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# Converging Tracks? Recent Developments in Canadian and UK Approaches to Tax Avoidance

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## ABSTRACT

For the time being, the courts in Canada and the United Kingdom seem to have reached similar positions on the application of general principles to tax avoidance. This is despite the existence of a general anti-avoidance rule (GAAR) in Canada and the absence of any such statutory provision in the United Kingdom. On this analysis, the Canadian GAAR adds nothing to modern principles of statutory interpretation. Arguably, legislation is needed in both jurisdictions, but for different purposes.

**KEYWORDS:** AVOIDANCE ■ GAAR ■ STATUTORY INTERPRETATION ■ SUPREME COURT DECISIONS ■ UNITED KINGDOM

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In 1986, Heward Stikeman wrote of tax-avoidance decisions in Canada and the United Kingdom that “[f]or many years the Courts of both our countries appeared to have been on parallel tracks. Those tracks are now diverging—perhaps!”<sup>1</sup>

Following decisions in two pairs of cases—*Canada Trustco*<sup>2</sup> and *Mathew*<sup>3</sup> in Canada, and *Barclays*<sup>4</sup> and *Scottish Provident*<sup>5</sup> in the United Kingdom—we might say that after some years of divergence, these tracks are now converging again—perhaps!

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1 H. Stikeman, “Furniss v Dawson: The Canadian Approach” (1986) vol. 7, no. 1 *Fiscal Studies* 82-94, at 82.

2 *The Queen v. Canada Trustco Mortgage Co.*, 2005 SCC 54. This note does not purport to give full coverage of this major case and its companion, *Mathew*, infra note 3, which have been well covered already by Canadian commentators and will no doubt be the subject of much further discussion. For an excellent analysis, see David G. Duff, “The Supreme Court of Canada and the General Anti-Avoidance Rule: Canada Trustco and Mathew” (2006) vol. 60, no. 2 *Bulletin for International Fiscal Documentation* 54-71.

3 *Mathew v. The Queen*, 2005 SCC 55.

4 *Barclays Mercantile Business Finance Ltd. v. HM Inspector of Taxes*, [2004] UKHL 51; [2005] STC 1.

5 *Inland Revenue v. Scottish Provident Institution*, [2004] UKHL 52; [2005] STC 15.

The “perhaps” is important. Tax-avoidance cases often leave as many questions open as they answer, and the most recent round of decisions is no exception. Neither in Canada nor in the United Kingdom have we reached the end of the line; there will be much more discussion and argument to come, not to mention the possibility of legislation in both jurisdictions. Nevertheless, at least on the surface, there are similarities between the positions reached in the two countries via different routes. In each country the intention of the particular statute concerned, as revealed by its wording construed in context, is paramount; in each jurisdiction the fact that a transaction is motivated by tax saving is not, on its own, fatal to its effectiveness for tax minimization purposes.

At this stage, therefore, it is tempting to speculate whether all roads lead to Rome when it comes to trying to devise methods of dealing with tax avoidance. Whether judicial or statutory formulations are adopted, it appears that the judiciary in both the United Kingdom and Canada have a profound concern with their constitutional role that still results in their applying a self-limiting ordinance, especially when it comes to taxation. They may now go beyond literal interpretation, but they will not stray into what appears to them to be the creation of new rules that Parliament might have introduced had it thought about it but which, in fact, it did not.<sup>6</sup> In the area of taxation, even more than in other contexts, Parliament often does not cover the fact situations that taxpayers and their advisers manage to devise. What is curious is that, despite the existence of a statutory general anti-avoidance rule (GAAR) in Canada,<sup>7</sup> the most recent judgments of the Supreme Court are, arguably, rather *more* conservative than the latest tax-avoidance decisions of the House of Lords in the United Kingdom, where there is no GAAR. One might have expected that the GAAR would give a legislative signal to judges to be bold, but it seems to have had the opposite effect of making them all the more careful to protect the taxpayer. In the United Kingdom, certainly, some will see this as a vindication of the policy of relying upon judicial creativity.

Stikeman’s comment above followed the decisions in *Stuart Investments Ltd v. The Queen*<sup>8</sup> in Canada and *Furniss v. Dawson*<sup>9</sup> in the United Kingdom. *Stuart* had definitively rejected the idea of a business purpose test for Canada.<sup>10</sup> *Furniss v. Dawson* was thought (though only by some)<sup>11</sup> to establish or at least herald such a test in the United Kingdom. The judicial approach to tax avoidance initiated in

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6 An approach once espoused by Posner, although apparently no longer. On this point and more generally on different schools of statutory interpretation in relation to taxing statutes, see Neil Brooks, “The Responsibility of Judges in Interpreting Tax Legislation,” in Graeme S. Cooper, ed., *Tax Avoidance and the Rule of Law* (Amsterdam: IBFD Publications BV, 1997), 93-129.

7 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.

8 [1984] 1 SCR 536.

9 [1984] AC 474 HL.

10 See *Stuart*, supra note 8, at 540 and 575-76.

11 See *Stuart*, *ibid.*, at 562-63, for the varying views of Canadian academics on *Ramsay* at this point.

*Ramsay*<sup>12</sup> appeared to be developing as the judges glossed it and evolved a formulation that seemed to include lack of business purpose as a factor.

In *Furniss v. Dawson*, Lord Brightman set out the extent of the *Ramsay* principle as follows:

First, there must be a pre-ordained series of transactions; or, if one likes, one single composite transaction. This composite transaction may or may not include the achievement of a legitimate commercial (i.e. business) end. . . . Secondly, there must be steps inserted which have no commercial (business) *purpose* apart from the avoidance of a liability to tax—not “no business *effect*.” If those two ingredients exist, the inserted steps are to be disregarded for fiscal purposes. The court must then look at the end result. Precisely how the end result will be taxed will depend on the terms of the taxing statute sought to be applied.<sup>13</sup>

It should be noted that, even in this, the strongest formulation of the “principle,” lack of business purpose alone was not enough to remove the effectiveness of a tax-avoidance scheme; all depended upon the wording of the statute. The better view is that there never was a business purpose test in the United Kingdom.<sup>14</sup> Certainly, if it ever did exist, it has been firmly rejected by the House of Lords in *Barclays*. Lord Nicholls, delivering the opinion of all members of the Appellate Committee of the House of Lords,<sup>15</sup> stated:

Cases such as these [*IRC v. Burmah*,<sup>16</sup> *Furniss v. Dawson*, and *Carreras Group Ltd. v. Stamp Commissioner (Jamaica)*<sup>17</sup>] gave rise to a view that, in the application of *any* taxing statute, transactions or elements of transactions which had no commercial purpose were to be disregarded. But that is going too far.<sup>18</sup>

He then went on to explain the rule in *Ramsay* as a general rule of statutory construction, as had been emphasized earlier in *MacNiven v. Westmoreland Investments*<sup>19</sup> and *The Collector of Stamp Revenue v. Arrowtown Assets Ltd.*<sup>20</sup> Already, both in *Westmoreland* and in *McGuckian v. Commissioners of Inland Revenue*,<sup>21</sup> the House of

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12 *W.T. Ramsay v. Inland Revenue Comrs.*, [1982] AC 300 (HL).

13 *Supra* note 9, at 527.

14 Richard M. Ballard and Paul E.M. Davison, “United Kingdom,” in *Form and Substance in Tax Law*, Cahiers de droit fiscal international, vol. 87a (The Hague: Kluwer Law International, 2002), 569-90.

15 Lord Nicholls, Lord Steyn, Lord Hoffmann, Lord Hope, and Lord Walker.

16 [1982] STC 30 (HL).

17 [2004] UKPC 16.

18 *Supra* note 4, at paragraph 36.

19 [2001] STC 237 (HL).

20 [2003] HKCFA 46.

21 (1997), 69 TC 1 (HL).

Lords had rejected the notion of *Ramsay* as a judicial doctrine. This development was muddled by the introduction into the picture by Lord Hoffmann of what for a while appeared to be a new, and completely unworkable, distinction between juristic and commercial meaning. In *Westmoreland*, Lord Hoffmann suggested that

[t]he innovation in *Ramsay* was to give the statutory concepts of “disposal” and “loss” a commercial meaning. The new principle of construction was a recognition that the statutory language was intended to refer to *commercial* concepts, so that in the case of a concept such as a “disposal,” the court was required to take a view of the facts which transcended the *juristic* individuality of the various parts of a preplanned series of transactions.<sup>22</sup>

The obvious problem was to know in advance whether a concept would be construed as commercial or juristic (legal). In *Westmoreland*, payment was held to be a legal concept, and so the scheme there succeeded. The same word, however, was held to have a commercial meaning in another case and another context.<sup>23</sup> This legal/commercial dichotomy was much criticized<sup>24</sup> and was laid to rest in *Barclays*, where the House of Lords rejected the notion that “an answer can be obtained by classifying all concepts *a priori* as either ‘commercial’ or ‘legal.’ That would be the very negation of purposive construction.”<sup>25</sup>

The House of Lords has now confirmed that the essence of the “new approach” to tax avoidance in the United Kingdom is that the court gives tax provisions a purposive construction in order to determine the nature of the transaction to which it is intended to apply, before going on to decide whether the actual transaction (which might involve considering the overall effect of a number of elements intended to operate together) answers that statutory description.<sup>26</sup> The Law Lords stressed that *Ramsay* did not introduce a new doctrine operating within the special field of revenue law statutes but “rescued tax law from being ‘some island of literal interpretation’ and brought it within generally applicable principles.”<sup>27</sup> Writing in the *British Tax Review*, Lord Hoffmann has, with characteristic frankness, admitted that “[i]n choosing the constructional approach rather than the *Furniss v. Dawson* formula, the House had to rewrite history in a way that struck some people as a little disingenuous.”<sup>28</sup> Whether the latest analysis by the House of Lords is a rewrite

22 Supra note 19, at paragraph 32 (emphasis added).

23 *DTE Financial Services v. Wilson*, [2001] STC 777 (CA) (in the context of “pay as you earn” [PAYE]).

24 Most notably by Lord Millett in *Arrowtown*, supra note 20, at paragraph 150: “[H]is speech has had most unfortunate consequences. It has led to arid debates in an endeavour to fit the statutory language into one or other conceptual category.”

25 Supra note 4, at paragraph 38.

26 Ibid., at paragraph 32.

27 Ibid., at paragraph 33, citing Lord Steyn in *McGuckian*, supra note 21, at 79.

28 Leonard Hoffmann, “Tax Avoidance” [2005] no. 2 *British Tax Review* 197-206, at 202.

or a reversion to what was originally meant, however, it does appear to represent the UK position now—perhaps!

The current situation does not result in stability and predictability and, in practice, gives quite considerable discretion to the courts. It is not impossible that we shall see the re-emergence of a *Ramsay* doctrine. In the *Scottish Provident* case, for example, decided on the same day and by a committee of exactly the same composition as in *Barclays*, the House of Lords found that a scheme entered into by the taxpayer was ineffective for tax purposes. In that case, a new legislative regime was being introduced to tax certain types of derivative contracts on which gains and losses had not been taxable previously. The scheme was designed to take advantage of the transition and had no other purpose. If effective, it would achieve a non-taxable gain and an allowable loss. The scheme used two sets of options, designed in practical economic terms to net off against each other. The Law Lords in *Scottish Provident* gave the statutory language a “wide practical meaning” and so the case can be explained as one of statutory construction. On the other hand, they also referred in this case to the “*Ramsay* principle.” They held that the court of first instance (the Special Commissioners) had erred *in law* in concluding that their finding that there was a realistic possibility of the options not being exercised simultaneously meant, without more, that the scheme could not be regarded as a single composite transaction.<sup>29</sup> This actually marks an important development of *Ramsay*-style thinking, and it could be argued that a finding of law of this nature once again transports the court away from a pure principle of construction. The discussion is not at an end.

Just as most practitioners and commentators in Canada seemed to think that *Canada Trustco* would be decided in favour of the taxpayer and *Mathew* against, and, at least among the practitioners, there was considerable support for this result, so in the United Kingdom the final split between a decision in *Barclays* in favour of the taxpayer and in *Scottish Provident* against was widely predicted and supported.<sup>30</sup> In both jurisdictions the test of why the cases fell on different sides of the line seems to be more intuitive than might be desirable for the purposes of legal science. Some might argue that this is the only practical way of dealing with tax-avoidance issues where bright lines can be utilized by tax planners as well as compliers, while others might find the lack of detailed analysis in both jurisdictions disappointing. In both jurisdictions, the reason why the courts decided against the taxpayers where they did could hold a more promising key to future developments than the cases where the taxpayers were successful. One interesting question to ask is whether in the United Kingdom the decision in *Scottish Provident* could have been reached without *Ramsay*, and whether in Canada the GAAR was essential to the decision in

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29 *Supra* note 5, at paragraph 24.

30 These observations are based on comment in the specialist press in both jurisdictions as well as anecdotal evidence, including, in Canada, the discussions at the Canadian Tax Foundation annual conference, September 2005.

*Mathew*. In other words, does either *Ramsay* or section 245, or both of them, do anything that judges could not achieve purely on the basis of statutory construction?

The Supreme Court of Canada has made it clear in *Canada Trustco* that section 245 of the Act (the GAAR) “does not rewrite the provisions of the *Income Tax Act*; it only requires that a tax benefit be consistent with the object, spirit and purpose of the provisions that are relied upon.”<sup>31</sup> In *Canada Trustco*, “cost” was given what Lord Hoffmann might have called in *Westmoreland* a “legal” meaning, and the mere fact that an economic or commercial purpose was not present was held to be insufficient to show that a transaction resulted in abusive tax avoidance. It was held that economic substance must be considered in relation to the proper interpretation of specific provisions. Here, the relevant provisions did not refer to economic risk but to cost, which in the context of the relevant legislation is a well-understood *legal* concept.<sup>32</sup> In *Mathew*, on the other hand, textual, contextual, and purposive interpretation of the specific provisions in question resulted in the conclusion that Parliament could not have intended the scheme used there to be effective.

To an observer from the United Kingdom, superficially at least, this outcome looks very similar, even in the use of terminology and the notion of legal concepts, to the recent jurisprudence of the House of Lords. The question that then jumps out is whether the GAAR in section 245 adds anything at all to the general law following the construction in *Canada Trustco*. Subsection 245(2) expressly states that it applies to deny a tax benefit where there would be one based purely on the application of a specific taxing provision. Thus the intention of Parliament in introducing this provision must have been to go beyond ordinary principles of statutory construction. To construe the specific statute contextually and in line with its object, spirit, and purpose is simply an application of modern purposive statutory construction, which a UK reader would expect to happen in any case. What does section 245 add?

The Supreme Court’s discussion in *Canada Trustco* affirms that all statutes in Canada, including the *Income Tax Act*, must be interpreted in a textual, contextual, and purposive way.<sup>33</sup> On the other hand, the court seems to suggest that tax statutes might be more likely to be given a textual than a contextual interpretation. The *Duke of Westminster* case<sup>34</sup> is blamed for starting the courts on the literal path for tax legislation, and despite the acknowledged change in approach for all statutes since then, including the *Income Tax Act*, the particularity and detail of tax provisions is said to continue to lead to an emphasis on textual interpretation in tax cases. This seems particularly odd when one returns to *Stubart*, a case that did not rely on the GAAR and that rejected the business purpose test in Canada, but that did set out principles of construction that would allow the courts to look at the object and

31 *Supra* note 2, at paragraph 54.

32 *Ibid.*, at paragraph 75.

33 *Ibid.*, at paragraph 11.

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

spirit of legislation in some cases and that most certainly did not lay down a literal approach. Unfortunately, the *Stuart* principles of construction were not robust enough to ensure that strict statutory interpretation would not return.<sup>35</sup> In *Canada Trustco*, the Supreme Court explains this history and the fact that Parliament deemed *Stuart* to be an inadequate response to the problem of tax avoidance and so enacted the current GAAR.<sup>36</sup> Even so, to give that current GAAR in section 245 some meaning, this provision must be required to go beyond the guidelines in *Stuart*, but how far and to what effect is simply not explained by the Supreme Court.<sup>37</sup> Here, after a clear and promising explanation of its thinking so far, the court's decision stops in mid-air:

The GAAR's purpose is to deny the tax benefits of certain arrangements that comply with a literal interpretation of the provisions of the Act, but amount to an abuse of the provisions of the Act. But precisely what constitutes abusive tax avoidance remains the subject of debate.<sup>38</sup>

The most surprising thing about this statement is not that we do not get a definitive answer to the question posed in the many pages that follow,<sup>39</sup> but the reference to "arrangements that comply with a literal interpretation." Surely there is no question of a literal interpretation, even without the GAAR? This seems, to an outside observer not steeped in the learning of the GAAR, to be the wrong starting place. It would not be the starting point in the United Kingdom.

Both *Canada Trustco* and *Mathew* raise further doubts over what is being added by the GAAR. Subsection 245(4) requires the court to consider whether there has been a misuse of the provisions of the Income Tax Act or an abuse having regard to the provisions of the Act read as a whole.<sup>40</sup> The Supreme Court rejected the

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35 Indeed there was a reaffirmation of a literalist approach in the form of the plain meaning rule in *H.B. Antosko v. The Queen*, [1994] 2 CTC 25 (SCC), and *J. Friesen v. The Queen*, [1995] 2 CTC 369 (SCC). This development is examined in detail in David G. Duff, "Interpreting the Income Tax Act—Part 1: Interpretive Doctrines" (1999) vol. 47, no. 3 *Canadian Tax Journal* 464-533.

36 *Supra* note 2, at paragraph 14.

37 One of the problems here is that the extent of the *Stuart* guidelines was the subject of debate in subsequent cases, as discussed by Duff, *supra* note 35. This does not detract from the point that, given that the Supreme Court in *Canada Trustco* clearly recognizes that a literal approach was rejected in *Stuart* and yet that the legislature still did not feel this went far enough and so enacted the GAAR, the court is obliged to give the GAAR some meaning that takes it beyond the guidelines in the *Stuart* case.

38 *Supra* note 2, at paragraph 16.

39 Paragraphs 60- 62 of *Canada Trustco*, *ibid.*, give a little guidance, but only a little.

40 This point has been discussed in considerable detail in the cases and literature. The English wording of the statute differs from the French. The treatment of the issue is necessarily a simplified version within the confines of this note but is sufficient for the purposes of the current argument. For a more comprehensive discussion of the language of the Act, see Duff, *supra* note 2.

two-stage analysis adopted by the Federal Court of Appeal in *OSFC*<sup>41</sup> in its reading of this requirement—first the narrow textual analysis, followed by the purposive analysis—in favour of a unified one-stage approach. The court’s reasoning for this in *Canada Trustco* is interesting. It states that Parliament could not have intended this two-step approach, which raises the “impossible” question of how one can abuse the Act as a whole without misusing any of its provisions.<sup>42</sup> In *Mathew*, the court confirms this point by making it clear that the process to be gone through in interpreting the statute is one that applies to any legislation in any event:

There is an abiding principle of interpretation: to determine the intention of the legislator by considering the text, context and purpose of the provisions at issue. This applies to the *Income Tax Act* and the GAAR as much as to any other legislation.<sup>43</sup>

This suggests very strongly that the court might have found it possible to reach its conclusion without the benefit of section 245. That impression is sustained by the words of the court:

The basic rules of statutory interpretation require that the larger legislative context be considered in determining the meaning of statutory provisions. This is *confirmed by s. 245(4)*, which requires that the question of abusive tax avoidance be determined having regard to the provisions of the Act, read as a whole.<sup>44</sup>

If all that subsection 245(4) is doing is confirming that the Act must be read as a whole, it does not seem to add very much. Brian Arnold predicted in this journal in 2004 that the GAAR could come to be applied “only in those clear cases of egregious conduct where, arguably at least, the tax benefits of the schemes could be denied simply by applying the provisions of the Act in a reasonable way.”<sup>45</sup> If the direction to look at the provisions of the Act read as a whole is what is added by subsection 245(4), then the interpretation given to this provision by the Supreme Court seems to have rendered these words otiose, because that process has been rolled into the general one-stage statutory interpretation. In the United Kingdom, there is a presumption of statutory interpretation against holding words in a statute to be idle, but this point does not seem to have been discussed in either *Canada Trustco* or *Mathew*.<sup>46</sup> The Supreme Court took the view that although the purpose of the GAAR was to prohibit tax avoidance, it must be done without jeopardizing

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41 *OSFC Holdings Ltd. v. The Queen*, 2001 FCA 260.

42 *Supra* note 2, at paragraph 39. There is a detailed discussion of this issue in Duff, *supra* note 2.

43 *Mathew*, *supra* note 3, at paragraph 42.

44 *Ibid.*, at paragraph 47 (emphasis added).

45 Brian J. Arnold. “The Long, Slow, Steady Demise of the General Anti-Avoidance Rule” (2004) vol. 52, no. 2 *Canadian Tax Journal* 488-511, at 510.

46 F. Bennion, *Statutory Interpretation*, 4th ed. (London: Butterworths LexisNexis, 2002), 992-95.

consistency, predictability, and fairness in tax law. "These three latter purposes would be frustrated if the Minister and/or the courts overrode the provisions of the Income Tax Act without any basis in a textual, contextual and purposive interpretation of those provisions."<sup>47</sup> The question of frustrating the purpose of the GAAR was not considered.

Is it right to say that Canada and the United Kingdom have reached similar positions by different routes? In both jurisdictions we seem to be thrown back to purposive statutory construction as our only guidance. This does not mean that the GAAR will never be held to apply, as we have seen in *Mathew*, but the courts *might* have reached the same conclusion had there been no GAAR.<sup>48</sup> In the United Kingdom, as *Scottish Provident* has already shown, the judiciary will not be averse to making findings of law about when the *Ramsay* principle should apply, and it is not impossible that that principle will be developed further, under the shaky guise of statutory construction, despite all that was said in *Barclays*. The possibility of developments seems greater in the United Kingdom than in Canada, if no amending legislation is introduced in the latter jurisdiction.

Proponents of a GAAR in the United Kingdom<sup>49</sup> will not have gained support from Canadian developments but might continue to argue that a GAAR is needed to give judicial activism authority and define its scope. In Canada, amending legislation may be needed to open up the scope of judicial activity. The tracks may have converged for a while, but we might yet see them diverge again.

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47 *Canada Trustco*, supra note 2, at paragraph 42.

48 While it could be argued that cases such as *Antosko* (supra note 35) suggest otherwise, the point here is that the judges *might* have been more ready to take a purposive view of legislation themselves in appropriate cases if there had been no GAAR.

49 Including this author: see Judith Freedman, "Defining Taxpayer Responsibility: In Support of a General Anti-Avoidance Principle" [2004] no. 4 *British Tax Review* 331-57.