . . Part 3" (1988), vol. 36, no. 6 *Canadian Tax Journal* 1369-1410; Michael Hiltz, "Section 245 of the Income Tax Act," in *Report of Proceedings of the Fortieth Tax Conference*, 1988 Conference Report (Toronto: Canadian Tax Foundation, 1989), 7:1-9; Jacques Sasseville, "Implementation of the General Anti-Avoidance Rule," in *Income Tax Enforcement, Compliance, and Administration*, 1988 Corporate Management Tax Conference (Toronto: Canadian Tax Foundation, 1988), 4:1-16; David A.G. Birnie, "Living with GAAR: The Effect on Tax Practice," ibid., 5:1-16; David A. Dodge, "A New and More Coherent Approach to Tax Avoidance" (1988), vol. 36, no. 1 *Canadian Tax Journal* 1-22; Howard J. Kellough, "A Review and Analysis of the Redrafted General Anti-Avoidance Rule" (1988), vol. 36, no. 1 *Canadian Tax Journal* 23-78; and Joel Nitikman, "Is GAAR Void for Vagueness?" (1989), vol. 37, no. 6 *Canadian Tax Journal* 1409-47.

[3] Three exceptions are Howard J. Kellough, "GAAR—Are There Circumstances When It Will Not Have Application?" in *1994 British Columbia Tax Conference* (Toronto: Canadian Tax Foundation, 1994), tab 5; Richard G. Tremblay, "GAAR and Treaty Shopping," in *Report of Proceedings of the Forty-Seventh Tax Conference*, 1995 Conference Report (Toronto: Canadian Tax Foundation, 1996), 38:1-42; and Daniel Sandler, "The General Anti-Avoidance Rule: A Prognosis," in *1996 Ontario Tax Conference* (Toronto: Canadian Tax Foundation, 1996), tab 14.

the long-established principles in Canadian income tax law that there is no general business purpose test and that a taxpayer is entitled to arrange his affairs so as to pay the least tax necessary, the GAAR operates to classify as an avoidance transaction any transaction, or any one of a series of transactions, that is structured to take advantage of a particular provision of the Act—even if that is only one of the transaction's purposes. It should therefore, in theory, be a relatively straightforward task for the courts to determine when a particular transaction will constitute an avoidance transaction. The more difficult task faced by the courts is the assessment of whether the avoidance transaction constitutes a misuse of a provision of the Act or an abuse having regard to the provisions of the Act read as a whole. I will argue that it is incumbent upon the courts to develop an approach to the application of the GAAR that both preserves the function and purpose of the rule and provides taxpayers with a reasonable degree of certainty as to the circumstances in which it will apply. In particular, the GAAR should not be used to replace legislative process with judicial fiat.[4]

ANALYSIS OF THE GAAR

The operative parts of the GAAR are in subsections 245(1), (2), (3), and (4). Subsection 245(1) defines "tax benefit," "tax consequences," and "transaction," while subsection 245(3) states what constitutes an avoidance transaction. Where an avoidance transaction exists, subsection 245(2) allows the minister to determine the tax consequences so as to deny the tax benefit, unless the exception in subsection 245(4) applies.

Based on this statutory scheme, the questions to be asked in determining whether the GAAR will apply in any given circumstance are as follows:

1) Is there a "transaction" as defined in subsection 245(1)? If not, the GAAR will not apply.

2) If there is a transaction, does it result in a "tax benefit" as defined in subsection 245(1)? If not, the GAAR will not apply.

3) If there is a tax benefit, is the transaction an "avoidance transaction" as defined in subsection 245(3)? If not, the GAAR will not apply.

4) If the transaction is an avoidance transaction, does it result in a misuse of any provision of the Act or an abuse having regard to the provisions of the Act read as a whole? If not, the GAAR will not apply.

Transaction or Series of Transactions

In order for the GAAR to apply, there must be a transaction. The word "transaction" is defined to include "an arrangement or event." Because

[4] For a concise review of the issues surrounding the use of general anti-avoidance provisions, see Peter Nias and Gareth Amdor, "Tax Avoidance Unwrapped and Redefined" (December-January 1998), 10 *International Tax Review* 45-46.

the definition is inclusive, it is not exhaustive and reference must be had to the ordinary or plain meaning of the word to determine its scope.[5]

In *MNR v. Dufresne*, Mr. Justice Jackett stated in the context of old subsection 245(2) that "the word 'transaction' or 'operation' is used in the widest possible sense as meaning any act having operative effect in relation to a business or property."[6] Similarly, in *MNR v. Granite Bay Timber Co. Ltd.*, Mr. Justice Thurlow stated:

> In my opinion, the expression "one or more transactions" in s. 8(3) is wide enough to embrace all types of voluntary processes or acts by which property of one person may become vested in another without regard for the reason or occasion for such processes or acts and regardless also of whether the process is undertaken or the act is done for consideration in whole or in part or for no consideration at all. It may not be wide enough to embrace a transmission or devolution upon death but as used in s. 8(3), I think it is wide enough to include any voluntary transfer of property between existing persons falling within the class referred to as "persons not dealing at arm's length."[7]

In light of the approach taken by the Exchequer Court in the above situations, it is likely that a court would give the word "transaction" as employed in section 245 a very broad meaning. Certainly, the word should extend to any voluntary transfer or dealing in respect of a business or property. It should be noted, however, that the above definitions require some form of action on the part of the taxpayer. To the extent that an event transpires without any direct or indirect action or involvement by the taxpayer, it may not be viewed as a "transaction" under these common law definitions. The definition employed in subsection 245(1) is broader in that it includes any "event," which conceivably would include the types of events described by Mr. Justice Thurlow in *Granite Bay* as not falling within the common law definition.

Subsection 248(10) provides that for the purposes of the Act, a reference to a series of transactions or events is deemed to include any related transactions or events completed in contemplation of the series. This extension of the concept of a "series of transactions" may have application to the definition of "avoidance transaction," which is discussed below.[8]

"Tax Benefit"

Subsection 245(1) defines a "tax benefit" as a "reduction, avoidance or deferral of tax or other amount payable under this Act or an increase in a refund of tax or other amount under this Act."

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[5] *CBA Engineering Ltd. v. MNR*, 71 DTC 5282; [1971] CTC 504 (FCTD); *Nova v. Amoco Canada et al.*, [1981] 2 SCR 437; and *The Queen v. Mansour*, [1979] 2 SCR 916.

[6] 67 DTC 5105, at 5110; [1967] CTC 153, at 162 (Ex. Ct.).

[7] 58 DTC 1066, at 1071; [1958] CTC 117, at 128 (Ex. Ct.), aff'd. without written reasons 59 DTC 1262 (SCC).

[8] The phrase "series of transactions" as employed in subsection 55(2) was considered by the Tax Court in *Les Industries SLM Inc. v. MNR*, [1996] 2 CTC 2572.

One possible interpretation of this definition is that it assumes that for every transaction there is a normal or proper amount of tax that is payable under the Act,[9] and it should be possible to determine whether there is a reduction, avoidance, or deferral of that amount.[10] It could be argued on that basis that the GAAR cannot apply unless a normal or proper amount of tax can be quantified in respect of a particular transaction, and that the tax consequences of a transaction structured to take advantage of, for example, a relieving provision in the Act can never result in a tax benefit. The reason is that the proper amount of tax payable must take into account the application of the relieving provision. Provided that the transaction giving rise to the application of the relieving provision is not a sham, and assuming that the application of the relieving provision is clear, it is reasonable to conclude that the taxpayer has not received a tax benefit since the intended amount of tax has been imposed.

Consider, for example, the relief provided by the intercorporate dividend deduction in subsection 112(1). A corporation that receives a dividend from a taxable Canadian corporation in circumstances such that it is not subject to any of the restrictions on deductibility in the Act[11] has reduced or avoided tax that would otherwise be payable under the Act were it not for the deduction provided by subsection 112(1). However, it is arguable that the reduction or avoidance cannot properly be viewed as a "tax benefit" because there has in fact been no reduction or avoidance of the amount of tax that would ordinarily be payable under the Act as a consequence of the receipt of a dividend in the particular circumstances.

On the other hand, if a particular transaction allowed a corporation to receive a tax-free intercorporate dividend in circumstances where one could reasonably conclude that one of the anti-avoidance provisions in the Act was intended to apply but did not because of steps taken by the taxpayer to achieve this result, then it would be reasonable to conclude that the corporation had received a "tax benefit."

This approach to the interpretation of the definition of "tax benefit" would require a court to assess at the outset whether the tax reduction, avoidance, or deferral obtained by the taxpayer was intended in the particular circumstances. Since such an analysis could preclude a court from considering whether the transaction in question is an "avoidance transaction,"[12] and since a similar analysis appears to be required by the definition of "avoidance transaction" and by subsection 245(4), it is not appropriate for the courts to adopt such an approach. Rather, the courts should conclude that a tax benefit arises in any circumstance where the transaction

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[9] Arnold and Wilson, supra footnote 2, at 1154-55.

[10] This is the approach taken by Judge Bonner in *McNichol et al. v. The Queen*, 97 DTC 111; [1997] 2 CTC 2088 (TCC), discussed later in the article.

[11] For example, subsections 55(2), 112(2.1), (2.2), and (2.4).

[12] The reason is that the definition of "avoidance transaction" contemplates the existence of a tax benefit. If there is no tax benefit, there can be no avoidance transaction.

in question results in a reduction, avoidance, or deferral of tax whether or not that result flowed naturally under the Act as a consequence of the transaction. This issue is considered further in the next section.

"Avoidance Transaction"

General

"Avoidance transaction" is defined in subsection 245(3) as any transaction standing alone or any transaction that is part of a series of transactions that, but for section 245, would result in a tax benefit, "unless the transaction may reasonably be considered to have been undertaken or arranged primarily for *bona fide* purposes other than to obtain the tax benefit." "Bona fide" means "genuine" or "authentic."[13]

Purpose

The definition of "avoidance transaction" and, in particular, the exception to that definition requires the court to consider why the transaction was undertaken or arranged. In other words, the court must look to the purpose of the transaction: was the principal purpose to obtain a tax benefit? If not, it is not an "avoidance transaction."

It is not clear whether the "purpose" of a particular transaction is determined on an objective or a subjective basis. The better view is that subsection 245(3) is intended to establish a purpose test that is not based exclusively on the taxpayer's state of mind. This view is supported by the use of the phrase "may reasonably be considered."[14]

An example of the approach that a court may take to this issue is found in *McAllister Drilling Limited et al. v. The Queen*.[15] In that case, the Federal Court—Trial Division considered whether one of the main reasons for the separate existence of three corporations was to reduce the amount of taxes that would otherwise have been payable if their businesses had been carried on by only one corporation. In the course of its judgment, the court made the following statements:

> The question for determination is one of fact arising pursuant to section 247(3)(b)(ii) of the Act. It is whether, on a balance of probabilities, the Direction should be vacated. This will occur only if the plaintiff satisfies the onus of demonstrating that none of the main reasons for the separate existence of Drilling, Holdings and Waterwells was the reduction of taxes. . . .

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[13] *Webster's Third New International Dictionary (Unabridged)* defines "bona fide" as follows: "made in good faith without fraud or deceit . . . legally valid . . . sincere . . . made with earnest or wholehearted intention . . . genuine."

[14] Revenue Canada may argue that these words give rise to a strictly objective test that requires an assessment of the result of the transaction and not the mental state of the taxpayer. In my view, that approach is not supported by the words of the provision. See *Wu v. The Queen*, [1996] 3 CTC 2879 (TCC).

[15] 95 DTC 5001; [1994] 2 CTC 211 (FCTD).

> Much has been submitted about the onus borne by the plaintiffs. Counsel for Her Majesty the Queen ("Crown Counsel") relies on the decision of Mr. Justice Marceau in the case of *Her Majesty the Queen v. Covertite Limited*, [1981] C.T.C. 464 (F.C.T.D.) [81 DTC 5353]. In that case, His Lordship found that the plaintiff's denial of any tax motivation for their creation of separate corporations and their explanations for the existence of the separate companies were not credible. He therefore determined that no weight could be given to a taxpayer's mere denial of tax motivation as a main purpose. . . .
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> I am satisfied that this approach is the correct one in the majority of cases because, normally, the taxpayers' credibility will be in issue. However, Crown Counsel conceded in his opening statement and repeated in his final argument that the credibility of the plaintiffs and their witnesses was not in issue. *In the somewhat unusual circumstances of this case where credibility is conceded, if I agree that the taxpayers' evidence is credible, it will not require the bolstering or corroboration afforded by external facts* [emphasis added].[16]

Establishing an overall genuine business purpose is not sufficient, however, because subsection 245(3) refers not only to "a transaction" but also to a transaction that is undertaken as part of "a series of transactions." As noted above, subsection 248(10) provides that for the purposes of the Act, a reference to a series of transactions or events is deemed to include any related transactions or events completed in contemplation of the series. Accordingly, a particular transaction may be viewed as an avoidance transaction if the transaction itself is effected in order to obtain a "tax benefit" or if the transaction is part of a series of transactions (which includes all related transactions or events completed in contemplation of the series) that results in the aggregate in a tax benefit and the particular transaction is not undertaken or arranged primarily for bona fide purposes other than to obtain the tax benefit.

The question, then, is whether each of the events or arrangements constituting the series of transactions can reasonably be considered to have been undertaken or arranged primarily for bona fide purposes other than to reduce or avoid Canadian income tax. In addressing this question, the court is required to consider each step in a series of transactions in order to determine whether any such step constitutes an avoidance transaction.

Pursuant to the definition of "avoidance transaction," in any circumstance where a tax benefit results from a series of transactions, an avoidance transaction will exist if any transaction within the series is not undertaken or arranged primarily for bona fide purposes other than to obtain the tax benefit.

Requirement for a Tax Benefit

An issue raised by the incorporation of the definition of "tax benefit" in the definition of "avoidance transaction" is whether this inclusion is

[16] Ibid., at 5002; 213-14.

intended to provide a means for a court to limit the scope of the latter definition. Specifically, in order for a transaction to be an avoidance transaction, the transaction must result in a tax benefit but for the application of the GAAR. As noted above, one possible interpretation is that a tax benefit does not exist in any case where the reduction, avoidance, or deferral of tax is mandated by a provision of the Act. This interpretation leaves the court with the option of finding that a particular transaction does not result in a tax benefit and thus may provide the court with a means of limiting the circumstances in which a transaction can be considered an avoidance transaction.

The possible requirement for a two-pronged analysis in the definition of "avoidance transaction" could be explained on the basis that some provisions of the Act are intended to bring about a particular result regardless of the motivation of the taxpayer. For example, subsection 107(2) allows a personal trust to transfer assets to a Canadian resident beneficiary on a tax-deferred basis. If the trustee of a personal trust effected such a distribution for the sole purpose of avoiding the 21-year deemed disposition rule, the motivation for the distribution would be to defer tax and the transaction by which this deferral was accomplished would be the distribution of assets under subsection 107(2).

A court can take two views of this transaction. Either it can conclude that there is no tax benefit because the tax deferral was precisely as intended by the Act (based on the clear wording of subsection 107(2) and the scheme in which it is placed), or it can conclude that there was a tax benefit and that the transaction was not undertaken for bona fide purposes other than to obtain the tax benefit (since the tax benefit was the sole reason for undertaking the transaction). In the latter case, the transaction would be an "avoidance transaction," and the trust and/or beneficiary would have to rely on the exception in subsection 245(4) to avoid the application of the GAAR.

In my view, a court should take the latter approach because the definitions of "tax benefit" and "avoidance transaction" do not provide any statutory guidelines for determining whether a transaction should be excluded from the definition of "avoidance transaction" other than the "primarily for *bona fide* purposes" test. On the other hand, subsection 245(4) sets down a statutory standard that the courts can apply to assess whether a particular avoidance transaction should be subject to the GAAR. In the example above, a court should have little difficulty concluding that the transfer of property out of the trust does not constitute a misuse or abuse.[17] It is not at all clear that a court could articulate why the transaction does not result in a tax benefit or is not an avoidance transaction. In my view, any attempt to do so can only result in confusion as to the meaning of these phrases.

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[17] The methodology that a court might use to reach this conclusion is considered later in this article.

Conclusion

If the above argument is accepted, the definition of "avoidance transaction" casts a very broad net that will undoubtedly sweep in many transactions that would not ordinarily be considered avoidance transactions within the plain meaning of that expression. The taxpayer must then rely on the exception in subsection 245(4) to avoid the application of the GAAR.

"Misuse or Abuse"

General

Subsection 245(4) potentially plays a pivotal role in the application of the GAAR. Pursuant to subsection 245(4), subsection 245(2) does not apply to any transaction "where it may reasonably be considered that the transaction would not result directly or indirectly in a misuse of the provisions of this Act or an abuse having regard to the provisions of this Act . . . read as a whole." Subsection 245(4) may be viewed as the last line of defence against the application of the GAAR.

Arnold and Wilson explain the rationale behind subsection 245(4) as follows:

> The exception in subsection 245(4) can perhaps be better appreciated by recognizing that it was introduced in the December 16, 1987 version of the rule to replace the purpose clause in the original version. The purpose clause stated that the general anti-avoidance rule was intended "to counter artificial tax avoidance." Tax professionals criticized the purpose clause on the basis that it did not afford a substantive exemption from the rule for those transactions that resulted in tax avoidance but were in accordance with the object and spirit of the Act or were inoffensive in tax policy terms. Subsection 245(4) represents a response to this criticism.[18]

The explanatory notes that accompanied the introduction of section 245 also provide some insight into the intended purpose of subsection 245(4):

> New section 245 replaces existing subsection 245(1), which applies only to transactions resulting in deductions relevant in computing income. The wording of the new provision is intended to encompass all types of abusive and artificial tax avoidance schemes including the types to which existing subsection 245(1) already applies. It is an important supplement to the tools that may be used to counter abusive tax avoidance transactions.
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> Transactions that comply with the object and spirit of other provisions of the Act read as a whole will not be affected by the application of this general anti-avoidance rule. For example, a transaction that qualifies for a tax-free rollover under an explicit provision of the Act, and that is carried out in accordance not only with the letter of that provision but also with the spirit of the Act read as a whole, will not be subject to new section 245. However, where the transaction is part of a series of transactions designed to avoid tax and results in a misuse or abuse of the provision that allows a tax-free rollover, the rule may apply.[19]

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[18] Arnold and Wilson, supra footnote 2, at 1163-64.

[19] Canada, Department of Finance, *Explanatory Notes to Legislation Relating to Income Tax* (technical notes to Bill C-139) (Ottawa: the department, June 1988), clause 186.

These statements suggest that the wording of subsection 245(4) was intended to convey the concept that a particular transaction will not give rise to the application of subsection 245(2) where the result achieved by the taxpayer is consistent with the object and spirit of the provision(s) giving rise to that result and with the object and spirit of the Act read as a whole.

In light of the foregoing, the question to be asked in determining whether a particular transaction results in a misuse of a provision of the Act or an abuse of the Act read as a whole is whether the result is consistent with the object and spirit of the provision and with the object and spirit of the Act read as a whole. Stated another way, the court must endeavour to ascertain the intent and purpose of the particular provision and of the Act read as a whole in order to determine whether the result of the transaction is consistent with that intent and purpose.

What approach should the courts take to ascertaining the intent and purpose of a particular provision or of the Act read as a whole? A straightforward answer is that since the Act is a statute, the proper approach is to apply the principles of statutory interpretation generally applicable to taxing statutes. In a perfect world, these principles should guide the courts to a proper appreciation of what was intended by Parliament in enacting a particular provision or in developing a particular scheme within the Act.

To pursue this approach, one must first consider what are the rules of statutory interpretation generally applicable to taxing statutes. This area, in and of itself, is somewhat controversial although, as I suggest in the following analysis, a coherent set of rules can be drawn from the jurisprudence. Having identified the rules of statutory interpretation generally applicable to taxing statutes, one must then consider what latitude, if any, the courts should have in applying these rules to determine whether a transaction is a misuse or abuse. One possible approach that the courts might take to this issue is found in the decisions of the Federal Court of Appeal in *The Queen v. Fording Coal Limited*[20] and *The Queen v. Central Supply Co. (1972) Limited et al.*[21] These decisions suggest that in the context of a statutory anti-avoidance rule, the interpretation of a provision is not necessarily limited to its plain meaning but may extend to what Mr. Justice Linden has referred to as its "intended object and spirit."

In the remainder of this article, I will consider the rules of statutory interpretation generally applicable to taxing statutes with a view to identifying a cohesive set of rules that may be used in the application of subsection 245(4). I will then consider in a critical way the decisions of the Federal Court of Appeal in *Fording Coal* and *Central Supply*, with particular emphasis on whether the approach espoused by the majority of the court in those cases provides an appropriate methodology for the

[20] 95 DTC 5672; [1996] 1 CTC 230 (FCA).

[21] 97 DTC 5295; [1997] 3 CTC 102 (FCA).

application of subsection 245(4). Finally, I will review the decision of the Canadian International Trade Tribunal (CITT) in *Michelin Tires (Canada) Ltd. v. MNR*[22] and the decision of the Tax Court of Canada in *McNichol et al. v. The Queen*[23] to assess the approaches taken in those cases.

The Jurisprudence

The Interpretation of Taxing Statutes

The leading case on the modern approach to the interpretation of taxing statutes is *Stubart Investments Limited v. The Queen*.[24] In that case, the taxpayer had accumulated business losses, which it could bring forward to apply against future profits, and had acquired the assets of a profitable business from a related corporation. The related company continued to carry on the business as the agent, and for the benefit, of the taxpayer. The taxpayer sought to apply its accumulated losses against the profits earned in its new business.

Revenue Canada attacked the *Stubart* transaction on two grounds. First, a transaction that was not entered into for a valid business purpose could be ignored for income tax purposes. Second, the business had never been effectively transferred. In separate judgments, Mr. Justice Estey and Madam Justice Wilson rejected both of Revenue Canada's arguments, expressly finding that there is no "business purpose test" in Canadian income tax law.

In his judgment, Mr. Justice Estey reviewed the rules of statutory interpretation and noted:

> Professor Willis, in his article, *supra*, accurately forecast the demise of the strict interpretation rule for the construction of taxing statutes. Gradually, the role of the tax statute in the community changed, as we have seen, and the application of strict construction to it receded. Courts today apply to this statute the plain meaning rule, but in the substantive sense so that if a taxpayer is within the spirit of the charge, he may be held liable. . . .
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> While not directing his observations exclusively to taxing statutes, the learned author of "Construction of Statutes," 2nd ed., (1983), at p. 87, E.A. Dreidger [sic], put the modern rule succinctly:
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>> 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.[25]

This excerpt is often quoted in support of the demise of the rule of strict construction and the adoption of a purposive approach to the interpretation of taxing statutes. However, an important and often overlooked aspect of the *Stubart* decision is the fact that the interpretation of a

[22] (1995), 3 GTC 4040 (CITT) (under appeal to the FCTD).

[23] Supra footnote 10.

[24] 84 DTC 6305; [1984] CTC 294 (SCC).

[25] Ibid., at 6323; 316.

specific taxing provision was not in issue. The minister of national revenue did not argue in favour of the application of then subsection 137(1) of the Act, preferring instead to rely on general principles and the argument that a business purpose was a requisite to any legitimate tax-avoidance transaction. Mr. Justice Estey was not faced with the clear language of a statutory provision but instead was required to rely on the scheme of the Act, the object of the Act, and the intention of Parliament. While this approach may have been entirely appropriate in the circumstances, the jurisprudence after *Stubart* establishes that where the language of the statute is clear, this language forms the basis on which income tax is assessed. Only where the language of the statute is unclear or ambiguous will the principles in *Stubart* (and other cases)[26] be applied so as to determine the proper interpretation based at least in part on the scheme of the Act, the object of the Act, and the intention of Parliament.

Support for this proposition can be found in the following cases.

In *Morguard Properties Ltd. et al. v. City of Winnipeg*,[27] the Supreme Court was required to interpret certain amendments to a statute imposing property taxes. The decision of the court was rendered by Mr. Justice Estey approximately seven months before his decision in *Stubart*. It is therefore unlikely that he intended his statements in *Stubart* to be at odds with his position in *Morguard*.

In *Morguard*, Mr. Justice Estey made the following observations regarding the interpretation of taxing statutes:

> *If the statutes, when construed in accordance with the proper canons of construction, produce an unsatisfactory revenue conclusion, the political process and not the courts must seek a solution. . . .*
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> In more modern terminology the courts require that, in order to adversely affect the citizen's right whether as a taxpayer or otherwise, the Legislature must do so expressly. Truncation of such rights may be legislatively unintended or even accidental, *but the courts must look for express language in the statute before concluding that these rights have been reduced. . . . The Legislature has complete control of the process of legislation, and when it has not for any reason clearly expressed itself, it has all the resources available to correct that inadequacy of expression.* This is more true today than ever before in our history of parliamentary rule. . . .
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> As Lord Carins stated in *Partington v. Attorney General*, *supra*, if the subject comes within the letter of the law, he must be taxed. If he does not, the Court will not second guess the Legislature in order to impose a liability on the subject. The only qualification of this approach lies in the principle that the statute must be read as a whole [emphasis added].[28]

[26] For example, *Corporation Notre-Dame de Bon-Secours v. Communaute Urbaine de Quebec et al.*, 95 DTC 5017; [1995] 1 CTC 241 (SCC).

[27] [1983] 2 SCR 493.

[28] Ibid., at 507, 509, and 510.

With regard to his last remark, Mr. Justice Estey referred to *The King v. Fraser Companies, Ltd.*,[29] in which, His Lordship noted, the court refused to place a narrow and technical construction upon the precise words used in then paragraph 87(d) of the Excise Tax Act. The implication of Mr. Justice Estey's reference to this case is that the rules of statutory interpretation generally applicable to taxing statutes are not to be used to thwart the obvious intention of Parliament as reasonably expressed in the words employed in the taxing statute. In certain circumstances, as in the *Fraser* case, the words employed, when viewed within the context of the Act as a whole, lead to the reasonable conclusion that they were intended to capture within their scope the activities of a particular taxpayer.[30]

Mr. Justice Estey expanded on this point in *The Queen v. Golden et al.*, where he explained the approach adopted in *Stubart* as follows:

> In *Stubart* . . . the Court recognized that in the construction of taxation statutes the law is not confined to a literal and virtually meaningless interpretation of the Act where the words will support on a broader construction a conclusion which is workable and in harmony with the evident purposes of the Act in question. Strict construction in the historic sense no longer finds a place in the canons of interpretation applicable to taxation statutes in an era such as the present, where taxation serves many purposes in addition to the old and traditional object of raising the cost of government from a somewhat unenthusiastic public.[31]

Mr. Justice Estey again reviewed the proper approach to the interpretation of taxing statutes in *Johns-Manville Canada Inc. v. The Queen*.[32] There, the court was faced with the question whether expenditures incurred by the taxpayer to acquire properties surrounding its open pit mine were on capital or income account. This issue required the court to interpret the general provisions in subsection 9(1) and paragraph 18(1)(b). In reviewing these provisions, Mr. Justice Estey stated:

> On the other hand, if the interpretation of a taxing statute is unclear, and one reasonable interpretation leads to a deduction to the credit of a taxpayer and the other leaves that taxpayer with no relief from clearly *bona fide* expenditures in the course of his business activities, the general rules of interpretation of taxing statutes would direct a tribunal to the former interpretation. . . .

29 [1931] SCR 490.

30 In *Fraser*, ibid., at 492, Mr. Justice Smith stated, "With great respect, I am unable to take this view of the meaning and effect of these provisions of the Act. To so construe them is to put a narrow and technical construction upon the precise words used in clause (d), without taking into consideration the meaning and intent of the statute as a whole. It seems to me clear that the real intention was to levy a consumption or sales tax of four percent on the sale price of all goods produced or manufactured in Canada, whether the goods so produced should be sold by the manufacturer or consumed by himself for his own purposes."

31 86 DTC 6138, at 6140; [1986] 1 CTC 274, at 277 (SCC).

32 85 DTC 5373; [1985] 2 CTC 111 (SCC).

> Such a determination [that the expenditure is deductible] is, furthermore, consistent with another basic concept in tax law that where the taxing statute is not explicit, reasonable uncertainty or factual ambiguity resulting from lack of explicitness in the statute should be resolved in favour of the taxpayer.[33]

By these remarks, Mr. Justice Estey introduces the concept of equity as an element in the interpretation of taxing statutes. The essence of his remarks is that where one interpretation of a taxing statute may lead to hardship but another will not, the latter may be adopted if it is otherwise supported by the statutory language. This is a reasonable approach in the context of broadly worded provisions of general application such as those in issue before the court.

Since the decisions in *Stubart* and *Golden*, the Supreme Court and others have provided considerable additional clarification of the rules of statutory interpretation generally applicable to taxing statutes.

In *Canadian Marconi v. The Queen*, Madam Justice Wilson stated:

> "Active business" is nowhere restricted to manufacturing or processing business. If Parliament intended such a restriction, it must express itself clearly to that effect. In *Morguard Properties Ltd. v. City of Winnipeg* . . . Estey J. for the Court, stated . . . :
>
> > the courts require that, in order to adversely affect a citizen's right, whether as a taxpayer or otherwise, the Legislature must do so expressly. Truncation of such rights may be legislatively unintended or even accidental, but the courts must look for express language in the statute before concluding that these rights have been reduced.
>
> I would adopt and apply this same principle of construction to this case.[34]

Similarly, in *Mattabi Mines Ltd. v. Ont. (Min. of Revenue)*, Madam Justice Wilson made the following comments:

> The submission of the Minister is that a reading of the whole statute according to its plain meaning can defeat a narrow, technical interpretation of a particular provision. However, in the present case consideration of the whole statute reveals, if anything, support for the Company's position. "Income" is a defined term in Part II of the Act and the failure to define income differently for purposes of s. 106 which is contained in Part II has to be treated as significant. *Interpretation according to the "object and spirit" of the legislation cannot, in my view, overcome a clear statutory definition.* This is not a case in which the Court has a choice of the interpretations it may put upon the language used by the legislature. The legislature has specifically addressed the subject. I would therefore conclude that in assessing whether Mattabi had a "net loss" one must start with the finding that for purposes of s. 106(5)(b) its "incomes" were "nil" [emphasis added].[35]

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[33] Ibid., at 5382 and 5384; 123 and 126.

[34] 86 DTC 6526, at 6531; [1986] 2 CTC 465, at 472 (SCC).

[35] [1988] 2 SCR 175, at 194; [1988] 2 CTC 294, at 304.

Other courts have followed this line of reasoning. In *Carling O'Keefe Breweries of Canada Limited v. A-G Newfoundland*, the Newfoundland Supreme Court made the following observations about the rules of statutory interpretation set out in *Stubart*:

> *In my view Stubart does not support a position that the underlying purpose or intent of the legislature may itself be used to hold a taxing statute to have a particular effect in terms of imposing taxation where the language actually used by the legislature, considered in context, does not reasonably permit that construction.* Where the words of a taxing statute are "plain" in their meaning, that is, where no ambiguity truly exists, it is inappropriate to "warp" the words based solely on what the court finds to be the underlying purpose or intention of the legislature: *Mobil Oil Canada Ltd. v. Newfoundland* (1987), 68 Nfld. & P.E.I.R. 155; 209 A.P.R. 155 (Nfld. T.D.). This is consistent with the principle that the task of the court is to see whether the language used by the legislature accomplishes the underlying purpose, not to allow the underlying purpose to circumvent the language itself [emphasis added].[36]

In *Antosko et al. v. The Queen*,[37] *Friesen v. The Queen*,[38] *The Queen v. Province of Alberta Treasury Branches et al.*,[39] and a trilogy of criminal cases which I will not review here,[40] the Supreme Court of Canada implicitly sanctioned the approach described in *Carling O'Keefe*.

In *Antosko*, the taxpayers acquired from a provincial board all of the issued shares of a company for $1. The company owed the board approximately $5 million plus accrued interest as a consequence of calls on guarantees that the board had given in the company's favour. The board agreed to postpone the company's obligation to repay the indebtedness for a period of two years. In return, the taxpayers promised to operate the company in a good and business-like manner. The board agreed that, upon expiration of the two-year period and if all its conditions were met, it would sell the taxpayers the debt plus accrued interest for the sum of $10. This sale occurred after the taxpayers satisfied the board's conditions.

In the 1977 taxation year, the taxpayers each received $38,335 from the company in partial payment of the interest that the company had accrued on the total debt before the transfer. The taxpayers included this

36 (1993), 113 Nfld. & PEIR 271, at 283 (Nfld. SC).

37 94 DTC 6314; [1994] 2 CTC 25 (SCC).

38 95 DTC 5551; [1995] 2 CTC 369 (SCC).

39 96 DTC 6245; [1996] 1 CTC 395 (SCC).

40 *The Queen v. Heywood*, [1994] 3 SCR 761; *St. Pierre v. The Queen*, [1995] 1 SCR 791; and *The Queen v. McIntosh*, [1995] 1 SCR 686. In *McIntosh*, ibid., at 697, Chief Justice Lamer stated, "In resolving the interpretive issue raised by the Crown, I take as my starting point the proposition that where no ambiguity arises on the face of a statutory provision, then its clear words should be given effect. This is another way of asserting what is sometimes referred to as the 'golden rule' of literal construction: a statute should be interpreted in a manner consistent with the plain meaning of its terms. Where the language of the statute is plain and admits of only one meaning, the task of interpretation does not arise."

interest in income pursuant to paragraph 12(1)(c) and then claimed deductions of these amounts pursuant to paragraph 20(14)(b). In the 1980 taxation year, one of the taxpayers received $283,363 from the company as a similar payment of interest. This amount also was included as income and then claimed as a deduction.

Revenue Canada disallowed the deduction on the basis that the taxpayers did not satisfy the conditions of subsection 20(14). The taxpayers appealed. The Tax Court of Canada allowed the appeal, but the Federal Court of Appeal overturned the judgment of the Tax Court. The taxpayers appealed to the Supreme Court of Canada.

The Supreme Court concluded that the transactions did fall within the ambit of subsection 20(14) and that the taxpayers were entitled to the benefit of that provision. The reasoning of the court is set out in the following excerpts from the judgment of Mr. Justice Iacobucci:

> In this appeal, the appellants argue that their transaction was not structured so as to defeat the intention of Parliament. They sought to acquire the company's debt to preserve their economic control of the company. *The respondent argues that the conduct of the taxpayers in this case does not fall within the object and spirit of s. 20(14), and that to interpret the section to cover the transaction in this appeal is to give to the appellants a windfall not intended by Parliament. . . .*
>
> *It is this principle* [the quote from Driedger adopted in *Stubart*] *that must prevail unless the transaction is a sham or is so blatantly synthetic as to be effectively artificial.* As Estey, J. concludes at p. 580 (84 DTC 6324; [1984] CTC 317]:
>
> > . . . where the substance of the Act, when the clause in question is contextually construed, is clear and unambiguous and there is no prohibition in the Act which embraces the taxpayer, the taxpayer shall be free to avail himself of the beneficial provision in question. . . .
>
> This transaction was obviously not a sham. The terms of the section were met in a manner that was not artificial. Where the words of the section are not ambiguous, it is not for this Court to find that the appellants should be disentitled to a deduction because they do not deserve a "windfall," as the respondent contends. *In the absence of a situation of ambiguity, such that the Court must look to the results of a transaction to assist in ascertaining the intent of Parliament, a normative assessment of the consequences of the application of a given provision is within the ambit of the legislature, not the courts.* Accordingly, I find that the transaction at issue comes within s. 20(14) [emphasis added].[41]

The Supreme Court confirmed that the plain meaning of a provision assessed within the context in which it is placed must be determinative of its application unless the particular provision is ambiguous and therefore recourse must be had to the results of the transaction to assist in ascertaining the intent of Parliament in drafting the provision. More important, the court also confirmed that this is the correct approach even where it

[41] Supra footnote 37, at 6319-21; 31-33.

results in a windfall to the taxpayer. The court did note, however, that this approach may not apply where the transaction is a sham or is so blatantly synthetic as to be effectively artificial, or where the transaction results in an abuse of the provisions of the Act.[42] The reference to abuse presumably alludes to a transaction that is in technical compliance with a provision of the Act but is nevertheless an abuse of the Act on the basis of a plain reading of the statutory scheme of which the provision is a part.

The Supreme Court strongly reaffirmed its statements in *Antosko* in *Friesen* and in *Alberta Treasury Branches*. In *Friesen*, Mr. Justice Major made the following comments:

> As Hogg and Magee stated in *Principles of Canadian Income Tax Law*, supra at p. 453:
>
> > 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.
>
> Therefore, the object and purpose of a provision need only be resorted to when the statutory language admits of some doubt or ambiguity.[43]

In *Alberta Treasury Branches*, Mr. Justice Cory, after referring to excerpts from *Friesen*, concluded:

> Thus, when there is neither any doubt as to the meaning of the legislation nor any ambiguity in its application to the facts then the statutory provision must be applied regardless of its object or purpose.[44]

The above cases provide significant guidance as to the rules of statutory interpretation generally applicable to taxing statutes. However, the recent decision of the Supreme Court of Canada in *Corporation Notre-Dame de Bon-Secours v. Communaute Urbaine de Quebec et al.*[45] may be viewed as a departure from the approach adopted in those cases. Specifically, one might argue that it is not possible to reconcile the purposive approach adopted in *Bon-Secours* with the plain meaning approach espoused in *Antosko*. I submit, however, that a careful reading of the *Bon-Secours* case establishes that in fact the court's approach in that case is consistent with its statements in *Antosko*, *Friesen*, and *Alberta Treasury Branches*.

The essence of the court's analysis in *Bon-Secours* is found in the following excerpts from Mr. Justice Gonthier's judgment:

> [T]here is no longer any doubt that the interpretation of tax legislation should be subject to the ordinary rules of construction. At page 87 of his

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[42] Ibid., at 6319-20; 31-32. Exactly what the court meant by the reference to artificial is not clear. It is conceivable that the court was reserving the right to apply old subsection 245(1) if the circumstances warranted such an approach.

[43] Supra footnote 38, at 5561; 388.

[44] Supra footnote 39, at 6248; 403.

[45] Supra footnote 26.

> text *Construction of Statutes* (2nd ed. 1983), Driedger fittingly summarizes the basic principles: ". . . 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." The first consideration should therefore be to determine the purpose of the legislation, whether as a whole or as expressed in a particular provision. The following passage from Vivien Morgan's article "Stubart: What the Courts Did Next" (1987), 35 *Can. Tax. J.* 155, at pp. 169-70, adequately summarizes my conclusion:
>
>> There has been one distinct change [after *Stubart*], however, *in the resolution of ambiguities*. In the past, resort was often made to the maxims that an ambiguity in a taxing provision is resolved in the taxpayer's favour and that an ambiguity in an exempting provision is resolved in the Crown's favour. *Now an ambiguity is usually resolved openly by reference to legislative intent.*
>
> The teleological approach makes it clear that in tax matters it is no longer possible to reduce the rules of interpretation to presumptions in favour of or against the taxpayer or to well-defined categories known to require a liberal, strict or literal interpretation. . . .
>
> The rules formulated in the preceding pages, some of which were relied on recently in *Symes v. Canada*, [1993] 4 S.C.R. 695, may be summarized as follows:
>
> — The interpretation of tax legislation should follow the ordinary rules of interpretation;
>
> — A legislative provision should be given a strict or liberal interpretation depending on the purpose underlying it, and that purpose must be identified in light of the context of the statute, its objective and the legislative intent: this is the teleological approach;
>
> — The teleological approach will favour the taxpayer or the tax department depending solely on the legislative provision in question, and not on the existence of predetermined presumptions;
>
> — Substance should be given precedence over form to the extent that this is consistent with the wording and objective of the statute;
>
> — Only a reasonable doubt, not resolved by the ordinary rules of interpretation, will be settled by recourse to the residual presumption in favour of the taxpayer [emphasis added].[46]

The reference by Mr. Justice Gonthier to a need "to determine the purpose of the legislation, whether as a whole or as expressed in a particular provision" could conceivably be viewed as a judicial licence to reject the plain meaning approach altogether in favour of the wholesale adoption of a purposive approach to the interpretation of tax statutes. I submit, however, that this statement merely reflects the obvious fact that in cases of ambiguity, it is necessary to ascertain the purpose of the legislation in order to resolve the ambiguity. Mr. Justice Gonthier does

[46] Ibid., at 5022-23; 250-52.

not in any way suggest that this approach can be used to overrule the plain meaning of the words used in the statutory provision taken in their proper context. In fact, his immediate prior reference to the excerpt from Driedger adopted in *Stubart* and cited in *Antosko* as the "principle that must prevail" and his subsequent adoption of the "ordinary rules of interpretation" as the first principle to apply in interpreting tax legislation suggest quite the opposite. The failure of Mr. Justice Gonthier to expressly reconcile the approach in *Bon-Secours* with that in *Antosko* stems from the fact that His Lordship's judgment was clearly premised on the conclusion that the provision in issue was ambiguous.[47] Since the provision, in his view, did not have a plain meaning, it was necessary to consider in greater detail the rules of statutory interpretation applicable in such a case.

When the judgment is read in this context, it is clear that Mr. Justice Gonthier was not rejecting the approach in *Antosko* but rather was advocating the application of the purposive approach where the statutory provision is ambiguous. The crux of his comments was that the teleological approach makes it clear that it is not appropriate to rely on maxims or presumptions in resolving ambiguity; instead, the courts must endeavour to arrive at an appropriate interpretation of the statute itself based on a purposive analysis. Moreover, if after applying the teleological approach a reasonable doubt remains, the matter will be settled by recourse to the residual presumption in favour of the taxpayer.[48]

This explanation of Mr. Justice Gonthier's judgment is consistent with the apparent objective of the court in that case, which was to avoid the application of a negative presumption that may have precluded the taxpayer's reliance on the exemption provisions in issue. It is also supported by comments made by Mr. Justice Iacobucci at the Canadian Bar Association's Second Annual Tax Conference,[49] where His Lordship described the Supreme Court's approach to the interpretation of tax legislation, including the statements of Mr. Justice Gonthier in *Bon-Secours*. Mr. Justice Iacobucci indicated that a close reading of the decision reveals that the plain-meaning approach encompasses the purposive approach: if the words of the statute are clear and plain, the result is not altered by legislative purpose or object; if the words are not clear and plain, the

[47] This interpretation of the judgment is supported by the fact that immediately following his reference to "the purpose of the legislation," Mr. Justice Gonthier quoted from a portion of Vivien Morgan's article that addresses directly the interpretation of taxing statutes where it is necessary to resolve an ambiguity in a particular provision.

[48] It might be argued that Mr. Justice Gonthier rejected the presumption in favour of the taxpayer identified by Mr. Justice Estey in *Johns-Manville*, supra footnote 32. In my view, Mr. Justice Gonthier rightly pointed out that the principle expressed in *Johns-Manville* was a residual principle, and not a presumption, which dictates that matters involving the application of ambiguous provisions must be resolved in favour of the taxpayer. The residual nature of the principle was expressly acknowledged by Mr. Justice Estey in *Johns-Manville*, ibid., at 5384; 126.

[49] Niagara-on-the-Lake, June 4, 1996.

teleological approach must be followed; if ambiguity remains, the issue is resolved in favour of the taxpayer.[50]

Conclusion

The above analysis leads to the conclusion that under the rules of statutory interpretation generally applicable to taxing statutes, the intention of Parliament is manifest in the language employed in a provision. Where the meaning of the words viewed in context is clear, there is no room to interject the court's interpretation of the apparent intent of Parliament in enacting the provision. On the other hand, where a provision is ambiguous, the court may adopt the teleological approach in order that it may resolve the ambiguity by referring to legislative intent determined by means of a purposive analysis, and not by relying on presumptions in favour of the taxpayer or the revenue authorities.

This basic approach to the interpretation of taxing statutes leads to the question whether the courts should be able to adapt this approach to determine whether the exception in subsection 245(4) should be applied to a particular transaction.[51]

Does Subsection 245(4) Mandate a Different Approach?

General

The rules of statutory interpretation generally applicable to taxation statutes suggest a relatively straightforward methodology for determining whether the exception in subsection 245(4) should apply to an avoidance transaction. In particular, applying these rules to subsection 245(4) means that in assessing whether an avoidance transaction is a misuse of a provision of the Act, the court must glean the intended application of the provision from its language. If the meaning of the words viewed in context is clear, the court should not be able to reasonably conclude that the provision has been misused on the basis of a perceived intention that is not expressed in the language of the provision. On the other hand, if the meaning of the words is not clear, the court may apply the teleological approach to ascertain the most appropriate interpretation of the provision for the purpose of assessing whether the result sought by the taxpayer constitutes a misuse of the provision. If doubt still remains, it should be resolved in favour of the taxpayer. A similar approach should be taken in determining whether a transaction is an abuse having regard to the provisions of the Act read as a whole. That is to say, the scheme of the Act

[50] See Bob McMechan, "The Purpose of Teleology" (July 16, 1996), 4 *Canadian Tax Highlights* 49-50.

[51] It is not clear that the GAAR is necessary when the provision in issue is ambiguous. Presumably, the court can apply the teleological approach to assess whether the result sought by the taxpayer is consistent with the purpose of the statutory provision. If it is not, the provision should be held not to apply without the need to resort to the GAAR. If it is, the GAAR should be equally irrelevant.

must be drawn from the meaning and application of the specific provisions of the Act and not from a subjective assessment of what was intended by Parliament.

This approach provides a reasonable degree of certainty in that it limits the discretion of the courts to attribute an intent or purpose to clearly worded taxing provisions that is not expressly stated in the language of the provisions.[52] However, properly implemented within the statutory scheme of the GAAR, this approach should not provide taxpayers with free reign to rely on technical compliance with provisions of the Act as a defence to the GAAR.[53] The rules of statutory interpretation generally applicable to taxing statutes do not allow taxpayers to rely on a mechanical interpretation of the provisions of the statute where the words reasonably support a broader interpretation.

Consider, for example, the attribution rule in subsection 74.1(1). The application of that rule in a strictly mechanical sense is clear. If an individual has transferred or lent property to his or her spouse and certain other conditions are satisfied, the income from the property is attributed back to the transferor spouse.

A literal interpretation would suggest that in any circumstance where the transferor complies with the mechanical requirements of the provision, the provision must be held to apply. One might also suggest that the same result would follow from the plain meaning rule advocated in *Antosko* and that, as a consequence, such an approach to the application of subsection 245(4) would render the GAAR toothless. However, in my view, the plain meaning rule applied in the context of the judicial mandate implicit in the GAAR should allow the court to look beyond the purely mechanical requirements of a taxing provision to ascertain the purpose of that provision. This is not to say that the plain meaning of the words of the provision can be ignored in favour of a subjective assessment of what Parliament intended; rather, the court is entitled to consider what purpose a provision is intended to serve on the basis of a plain reading of the words of the provision and the context in which it is found.

In the case of subsection 74.1(1), the purpose that is manifest on the basis of the plain meaning of the words employed in the provision and the context in which the provision is found is that a transferor spouse should not be entitled to shift property income to a spouse who is taxed at a lower rate on that income. This assessment of purpose does not require

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[52] As a tax practitioner, I believe it is incumbent on the government to promote certainty in the interpretation of our tax laws. For a similar view, and the basis for it, see the comments of Bruce Sinclair in Guy Fortin, "Economic Reality Versus Legal Reality; Planning for Trusts: Deemed Disposition on January 1, 1999; Subsection 107(4.1) of the Income Tax Act," in *Report of Proceedings of the Forty-Eighth Tax Conference*, 1996 Conference Report, vol. 1 (Toronto: Canadian Tax Foundation, 1997), 5:1-39, at 5:20-22. See also Nias and Amdor, supra footnote 4.

[53] See, for example, *Antosko*, supra footnote 37, at 6319-21; and *Fraser*, supra footnote 29.

the court to disregard the plain meaning of the words, nor does it require the court to guess what the purpose might be on the basis of something other than the words used to express the provision. It simply acknowledges that the purpose of a provision is not necessarily coincidental with all the circumstances in which it could be applied.

In the context of the GAAR, a court may reasonably conclude that where subsection 74.1(1) is used to reduce the overall tax liability of an individual and his or her spouse,[54] such use constitutes a misuse of the provision based on its purpose as drawn from the plain meaning of its words.[55] This conclusion should not come as a surprise to a person structuring such a transaction since the use of subsection 74.1(1) in this manner is obviously contrary to its purpose as an attribution rule.

The advantage of this approach to taxpayers is particularly evident where the mechanical application of a provision is clear but the apparent purpose of the provision based on the plain meaning of the words does not resolve the circumstances in which the provision was intended to apply. An example of this latter type of provision is subsection 85(1). The plain meaning of the words of the provision provides clear guidance as to the circumstances in which it will apply (that is, the mechanical application of the provision is straightforward). On the other hand, it is not possible to draw from the words of the provision a general description of the circumstances in which the rule was intended to apply. That is to say, the words do not provide any insight into the purpose of the provision outside of the fact that it provides taxpayers with the ability to transfer certain properties to a taxable Canadian corporation on a tax-deferred basis in prescribed circumstances. Moreover, the scheme of the Act read as a whole does not provide any substantive guidance as to the circumstances in which the provision is intended to apply. Accordingly, applying the rules of statutory interpretation mandated by the Supreme Court, it should not be possible for a court to conclude that any particular use of subsection 85(1) is a misuse of that provision based on its apparent purpose unless the minister can establish that a particular transaction was inconsistent with the mechanical rules in the provision.[56] In my view, this

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[54] It is still incumbent on the court to assess the transactions in context to determine whether a reduction of tax liability was indeed the predominant purpose of the transactions. This assessment can be made in the context of whether there is an avoidance transaction.

[55] It is, of course, open to debate whether, in the absence of the GAAR, the rules of statutory interpretation would allow a court to conclude that subsection 74.1(1) is not applicable where the transaction is not artificial or a sham and the mechanical requirements of the provision are satisfied. Presumably, it was in order to close this possible loophole that Parliament enacted subsection 74.5(11) to ensure that such planning could not take place. One might suggest that the GAAR should avoid the need for such detailed anti-avoidance provisions where the purpose of a provision is clear. In my view, such detailed and focused anti-avoidance provisions are a useful aid in assessing the purpose of the rules they are intended to protect.

[56] The mechanical rules in subsection 85(1) do provide guidance for a court in that the provision describes explicitly the types of property that are eligible for the rollover. The (The footnote is continued on the next page.)

result is appropriate since it avoids the uncertainty of the court's "guessing" when the provision was intended to apply where guidance cannot be taken from the provision itself or the context in which it is placed.

Notwithstanding the relative degree of certainty provided by this approach, one may argue that it does not provide the courts with the level of discretion that is essential to the effective application of the GAAR. This view was advocated in the context of old subsection 245(1) by the majority of the Federal Court of Appeal in *Fording Coal* and *Central Supply*. Although not directly addressing the application of the GAAR, these cases provide a possible alternative approach to the application of the limitation in subsection 245(4).

The Fording Coal Case

In *Fording Coal*, the issue was whether the taxpayer was entitled to deduct the unused Canadian exploration expense (CEE) and Canadian development expense (CDE) of its predecessor corporation, Elco Mining Limited ("Elco"). On December 2, 1985, Elco acquired a 0.001 percent interest in the taxpayer's coal mine. On December 30, 1985, as part of a larger transaction, the taxpayer reacquired Elco's 0.001 percent interest. Pursuant to the so-called successor rules in the Act, the taxpayer deducted approximately $13 million of Elco's unused CEE and CDE. Revenue Canada denied this deduction. The taxpayer's appeal to the Tax Court of Canada was allowed. The Crown appealed to the Federal Court of Appeal.

Mr. Justice Strayer concluded that although the seeding transaction clearly fell within the wording of the successor rules, the application of the rules resulted in an artificial reduction of the taxpayer's income which was denied by old subsection 245(1). In reaching this conclusion, Mr. Justice Strayer reasoned that although on a plain interpretation of the relevant provisions the taxpayer was entitled to the deductions claimed, to allow such a deduction was contrary to the object and spirit of the Act. While this finding did not allow the court to interpret the provisions in a manner inconsistent with their plain meaning, it did provide a basis on which to apply old subsection 245(1). Mr. Justice Strayer's analysis is captured in the following excerpts from his judgment:

> *Although I find, for reasons to be discussed later, that such a deduction in these circumstances is contrary to the object and spirit of the sections in question and of the Act*, I do not consider this to be justification for treating the "seeding transaction" as of no effect for the purposes of subsection 66.1(4) and 66.2(3). . . .

[56] Continued . . .
omission of certain types of property (for example, real estate inventory) strongly suggests that the provision was not intended to facilitate the transfer of such properties to a corporation on a tax-deferred basis. This guidance should allow a court to conclude, for example, that a series of transactions whose purpose is to transfer ineligible property to a corporation is subject to the GAAR.

> But I find that the deductions in the circumstances of the present case were contrary to the object and spirit of the Act. I do not understand the respondent to argue otherwise. The respondent simply relies on the literal interpretation of the Act as supporting its deductions. *No one has suggested a rational legislative purpose which would be served by permitting the deductions in this case*. I believe that the appellant has correctly described that intention as being to allow the purchaser of mining property to acquire along with that property (if the vendor so agrees) the benefit of unused tax pool deductions including CCEE [cumulative CEE] and CCDE [cumulative CDE], available for use against income derived in the future from that property. There is eminent sense in encouraging: firstly, the initial investment through making expenses potentially deductible, with added value to the property by making those expense pools transferable to a purchaser; and secondly, the further development and putting into production of that same mining property by one who takes it over. *But I can imagine no public purpose, nor has any been suggested, which would be served by allowing the deduction in the present case so as to allow the respondent to deduct, from future income from properties it previously owned, the expenses incurred in the past exploration and development of other newly acquired property which has produced nothing since its acquisition.* In my view, these deductions being contrary to the object and spirit of the sections which nevertheless permit them, they may be seen as artificially reducing income [emphasis added].[57]

In the course of his analysis, Mr. Justice Strayer described the purpose of the provisions in issue as being to allow a purchaser of mining property to acquire the benefit of unused tax pool deductions associated with that property. While this is no doubt the purpose of the provisions in generic terms, it does not support Mr. Justice Strayer's conclusion that the use of these provisions in the circumstances under consideration was contrary to the object and spirit of the sections in question and of the Act. In order to reach that conclusion, Mr. Justice Strayer was forced to rely on the fact that the taxpayer was unable to identify a rational legislative purpose that would be served by allowing the deduction claimed by the taxpayer in the particular circumstances under consideration. This line of reasoning suggests that unless the taxpayer can establish a rational legislative purpose to the application of the provisions in question, the taxpayer should be denied the benefit of the provisions. Why the taxpayer should be required to satisfy this onus is unclear, given that the taxpayer has prima facie established the application of the provisions.[58] Moreover, how the taxpayer can establish a rational legislative purpose where the plain words of the provisions provide no guidance beyond an obvious generic purpose is even less clear. In fact, one might suggest that the taxpayer is left with an impossible task in the absence of guidance in the legislation.

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[57] Supra footnote 20, at 5673 and 5676; 244 and 248.

[58] One would think that the onus of establishing the application of a broad anti-avoidance provision would fall on the minister, not the taxpayer. However, it appears that the minister need only argue that the result could not have been intended by Parliament, even though evidence of this cannot be found in the Act itself.

It is apparent that Mr. Justice Strayer is applying a subjective judicial standard to determine whether a taxpayer should be entitled to the benefit of a provision of the Act that on a plain reading of its words applies to the transactions undertaken by the taxpayer. Unfortunately, as with all subjective tests, it is difficult to identify the bounds of what will be viewed as acceptable or unacceptable tax avoidance.

In dissent, Mr. Justice McDonald took an approach more in keeping with the rules of statutory interpretation set down by the Supreme Court of Canada:

> Judges must be careful when engaging in an object and spirit analysis. *It must not become a means by which every loophole or omission in the Act is rectified to the detriment of the taxpayer by a judiciary agreeable to the Minister's frequent argument that such an interpretation of the section could not have been what Parliament intended. The judiciary is not to do the job of Parliament.* Neither are we to contradict what Parliament has chosen to do in the face of a plainly worded section and with the evidence of obvious Departmental consideration and specific legislative amendment. Presumably there was a policy objective in maintaining the section unchanged for as long as it was, and in later grandfathering the sections relevant to this appeal. Parliament anticipated precisely the situation we are dealing with. They chose to address it in a specific way and amended the Act accordingly. In so doing it did not make the changes retroactive. *It is not for the judiciary to do so* [emphasis added].[59]

Mr. Justice McDonald's analysis of the provision was twofold. First, he determined that on a plain reading of the provision, it applied to the taxpayer and there was nothing in the wording of the provision that suggested otherwise. Having made this determination, he then considered whether there was any evidence in the scheme of the Act or elsewhere that demonstrated that Parliament could not have intended the result sought by the taxpayer. In this regard, he undertook a detailed review of the history of the provision and the various commentaries made by the Department of Finance over the life of the provision.[60] From this review, Mr. Justice McDonald was able to conclude that the Department of Finance was aware of the type of transaction undertaken by the taxpayer and had chosen not to address any concerns it may have had regarding this transaction until the amendments in 1987. Mr. Justice McDonald concluded that it was not possible to say that the interpretation sought by the taxpayer could not have been intended by Parliament.

The essence of Mr. Justice McDonald's analysis is that, in the absence of cogent evidence that Parliament intended a contrary result, the court should refuse to attribute an intention to Parliament that differs from the

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[59] Supra footnote 20, at 5681; 240.

[60] One might suggest that extrinsic evidence is never persuasive in interpreting a taxing statute and that this material merely bolstered Mr. Justice McDonald's conclusion that the Act did not demonstrate that Parliament did not intend the provisions to apply to the transactions undertaken by the taxpayer.

plain meaning of the words employed by Parliament in the section. In my view, this approach provides a more reasonable and predictable basis on which to assess whether a broad anti-avoidance provision should be applied in the circumstances.

The Central Supply Case

In *Central Supply*, Mr. Justice Linden also considered the rules of statutory interpretation in the context of the application of old subsection 245(1) of the Act. In that case, the two taxpayers, Central Supply Company (1972) Limited and Carousel Travel 1982 Inc., had acquired interests in four limited partnerships that had been engaged in financing an unsuccessful oil and gas exploration project. The interests were acquired on the last day of the 1987 fiscal period of the partnerships and were the subject of a put agreement pursuant to which the taxpayers could dispose of the interests for nominal consideration. On the day following the acquisition, the taxpayers disposed of their interests pursuant to the put agreement. The minister denied the deductions claimed by the taxpayers. The Tax Court of Canada allowed the taxpayers' appeal, and the minister appealed to the Federal Court of Appeal.

The principal issue on appeal (and the only issue resolved by the court) was whether old subsection 245(1) should be applied to disallow the deductions claimed by the taxpayers. Mr. Justice Linden commenced his analysis by reviewing the various judicial anti-avoidance doctrines that had been either adopted or rejected in Canada and concluded that any meaningful distinction between lawful and unlawful tax avoidance comes mainly from legislative anti-avoidance measures, not judicially created ones. Mr. Justice Linden then observed that the proper role of the rules of statutory interpretation in the context of an anti-avoidance provision had not been resolved by the Supreme Court of Canada. He went on to state:

> This Court has, however, reflected on the application of subsection 245(1), most recently in *H.M.Q. v. Fording Coal*. In applying subsection 245(1) to deductions taken by a taxpayer for cumulative CEE and cumulative Canadian development expense ("CDE"), Strayer J.A., writing for himself and Décary J.A., set out three factors relevant to the determination of whether a taxpayer has unduly or artificially reduced its income. These were, first, whether the deduction sought is contrary to the object and spirit of the provision of the Act, second, whether the deduction is based on a ". . . transaction or arrangement which is not in accordance with normal business practice," and third, whether there was a *bona fide* business purpose for the transaction. Strayer J.A., in conformity with *Stubart*, was careful to qualify the importance of a *bona fide* business purpose by stating that, although it ". . . is not determinative of the artificiality of the deduction," it ". . . is certainly relevant."[61]

Mr. Justice Linden then considered whether this approach was appropriate in light of the canons of statutory interpretation laid down by the

[61] Supra footnote 21, at 5301; 116-17.

Supreme Court of Canada in cases such as *Stubart* and *Antosko*, and that court's failure to apply old subsection 245(1) in *Mara Properties Ltd. v. The Queen*.[62] He concluded that *Mara Properties* did not stand for the proposition that the Supreme Court had adopted a narrow approach to the rules of statutory interpretation as they apply to subsection 245(1). He went on to describe the role of such anti-avoidance rules before concluding that, in light of the absence of any guidance on the issue from the Supreme Court of Canada, the approach set down by Mr. Justice Strayer in *Fording Coal* is to be preferred over that of Mr. Justice McDonald:

> Each of these anti-avoidance provisions was aimed at a particular subset of tax avoidance schemes. In this sense, and in contrast to the current GAAR, they can best be characterized as "partial" anti-avoidance rules. *Despite their partial nature, however, they indicate beyond question that, even prior to the new GAAR, Parliament intended to draw a line between lawful and unlawful tax avoidance*. As a result, while it may not be the role of Canadian Courts to apply anti-avoidance doctrines as general principles of interpretation, they must respect the existence of particular tax avoidance provisions in the Act. . . .
>
> Parliament has indicated its desire to set limits on the permissible scope of tax avoidance through the former subsection 245(1) and other similar anti-avoidance provisions. The particular criteria adopted by Strayer, J.A. to assess the undue or artificial reduction of income constitute a sound mechanism by which Courts can be true to this legislative goal [emphasis added].[63]

In adopting the approach of the majority in *Fording Coal*, Mr. Justice Linden rejected the taxpayers' contention that a transaction that technically fits within the provisions of the Act cannot unduly or artificially reduce income, on the basis that to hold otherwise would entirely eviscerate the effect of subsection 245(1).[64] Moreover, he noted that Parliament chose to enact subsection 245(1) and that by applying the provision in appropriate cases, the court is not usurping the legislative will but obeying it:

> In enacting anti-avoidance laws such as subsection 245(1), Parliament indicated that it could not, in drafting specific taxing provisions, anticipate every conceivable manipulation of the wording of that provision. Avoidance schemes which are concocted to take advantage of the literal wording of taxing provisions are notoriously difficult to anticipate precisely because they do not seek to satisfy the intended object or spirit of the provision, nor are they anchored by a commercial logic or business purpose. For this reason, they often lie outside the bounds of what might reasonably be contemplated by the legislature in enacting a particular provision of the

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[62] 96 DTC 6309; [1996] 2 CTC 54 (SCC).

[63] Supra footnote 21, at 5299-5300 and 5302; 114-15 and 119.

[64] It is difficult to dispute this general contention. However, the conclusion begs the question whether the taxpayer's compliance with the provisions was merely technical (mechanical?) in the absence of cogent evidence in the Act that Parliament did not intend the provisions to apply in the taxpayer's particular circumstances.

> Act. In measuring tax avoidance schemes against these three factors, however, Courts may effectively limit the kinds of arrangements giving rise to expenses or deductions provided by the Act *to those which could reasonably have been intended by Parliament* or, in other words, do not unduly or artificially reduce income [emphasis added].[65]

Mr. Justice Linden did not identify the basis on which a court should ascertain whether a particular expense or deduction could "reasonably have been intended by Parliament." Moreover, of the three tests identified, only the "object and spirit" test should be relevant to this issue since not all provisions of the Act require a business purpose or a commercial motivation in order to apply.

Having identified the ground rules for the application of subsection 245(1), Mr. Justice Linden then applied them to the circumstances in issue. In this regard, he concluded first that the taxpayers' attempted use of the exploration expense provisions fell outside their intended object and spirit. He reached this conclusion on the following basis:

> The problem with the respondents' participation in the limited partnerships for the purpose of obtaining this benefit, as I view it, is that the respondents have not in any way engaged in the business which the exploration expense provisions are designed to promote. . . .
>
> In this case, however, because government assistance was not subtracted from the cumulative CEE total, the respondents' claimed a deduction of 100% of the exploration expense associated with the Narwhal F-99 Well, despite the fact that the Government ultimately compensated the partnerships for 80% of those expenses. The effect for the Government, as is argued by the appellant is a cost of more than 100% of the actual cost of exploration. *Such an absurd result could not have been the intention of Parliament in enacting these provisions* [emphasis added].[66]

Mr. Justice Linden then found that, unlike the taxpayers in *The Queen v. Alberta & Southern Gas Co. Ltd.*[67] and *Edmonton Liquid Gas Limited v. The Queen*,[68] "[t]he respondents in this case had no similar good faith intention to invest in resource exploration."[69] Consequently, the taxpayers completely failed to bring themselves within the object and spirit of the exploration deduction provisions in the Act.

Mr. Justice Linden also found that the transactions were far removed from ordinary commercial practice and were in fact a "tax scheme, pure and simple, not a business deal," which was devoid of business purpose.[70]

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65 Supra footnote 21, at 5302-3; 120.

66 Ibid., at 5308-9; 131-32.

67 77 DTC 5244; [1977] CTC 388 (FCA), aff'd. 78 DTC 6566; [1978] CTC 780 (SCC).

68 84 DTC 6526; [1984] CTC 536 (FCA).

69 Supra footnote 21, at 5310; 134.

70 In the context of the GAAR, this aspect of the court's approach should be relevant to the determination of whether there is an avoidance transaction but not to the determination of whether the exception in subsection 245(4) applies. Consider, for example, the discussion of subsection 107(2) earlier in this article.

On the basis of these findings, Mr. Justice Linden concluded that old subsection 245(1) applied to deny the deduction of the CEE claimed by the taxpayers.

In my view, although many reasons are tendered in support of the application of old subsection 245(1), in substance Mr. Justice Linden based his conclusion on the perception that Parliament could not have intended the result achieved by the taxpayer. Unfortunately, he did not point to any evidence in the Act or elsewhere in support of this view.[71] Accordingly, one is led to believe that Mr. Justice Linden's finding in this regard was really a subjective assessment of what is an appropriate result under the Act.

In his dissenting judgment, Mr. Justice McDonald followed the approach he took in *Fording Coal*. He argued that it is not permissible to apply old subsection 245(1) to disallow deductions where the deductions are permitted by the express terms of the Act and are not inconsistent with the object and spirit of those provisions. In this regard, he noted:

> In this case, the taxpayers were members of the partnerships at the end of the fiscal year. The provisions of the Act specifically resulted in attribution of the CEE to them as members of the partnerships at the end of the partnerships' fiscal year. Other than joining the partnerships immediately before year end, the taxpayers did nothing to create this situation, as the attribution resulted by operation of the *Income Tax Act*. This is similar to the situation faced by this Court in *Canada v. Mara Properties Limited*, [1995] 2 F.C. 433 where I was of the view that deductions could not be said to be artificial or undue where they arose by specific operation of the Act. On this point, my brother Marceau, J.A. and I were in agreement.[72]

Mr. Justice McDonald concluded that the taxpayers were entitled to the exploration deductions based on a plain reading of the provisions of the Act and that this result was not inconsistent with the object and spirit of the legislation. In reaching this conclusion, Mr. Justice McDonald noted that the structure entered into by the taxpayer was not uncommon and that that particular type of financing arrangement was normal business practice in the industry at the time. Moreover, he noted that although the clear intention of the taxpayers was to purchase the CEE and not to participate in the exploration business, this was not a basis on which to find that the taxpayers had unduly or artificially reduced their income:

> For the taxpayers in this case, the clear purpose of the transactions was to purchase the CEE losses to use as deductions against income. There was no intention on the part of these taxpayers to become active participants in the oil and gas exploration market. This is not fatal for the taxpayer. As was

[71] While the perceived inappropriateness of a particular result might be relevant when dealing with ambiguity—consider, for example, Mr. Justice Estey's comments in *Johns-Manville*, supra footnote 32—it is not evidence of the intent of Parliament, but only of the apparent flaw in the legislation.

[72] Supra footnote 21, at 5311-12; 138.

held by Jackett, C.J. in *Alberta and Southern Gas Co. v. Canada* . . . and cited approvingly by the majority of the Supreme Court of Canada in *Stubart* (*supra*),

> . . . a transaction that clearly falls within the object and spirit of [a given section of the Act] cannot be said to unduly or artificially reduce income merely because the taxpayer was influenced in deciding to enter into it by tax considerations.

What is most important here is that the taxpayers claimed the deduction incurred in their capacity as limited partners. *The entity in which they were partners did legitimately incur CEE and was actively involved in oil and gas exploration. . . .*

It was later recognized by Parliament that this regime had outlived its usefulness, and the provisions were changed to tighten the system. Until this realization, though, the regime was in place to encourage investment in a risky enterprise, all for the sake of the national energy policy. When you add into the mix that there was some political will to encourage exploration of Canada's east coast and potentially invigorate a depressed economy, *it no longer seems implausible that Parliament would have allowed deductions to be taken by taxpayers who were not actual players in the industry. This was, we must remember, an incentive scheme* [emphasis added].[73]

Once again, the essence of Mr. Justice McDonald's judgment is that he is reluctant to fly in the face of clearly worded statutory provisions in the absence of clear and cogent evidence that Parliament did not intend the provisions to apply in the circumstances advocated by the taxpayers.

Conclusion

The approach taken by the majority of the Supreme Court in *Fording Coal* and *Central Supply* provides the courts with significant discretion as to the circumstances in which the GAAR should apply. Unfortunately, this discretion will make it very difficult for taxpayers and their advisers to assess with any reasonable degree of certainty the circumstances in which the GAAR might apply. Moreover, it will undoubtedly give rise to many situations in which the minister will attempt to apply the GAAR to remedy deficiencies in the Act, probably with some considerable success. This is not an appropriate role for a statutory anti-avoidance provision.

The GAAR Cases

To date, there is one Tax Court of Canada case—*McNichol*—that directly addresses the application of the GAAR. There is also a second case—*Michelin*—which considers the application of a similar general anti-avoidance rule in the Excise Tax Act.[74] These cases provide the first insight into the way in which the courts may interpret the GAAR.

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[73] Ibid., at 5313-14; 141-42.

[74] RSC 1985, c. E-15, as amended (herein referred to as "the ETA").

The Michelin Case[75]

Background

In 1990, government and business were preparing for the transition from the federal sales tax (FST) to the goods and services tax (GST) on January 1, 1991. The change from FST to GST meant that businesses needed refunds for the FST cost embodied in their inventories on the transition date; otherwise, goods would be subjected to both taxes.

The problem was that refunds to all businesses at the then current FST rate of 13.5 percent would have resulted in a total payment by the federal government far exceeding the actual FST incorporated in inventories across the country. The FST was imposed at the basic levels of trade—on manufacturers and importers. As goods passed on to distributors and then to retailers, the percentage FST content of the inventory cost generally decreased as the percentage attributable to the markup of intermediaries increased. The federal government determined that 8.1 percent of the cost of the aggregate inventory of Canadian business represented FST and decided that the FST rebate would be paid at this rate to all persons, regardless of their position in the production and distribution chain. Companies, such as Michelin, that had an actual FST cost closer to 13.5 percent were disadvantaged by this arbitrary rate.

In 1990, Michelin had an inventory of imported tires on which it had paid 13.5 percent tax amounting to approximately $2.3 million. Under the FST rebate, Michelin would have been entitled to a rebate of only 8.1 percent of the value of the inventory, roughly $1.4 million. Michelin therefore looked for an alternative means of recovering the $900,000 shortfall. It found one in the general FST refund provisions of the ETA.

In brief, Michelin proposed to sell the tires to an affiliated company, Uniroyal Goodrich Canada Inc., which applied to Revenue Canada to be deemed under section 48 of the ETA to be the manufacturer of the tires and for those goods to be partly manufactured goods produced or manufactured in Canada. If this application was granted—as it was—on completion of the sale, Michelin would become entitled under section 68.2 of the ETA to claim a refund of the FST it had paid on importation of the tires.

A sale agreement was entered into on November 16, 1990 with an effective date of December 28, 1990. The tires were not physically delivered to Uniroyal but instead were to be stored with Michelin for a weekly fee of $30,000. As well, Uniroyal insured the tires from December 27, 1990 until January 3, 1991.

Under a second agreement signed on January 2, 1991 and January 4, 1991, Michelin repurchased the tires from Uniroyal effective January 2, 1991. Since this sale took place in 1991, it was under the GST regime, which provided for the recovery of FST.

[75] Supra footnote 22.

In February 1991, Michelin applied under section 68.2 for a full refund of the $2,265,929.10 in FST originally paid on the imported tires. Revenue Canada denied the section 68.2 application on the basis that there had been no bona fide sale to Uniroyal. The notice of determination denying the refund claim did not refer to the GAAR under the ETA. Michelin then applied for the 8.1 percent FST transitional inventory rebate of $1,438,140.06, which was granted with interest.

Michelin objected to the determination, and Revenue Canada confirmed it in October 1993, still without making reference to the GAAR. Michelin appealed the denial of the refund to the CITT. Before the appeal was heard, counsel for Revenue Canada notified counsel for Michelin that it would be seeking to apply the GAAR to deny the FST refund claim.

At the CITT: The Minister's Non-GAAR Arguments

Although the application of the GAAR is the most notable feature of the decision, the *Michelin* case is also interesting for its discussion of the additional grounds on which Revenue Canada defended the denial of the refund. The arguments related to the nature of the sale transaction—that is, whether it was legally effective or a sham—and whether Michelin and Uniroyal were so closely related that they constituted one economic entity.

The CITT rejected these arguments and decided that the sale was legally effective, so that Michelin satisfied the technical requirements of section 68.2. The CITT then considered the minister's argument that the refund should be denied on the basis of the GAAR.

Application of the GAAR

The CITT observed that the transactions resulted in a benefit to Michelin, which was the increased FST refund (13.5 percent versus 8.1 percent). Furthermore, the transaction could not be justified on the grounds that there was a bona fide business purpose other than the obtaining of a tax benefit, since there was no other reason for the transaction.

The CITT had to consider whether the transaction resulted in a misuse or abuse of the ETA. Michelin argued that the onus of proving misuse or abuse was on the minister. The CITT, however, stated that there is no support in the case law for such a proposition and that, in general, the onus of demonstrating that an assessment is wrong lies with the taxpayer.

No matter where the onus lay, the CITT concluded that the evidence "clearly" showed that there was a misuse of section 68.2 (the refund provision), section 48 (under which Uniroyal applied to be deemed the manufacturer of the tires), and an abuse of the ETA as a whole. Unfortunately, the CITT offered very little reasoning for its conclusion and did not discuss in any detail the concepts of misuse of a provision or abuse of the provisions of the ETA as a whole. In fact, to make its determination, the CITT appears to have relied only on Revenue Canada's own interpretation of the GAAR as set out in *GST Memorandum* 500-6-9, to the effect that relying on the strict wording of a provision to gain a tax benefit where none was intended would be a misuse or abuse of the legislation.

The CITT simply concluded that to allow the refund, it would have to rely on the strict wording of section 68.2, and the result would be inconsistent with the overall intent of that section and the ETA. There was no discussion of why Michelin was considered to be relying on the *strict* wording of section 68.2 or of the relevance of this presumption to the CITT's decision. The CITT went on to note that any doubt concerning the application of the GAAR should be resolved in favour of Michelin, but, in the circumstances, there was no doubt.

The absence of analysis makes it difficult to draw a principle from the decision in *Michelin*. It may be inferred from the facts that the CITT was influenced in its decision by two principal considerations: (1) the fact that the transactions were undertaken wholly at the direction of Michelin, and (2) the fact that the transactions were undertaken outside the ordinary course of Michelin's business and solely for the purpose of generating the refund of FST. Under the circumstances, although the transactions technically complied with the language of section 68.2, they did not arise in circumstances that were consistent with the object and spirit of that provision or of the ETA read as a whole.

At first blush, the decision in *Michelin* appears to favour the approach of the majority of the Federal Court of Appeal in *Fording Coal* and *Central Supply* over that of the minority. However, if one considers the facts carefully, an argument can be made that the *Michelin* case is an example of a situation where the transactions were so blatantly synthetic that they did not bring the taxpayer within the wording of the provision. In other words, the CITT concluded that the plain meaning of the provision in issue, when viewed in the context of the Excise Tax Act as a whole, reasonably suggested that the provision was intended to apply to legitimate commercial transactions and not to transactions that were devoid of commercial animus and implemented for the sole purpose of obtaining a refund. The *Michelin* case is thus distinguished from *Fording Coal* and *Central Supply* on the basis that the provisions in issue in those cases did not suggest the circumstances in which Parliament intended them to apply, beyond the generic observation that they were intended to promote exploration and development in Canada.[76]

One could nevertheless argue that the CITT was wrong to deny the application of a provision that on its face was clear and unambiguous. Such an approach, however, fails to recognize that the mechanical conditions for the application of a provision do not necessarily dictate the

[76] In both *Fording Coal* and *Central Supply*, the deductions resulted from actual expenses incurred in respect of exploration and development. Moreover, the taxpayers acquired the benefit of these deductions in accordance with the express provisions of the Act. In the absence of cogent evidence to the contrary, it could not be said that the result obtained by the taxpayers in those cases was not intended by Parliament. In *Michelin*, the entire series of transactions was contrived to produce a refund of tax and nothing else. The transactions were not commercial transactions structured so as to produce a beneficial tax result. The sole purpose of the transactions was to produce a refund of tax under a relatively mechanical taxing statute.

circumstances in which that provision should apply where the words employed, when viewed within the context of the Act as a whole, lead to the reasonable conclusion that they were not intended to capture within their scope the activities of the taxpayer. In the *Michelin* case, the context of the refund provision suggested that Parliament intended the provision to provide relief to taxpayers engaged in the commercial sale of goods on which FST had been previously assessed. The apparent rationale of the CITT in denying the refund is therefore not markedly different from the rationale of the Supreme Court of Canada in the *Fraser* case.[77]

The McNichol Case[78]

McNichol is the first income tax case to apply the GAAR. In that case, the Tax Court used the GAAR to tax as a taxable dividend a capital gain realized by the taxpayers. Unfortunately, the court's analysis of subsection 245(4) is brief and not particularly instructive.

Facts

The case involved four individual taxpayers who were partners in a law firm and equal shareholders in Bec Holding Corporation Limited ("Bec"). Bec owned the building in which the law firm had its offices. Following a difference of opinion, the law firm decided to move its offices to another building. As a result, Bec sold the old office building in January 1989 and realized a capital gain. Shortly after the sale, the non-taxable portion of the capital gain was distributed equally among the taxpayers as a tax-free capital dividend. Following this distribution, Bec's only substantial asset was $318,666 in cash, representing the remainder of the proceeds of disposition of the building, and the balance in its refundable dividend tax on hand account. Bec did not carry on any activity after the sale of the building.

The taxpayers had two options. First, they could wind up Bec and distribute the remaining cash among themselves. The amount distributed would have been treated as a taxable dividend because of the nominal paid-up capital of the shares. Second, the taxpayers could sell their shares in Bec, realize a capital gain on the disposition, and use the $100,000 lifetime capital gains exemption to eliminate the taxable capital gain. The taxpayers chose the latter course.

The taxpayers were approached first by Malcolm Dunfield, who expressed an interest in purchasing the shares for $40,000 less than their book value. Subsequently, Michael Forestell indicated that he might be interested. After some negotiation, the taxpayers agreed to sell their shares for $300,000 to Beformac Holding Limited ("Beformac"), a corporation of which Mr. Forestell was the president. Beformac arranged to borrow $300,000 from a bank to finance the purchase of the Bec shares. The loan was secured by Bec's cash on hand in the amount of $318,666.

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[77] Supra footnote 29.

[78] Supra footnote 10.

The share transaction closed on March 31, 1989; Bec and Beformac amalgamated on April 5, 1989; and the bank loan was repaid on April 21, 1989. There was no express fee for the transaction. Instead, Beformac agreed to purchase the Bec shares on the basis that it would realize approximately $18,000, representing the difference between the purchase price and the amount of Bec's cash on hand.

Revenue Canada reassessed the taxpayers, using the GAAR to treat the disposition of the shares as distributions from Bec and, consequently, as dividend income. The taxpayers appealed to the Tax Court of Canada, and the minister, in his original and amended replies, relied on subsection 84(2), section 84.1, and the GAAR.

The Judgment

Responding to the minister's first argument, the court found that subsection 84(2) had no application. Subsection 84(2) deems a dividend to have been paid to shareholders where a corporation distributes or otherwise appropriates property of the corporation to its shareholders. The court found that this provision was not applicable because Bec had not distributed anything to the taxpayers. Rather, it was property of Beformac, in the form of funds borrowed from the bank, which had found its way to the taxpayers. Although the Crown attempted to recharacterize the transaction, the court rejected this argument:

> Subsection 84(2) is not ambiguous. It applies only "where funds or property of a corporation . . . have . . . been distributed or otherwise appropriated in any manner whatever to or for the benefit of the shareholders. . . ." It is impossible to conclude that the money which found its way into the pockets of the appellants was Bec's money in the face of evidence which demonstrates clearly that (a) Beformac used money borrowed from CIBC . . . and (b) Bec's money remained in its bank account.[79]

The Crown was equally unsuccessful in arguing that section 84.1 applied to the transaction. This anti-avoidance provision is designed to prevent individuals from converting corporate surplus into paid-up capital, debt, or other hard consideration by selling the shares of a resident corporation to another corporation and realizing a capital gain on the sale. Importantly, the section applies only where the transferor does not deal at arm's length with the purchaser corporation and where, after the transaction, the purchaser corporation and the corporation whose shares are sold are connected within the meaning of subsection 186(4). As with subsection 74.1(1) discussed earlier, one might reasonably infer from the mechanics of this provision (derived from the plain meaning of its words) that Parliament considered arm's-length sales utilizing the lifetime capital gains exemption to be acceptable even if the subject of the sale was essentially corporate surplus.

The court concluded that on the basis of the evidence presented, the taxpayers and Beformac were dealing at arm's length and, consequently, section 84.1 did not apply:

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[79] Ibid., at 115; 2097-98.

> The evidence in the present case shows that arm's length bargaining was present in the sale of the Bec shares. The interests of vendors and purchasers were divergent with regard to the purchase price. . . . Buyer and seller do not act in concert simply because the agreement which they seek to achieve can be expected to benefit both.[80]

The court then sought to determine whether the GAAR applied. It commenced its analysis by considering whether the sale of shares was an "avoidance transaction" within the meaning of subsection 245(3). The court concluded that it was.

First, the sale of the shares was clearly a transaction.

Second, the sale resulted in a clearly identifiable "tax benefit"—the reduction of tax resulting from the realization of a capital gain rather than a taxable dividend. Curiously, the court did not comment on the fact that it was the capital gains exemption that provided the benefit and not the capital gain per se, since the capital gain was otherwise taxable at essentially the same rate as a taxable dividend.[81] Also of note is the fact that the court held that there must be a standard against which to assess the existence of a tax benefit:

> Clearly a reduction or avoidance of tax does require the identification in any given set of circumstances of a norm or standard against which reduction is to be measured. Difficulties may exist in other cases in identifying the standard but in this case there is no such difficulty. The benefit sought by the appellants is clearly identified. . . . It is the difference between tax payable by the appellants upon receipt of taxable dividends and that payable upon realization of capital gains from the disposition of shares.[82]

This approach will no doubt cause problems in circumstances where the norm or standard is not so obvious.[83] I submit that the court should have found a "tax benefit" because the capital gains exemption applied to the capital gain realized on the sale, and not because the resulting tax was lower than the tax on a taxable dividend. If necessary, the court could then have considered in its analysis of subsection 245(4) whether the use of the exemption was appropriate in the circumstances.

As to the third component of an avoidance transaction (whether the transaction could reasonably be considered to have been undertaken or arranged primarily for bona fide purposes other than to obtain the tax benefit), the court rejected the taxpayers' argument that the purpose of the transaction was to terminate their association. The court found that

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[80] Ibid., at 118; 2103.

[81] Assuming the two-thirds inclusion rate in effect in 1989. Today, capital gains realized by individuals are taxed at a higher rate than dividends, unless the capital gains exemption applies.

[82] Supra footnote 10, at 119; 2108.

[83] It is not clear that the norm or standard in this case was as obvious as the court suggests. The amount of tax paid was the amount of tax that the Act requires an individual to pay on an arm's-length sale of shares to which the capital gains exemption applies.

the taxpayers could have terminated their association in other ways, particularly by distributing the surplus through taxable dividends. The court decided that the taxpayers opted for the sale of the shares strictly to obtain the tax benefit and for no other bona fide purpose.[84]

With respect, the court's analysis of this issue is not entirely convincing. In fact, it seems to suggest that a taxpayer must always choose the most tax-inefficient means of accomplishing a commercial objective in order to have a bona fide purpose other than to obtain a tax benefit. In this case, the taxpayers had as their commercial objective the dissolution of their relationship as shareholders in Bec. This was clearly their principal objective and the reason for effecting either the winding up of Bec or the sale of its shares. Having fixed on this principal objective, the taxpayers then considered which of two possible alternatives provided the more favourable tax consequences. They concluded that a sale was by far the better choice. Although this decision was clearly motivated by the more favourable tax consequences of a sale, it does not displace the fact that the purpose or objective of the taxpayers in undertaking the transaction in the first place was to dissolve their relationship. I submit that it is inappropriate to disregard this base purpose without further analysis simply because the route chosen provided a better tax result. While the court's analysis may have been appropriate if the sale had been inserted into a series of otherwise commercial transactions in order to obtain a tax benefit, it was not appropriate where there was only one transaction[85] by the taxpayers and that transaction achieved the commercial objective in the most tax-efficient manner.[86]

Having found the sale of shares to be an avoidance transaction, the court proceeded to analyze whether subsection 245(4) operated to prevent the application of subsection 245(2). Subsection 245(4) provides that subsection 245(2) will not apply to a transaction where it may reasonably be considered that the transaction would not result directly or indirectly in a

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[84] Although the court did not accept the taxpayers' assertions as to purpose, its interpretation of this provision is clear: a transaction will not be an avoidance transaction if there is a bona fide purpose to the transaction other than the obtaining of a tax benefit.

[85] One might argue that there was a series of transactions—the sale of the shares by the taxpayers followed by the amalgamation of Bec and Beformac. However, Judge Bonner did not suggest that his conclusions were based on the interposition of a sale in a series of transactions. It is therefore unlikely that this is the justification for his conclusion that the sale was an avoidance transaction.

[86] The technical notes that accompanied the introduction of the GAAR support this position: "Where a transaction is carried out for a combination of bona fide non-tax purposes and tax avoidance, the primary purposes of the transaction must be determined. This will likely involve weighing and balancing the tax and non-tax purposes of the transaction. If, having regard to the circumstances, a transaction is determined to meet this non-tax purpose test, it will not be considered to be an avoidance transaction. Thus a transaction will not be considered to be an avoidance transaction because, incidentally, it results in a tax benefit *or because tax considerations were a significant, but not the primary, purpose for carrying out the transaction* [emphasis added]." See the technical notes to Bill C-139, supra footnote 19, at clause 186.

misuse of the provisions of the Act or an abuse having regard to the provisions of the Act read as a whole. In the court's opinion, this provision

> must have been intended to make allowance for transactions which the legislature sought to encourage by the creation of tax benefit or incentive provisions or which, for other reasons, do no violence to the Act, read as a whole.[87]

The court does not explain the basis for this approach, which seems to unjustifiably limit the circumstances in which subsection 245(4) may apply. On its face, subsection 245(4) requires the court to assess whether there has been a misuse or abuse. Nothing in the language of the provision suggests that its application is limited in the manner suggested by the court.

With respect to the concept of "misuse," the court stated succinctly that the transaction in question was a misuse of sections 38 and 110.6. Unfortunately, the court failed to state how or in what respect this was so. Sections 38 and 110.6 are simple, mechanical inclusion/deduction mechanisms that either apply or not. Certainly, neither the language employed nor the mechanics that this language describes suggest that either provision was intended to apply in any particular set of circumstances. In fact, the only guidance as to the circumstances in which the provisions were intended to apply is found in other provisions of the Act, such as subsection 55(2), section 84, and section 84.1. Moreover, the court's analysis of the latter two provisions leads one to conclude that sections 38 and 110.6 were intended to apply in the particular circumstances in issue (that is, to an arm's-length sale of shares). At the very least, one may conclude that there is no cogent evidence that Parliament did not intend these sections to apply in the particular circumstances.

Under the circumstances, it is difficult to conceive how the court could conclude that the provisions were being "misused" unless, in the words of Mr. Justice Iacobucci, the transaction attracting their application "is a sham or is so blatantly synthetic as to be effectively artificial."[88] Certainly, such a conclusion does not accord with the court's finding that the shares were sold in an arm's-length sale—an ordinary commercial transaction to which subsection 110.6(3) was clearly intended to apply. Nor does it accord with the court's findings that the transaction was not a sham, was not a distribution of Bec's surplus, and was not a transaction to which subsection 84.1(1) applied.

The court spent considerably more time analyzing whether the transaction constituted "an abuse having regard to the provisions of [the] Act . . . read as a whole." To this end, the court reviewed the provisions of the Act that create a scheme dealing with distributions of corporate property to shareholders, with particular emphasis on sections 12, 15, and 84. The court held out these provisions as examples of Parliament's intention that

[87] Supra footnote 10, at 120; 2109.

[88] *Antosko*, supra footnote 37, at 6319; 31.

distributions of corporate property to shareholders be included in income. In the context of this scheme, the court stated, "Where the legislature intends that distributions of corporate property to shareholders be excluded from income express provision is made as in subsection 83(2),"[89] regarding capital dividends. What is not clear is why the court viewed this scheme as relevant after expressly finding, in relation to the inapplicability of subsection 84(2), that "it cannot be said that Bec's property was distributed or otherwise appropriated to the appellants in any manner whatever."[90] If it was clear to the court that corporate property was not distributed to Bec's shareholders, one may question why the scheme of the Act with respect to the "proper" treatment of corporate distributions was relevant to an assessment of whether there was an abuse of the Act. An equally tenable argument can be made that, given the specific finding of the court that there was an arm's-length sale of the Bec shares, the scheme of the Act governing the taxation of capital gains was the scheme most relevant to determining whether there had been an abuse of the Act.

Even assuming that the dividend distribution scheme was relevant, I submit that the circumstances in which distributions are to be taxed are expressly set out in the provisions reviewed by the court, and the court itself held that these provisions did not apply. Given the use of such broad concepts as "arm's length"[91] and "in any manner whatever"[92] in these provisions, one may argue that the sale of the Bec shares, which was in no way artificial or contrived, was in fact consistent with the scheme of the Act based on a reasonable interpretation of its provisions and was therefore not an abuse.

The basis of the court's conclusion that the exclusion in subsection 245(4) was not applicable to the sale is found in the following passage:

> It is sufficient to note that on any view of subsection 245(4), the transaction now in question, which was, or was part of, a classic example of surplus stripping, cannot be excluded from the operation of subsection (2). After all, Bec's surplus was, at the very least, indirectly used to fund the price paid to the appellants for their shares.[93]

The clear implication of this statement is that the practice commonly referred to as surplus stripping is inherently an abuse of the Act. This

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[89] Supra footnote 10, at 121; 2112.

[90] Ibid., at 116; 2100. In *RMM Canadian Enterprises Inc. et al. v. The Queen*, 97 DTC 302 (TCC), Judge Bowman reviewed a similar transaction involving a "surplus strip" by a non-resident corporation. Judge Bowman concluded that both subsection 84(2) and subsection 212.1(1) (the non-resident counterpart to subsection 84.1(1)) applied to tax the sale proceeds as a dividend. This is perhaps the route that should have been taken in *McNichol*. Unfortunately, Judge Bowman confused the GAAR issue further by finding in obiter that if these provisions had not applied, he would have adopted the rationale in *McNichol* and applied the GAAR to recharacterize the sale proceeds as dividends.

[91] Subsection 84.1(1).

[92] Subsection 84(2).

[93] Supra footnote 10, at 120; 2110.

presumption formed the basis for the court's conclusion that any action that amounted to surplus stripping in a purely economic sense could not be entitled to the protection of subsection 245(4) because it was ipso facto an abuse of the Act.

In reaching this conclusion, the court made reference to former subsection 247(1) as part of the legislative response to surplus stripping. Although the court clearly stated that it was not suggesting that the repealed provision was still effective, it did suggest that the repeal "cannot be regarded as a basis for a conclusion that the legislature intended to relax the strictures against surplus stripping."[94] In essence, the court adopted the position set out in the technical notes that accompanied the repeal of subsection 247(1) to the effect that the introduction of the GAAR meant that subsection 247(1) was no longer necessary. This analysis, however, ignores the fact that, unlike subsection 247(1), the GAAR is not a stand-alone provision. Subsection 245(4) clearly requires the presence elsewhere in the Act of substantive rules that provide the framework or scheme within which to determine whether a transaction constitutes a misuse or abuse. If a particular transaction is an ordinary commercial transaction that does not do violence to any specific provision of the Act or to the scheme of the Act as determined by a reasonable interpretation of *all* its provisions, the GAAR should not have any application. Moreover, I submit that the application of the GAAR should be based on legislative intent as drawn from the existing provisions of the Act (determined by applying the principles of statutory interpretation reviewed earlier in this article), and not from assumptions as to why a specific anti-avoidance provision was repealed.

Since former subsection 247(1) appears to have strongly influenced the court in its conclusion that surplus stripping is inherently contrary to the scheme of the Act, it is unfortunate that the court seems not to have considered the timing of the repeal of this rule. In particular, the repeal of subsection 247(1) coincided with an increase in the rate of taxation of capital gains to the point where, in the absence of the capital gains exemption, capital gains of individuals are taxed at a higher rate than taxable dividends. For this reason, I suggest that surplus stripping is not inherently abusive, and therefore it is not self-evident that an arm's-length transaction that allows a taxpayer to extract corporate surplus in the form of a capital gain rather than a taxable dividend is automatically excluded from the application of subsection 245(4).

The analysis of the court in *McNichol* is disappointing in that the court fails to provide a basis consistent with its express findings of fact and law for its conclusion that the arm's-length sale of shares was not entitled to the shelter afforded by the capital gains exemption. Instead, the court appears to apply a "smell" test akin to that adopted by the majority in *Fording Coal* and *Central Supply* in concluding that a sale of shares that, in economic terms, represents a distribution of corporate surplus is always

[94] Ibid., at 121; 2112.

an abuse of the Act read as a whole. This approach is not consistent with the rules of statutory interpretation set down by the Supreme Court of Canada in *Antosko* and the other cases reviewed earlier, nor is it consistent with the statutory scheme of section 245. Rather, the Tax Court in *McNichol* seems to favour a subjective approach to subsection 245(4) that provides the courts with the discretion to determine what is and is not acceptable tax planning, without any need to establish that the impugned transaction is contrary to the scheme of the Act as determined by a reasonable interpretation of its provisions and by a rational analysis of why those provisions produce a result that warrants the application of the GAAR. It can only be hoped that as higher courts consider the GAAR, they will not follow the approach suggested by *McNichol*.

CONCLUSION

In assessing the degree to which subsection 245(4) should be used to protect taxpayers from the application of the GAAR, the courts are faced with at least two possible alternatives. The first approach follows in general terms the rules of statutory interpretation set down by the Supreme Court of Canada in cases such as *Antosko* and *Bon-Secours*. Under this approach, the court is not confined to a literal interpretation of the provision in assessing whether it has been misused or abused, but rather is entitled to consider the purpose of the provision as reasonably construed from its language and the context in which it is found. This approach does not, however, provide the courts with carte blanche to attribute to Parliament an intention (or lack thereof) that cannot reasonably be extracted from the language of the provision or the context in which it is placed.

The second approach essentially ignores the rules of statutory interpretation in favour of a subjective assessment by the court of whether Parliament could have intended the provision to apply in the circumstances advocated by the taxpayer. This is a much more nebulous approach that undoubtedly would lead to great uncertainty as to the circumstances in which the GAAR may apply.

As a practitioner, I can only hope that the interpretation of the GAAR evolves more in line with the first approach than the second.