Policy Forum: Confusion Worse Confounded—The Supreme Court’s GAAR Decisions

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ABSTRACT
This article analyzes the Supreme Court of Canada’s decisions in Canada Trustco v. The Queen and Mathew v. The Queen, the first cases heard by the court involving the application of the general anti-avoidance rule (GAAR). The article begins with a review of the case law, followed by an examination of the Supreme Court’s statements with respect to statutory interpretation in general. The heart of the article deals with the court’s interpretation of the GAAR and its application in the two cases, and concludes with some speculation about the implications of the decisions for future cases involving the GAAR.

According to the author, the Supreme Court’s decisions are seriously deficient (irrespective of the results in the cases) for four reasons. First, the court fails to answer clearly the question of whether taxing statutes should be interpreted in the same way as other statutes, or differently. Second, it does not provide any clear guidance on the question of how to determine whether an avoidance transaction is abusive. Third, the court does not clarify the relationship between the interpretation of other provisions of the Income Tax Act and the determination of abuse under the GAAR. Fourth, and most important, the court fails to provide a principled basis to justify the different results in the Canada Trustco and Mathew cases.

KEYWORDS: GENERAL ANTI-AVOIDANCE RULE

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INTRODUCTION

On October 19, 2005, the Supreme Court of Canada released its first two decisions involving the application of the general anti-avoidance rule (GAAR) in section 245 of the Income Tax Act. The GAAR was introduced in 1987 in an attempt to control abusive tax avoidance and as a response to the Supreme Court’s rejection of a business purpose test in the Stubart case in 1984. The GAAR is an especially important provision in the context of the Canadian tax system because Canadian courts have rarely used judicial anti-avoidance doctrines, such as substance over form, sham, or business purpose, to prevent abusive tax avoidance.

This article analyzes the Supreme Court’s GAAR decisions in detail. It begins with a brief review of the case law in the Federal Court of Appeal and the Tax Court of Canada dealing with the GAAR. It then examines closely the Supreme Court’s statements about statutory interpretation in general, because those statements are confusing and problematic. The court’s interpretation of the GAAR and its application in the two cases form the heart of the article. The article concludes with some speculation about the implications of the decisions—for future cases involving the GAAR; for the Canada Revenue Agency (CRA) in applying the GAAR; for taxpayers and their advisers; and for the Department of Finance with respect to the possibility of amendments to the GAAR. Although it is only a few months since the Supreme Court’s decisions were released, the impact of the decisions can already be discerned, at least tentatively, in several Tax Court cases.

It is important that I disclose my bias at the outset. I was a consultant to the Department of Finance during the 1986-87 tax reform and I worked closely with Finance officials on the development of the GAAR. I have also written about the

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2 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.
3 Stubart Investments Ltd. v. The Queen, [1984] CTC 294 (SCC).
GAAR and the case law interpreting and applying it. In my view, a robust general anti-avoidance provision is an essential aspect of the Canadian tax system. Tax avoidance imposes significant costs on the tax system. It benefits wealthy individuals and large corporations disproportionately, at the expense of those taxpayers who cannot engage in tax avoidance, such as employees.

The article relies extensively on quotations from the Supreme Court’s decisions in the two GAAR cases to reveal what are, in my opinion, serious deficiencies in the court’s reasoning. My interpretation of the court’s words can then be easily checked against those words. There is, of course, always the danger of quoting out of context. I have tried to avoid doing so, occasionally by quoting at greater length than would ordinarily be the case. In the end, readers may find it necessary to refer directly to the decisions themselves to assess my reading of the cases.

I have been very critical of the Supreme Court’s tax decisions in the past, especially those dealing with tax avoidance, and I am very critical of its GAAR decisions in this article. The court has failed once again to articulate a clear approach to the interpretation of tax statutes. At best, it has failed to provide clear guidance for the application of the GAAR; at worst, it has rendered the GAAR largely meaningless. The court’s reasons in the two GAAR cases do not stand up to close scrutiny. At times, the court simply states conclusions without reasons to support them; at times, it displays a fundamental lack of understanding of the tax system. On issues as important as the interpretation of statutes and the role of the GAAR, the Supreme Court has an obligation to avoid confusion and provide clear guidance for taxpayers, lower courts, and tax officials. Otherwise, it would be preferable for the court not to hear tax cases.

BACKGROUND

In this section of the article, I describe briefly the prior case law dealing with the GAAR so that the Supreme Court decisions in Canada Trustco and Mathew can be considered against that background. The facts of the two cases are described in a later section dealing with the court’s application of the GAAR to the transactions in

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question. This organization may seem strange, because it is customary in case comments to set out the facts at the outset. However, in each case, the Supreme Court proceeds in its reasons for judgment by first analyzing and interpreting the GAAR in the abstract and then applying the GAAR to the facts of the case. For convenience, therefore, I have set out the facts in the context of the court’s application of the GAAR in each case.

The provisions of section 245 of the Act are well known and are not described here at length. The GAAR applies to “avoidance transactions” that misuse or abuse the provisions of the Act. Under subsection 245(3), an avoidance transaction is one that, either by itself or as part of a series, results in a tax benefit, which is broadly defined to include any reduction, avoidance, or deferral of tax or other amount payable under the Act, if the primary purpose of the transaction was to obtain that benefit. However, under subsection 245(4), the GAAR does not apply to an avoidance transaction unless the transaction can reasonably be considered to result in a misuse of the provisions of the Act or an abuse having regard to the provisions of the Act read as a whole.6

From the first GAAR case decided by the Tax Court in 1997 to the Supreme Court decisions in Canada Trustco and Mathew in October 2005, over 20 GAAR cases have been decided by the Tax Court and the Federal Court of Appeal.7 In most of those cases, the courts had little difficulty finding that there was a tax benefit and an avoidance transaction, although the series aspect of the definition of an avoidance transaction has raised two problems of interpretation.

6 In 2005, subsection 245(4) was amended to read as follows:

(4) Subsection (2) applies to a transaction only if it may reasonably be considered that the transaction
(a) would, if this Act were read without reference to this section, result directly or indirectly in a misuse of the provisions of any one or more of
(i) this Act,
(ii) the Income Tax Regulations,
(iii) the Income Tax Application Rules,
(iv) a tax treaty, or
(v) any other enactment that is relevant in computing tax or any other amount payable by or refundable to a person under this Act or in determining any amount that is relevant for the purposes of that computation; or
(b) would result directly or indirectly in an abuse having regard to those provisions, other than this section, read as a whole.

This amendment is discussed subsequently.

First, in the Canadian Pacific case, the Federal Court of Appeal suggested that any transaction forming part of a series could not have a primary purpose different from the primary purpose of the series as a whole. In that case, the overall purpose of the series was a clearly legitimate commercial purpose, namely, to obtain financing for the taxpayer’s business. However, subsection 245(3) requires the purpose of each step in a series to be determined independently, so that taxpayers are prevented from inserting tax-motivated steps into otherwise legitimate transactions. The Federal Court of Appeal’s interpretation of subsection 245(3) would severely narrow the scope of application of the GAAR in respect of a series of transactions: the GAAR would apply to a series only if the primary purpose of the series as a whole was to obtain a tax benefit, rather than some commercial objective. This aspect of the definition of an avoidance transaction was not at issue in either Canada Trustco or Mathew.

Second, in the OSFC case, the Federal Court of Appeal held that for purposes of subsection 248(10) a related transaction would be considered to have been carried out in contemplation of the series if the party to the related transaction knew about the series and took it into account. This backward-looking approach is too limited. It assumes—probably because that was the situation in the OSFC case—that the related transaction takes place after the series. It is arguable that subsection 248(10) should also encompass a forward-looking approach under which a related transaction is considered to have been carried out in contemplation of a series if at the time that the series commences, the related transaction is necessary to accomplish the objectives of the series.

The real issue in dispute in all of the GAAR cases has been whether the transactions involved a misuse of the provisions of the Act or an abuse of the Act as a whole. In the leading OSFC case, which involved the same series of transactions that was at issue in Mathew, Rothstein JA (then of the Federal Court of Appeal) held that the misuse and abuse test in subsection 245(4) required a two-stage analysis:

The first stage involves identifying the relevant policy of the provisions or the Act as a whole. The second is the assessment of the facts to determine whether the avoidance transaction constituted a misuse or abuse having regard to the identified policy.

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9 See Canada, Department of Finance, Explanatory Notes to Legislation Relating to Income Tax (Ottawa: Department of Finance, June 1988), clause 186.
10 For example, in the recent case of Evans v. The Queen, 2005 TCC 684, discussed at the end of this article, the Tax Court took the same approach as the Federal Court of Appeal and held that the GAAR did not apply to a series of surplus-stripping transactions because the overall purpose of the series was to distribute funds to the major shareholder of the corporation.
11 OSFC Holdings Ltd. v. The Queen, [2001] 4 CTC 82 (FCA).
12 Ibid., at paragraph 67.
He went on to hold that the GAAR could not be applied unless the policy of the Act was “clear and unambiguous.” Although he used the term “policy” to refer collectively to the purpose, scheme, object, and spirit of the legislation, subsequent courts undertook an often unsuccessful search for the underlying policy of the provisions of the Act.13 Moreover, Rothstein JA framed the issue of misuse and abuse as “an invoking of a policy to override the words Parliament has used.”14 The government challenged this way of framing the misuse and abuse issue in the Canada Trustco and Matthew cases because it is inherently biased against the application of the GAAR. The courts will always prefer statutory wording over unexpressed notions of legislative policy. The GAAR represents words that Parliament has used, just like any other statutory provision.

The other important aspect of the misuse and abuse analysis raised by the prior GAAR case law is the relevance of economic realities or economic substance. Although the Supreme Court has emphatically rejected any role for economic substance in the interpretation of the provisions of the Act apart from the GAAR,15 the explanatory notes to the GAAR16 clearly indicate that the economic substance of a transaction is intended to be relevant. However, those notes also state that transactions cannot be recharacterized for the purpose of determining whether they are avoidance transactions under subsection 245(3). Some GAAR decisions have confused these aspects of the explanatory notes and have rejected the government’s argument that a transaction is abusive because it lacks economic substance, on the basis that such an argument amounts to recharacterization of the transaction. For example, in Canadian Pacific, the Federal Court of Appeal rejected the government’s argument that a weak-currency borrowing converted into Canadian currency through a series of swap contracts was, in economic substance, simply a borrowing in Canadian currency. The government argued that the economic effect of the transactions was that part of the principal amount of the loan was converted into interest. The court rejected the argument “because it depends on recharacterizing the interest payments as capital payments.”17 Similarly, the Tax Court in Canada Trustco rejected the government’s argument that the transactions resulted in an abuse of the Act.

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13 See, for example, the Tax Court decisions in Hill v. The Queen, [2003] 4 CTC 2548, and Canada Trustco Mortgage Co. v. The Queen, [2003] 4 CTC 2009. In Hill, the Tax Court refused to apply the GAAR because the government could not explain why the Act distinguished between the deduction of simple interest on a payable basis under paragraph 20(1)(c) and the deduction of compound interest on a paid basis under paragraph 20(1)(d). In this instance, however, the policy or scheme of the Act is clear on its face, and it is unnecessary (even if it were possible) for a court to inquire into the deeper reasons for that policy.

14 Supra note 11, at paragraph 69.

15 See, for example, Shell Canada Ltd. v. The Queen, [1999] 4 CTC 313 (SCC); The Queen v. Singleton, [2002] 1 CTC 121 (SCC); and Ludo v. MNR, [2002] 1 CTC 95 (SCC).

16 Supra note 9, at clause 186.

17 Supra note 8, at paragraph 34.
because the taxpayer did not incur any economic cost or risk in respect of the assets on which it claimed capital cost allowance (CCA).

In summary, the prior case law dealing with the GAAR raised important issues concerning the series aspect of the definition of an avoidance transaction, the necessity for the government to show a clear and unambiguous legislative policy underlying the relevant provisions of the Act, and the relevance of the economic substance of the transactions. As I have pointed out previously, these aspects of the prior case law seriously undermined the effectiveness of the GAAR. It is against this background that the Supreme Court’s decisions in Canada Trustco and Mathew must be viewed. These recent cases raise most of the important issues emanating from the prior case law, with the exception of certain aspects of the concept of a series of transactions.

THE SUPREME COURT’S STATEMENTS ABOUT STATUTORY INTERPRETATION

In the Canada Trustco and Mathew cases, the Supreme Court analyzes the GAAR in the context of the interpretation of statutes generally. The court makes several comments about statutory interpretation in general, some of which appear to be new—for example, the relationship between the interpretation of the GAAR and other provisions of the Act. In my view, the court’s statements about statutory interpretation are internally inconsistent, reflect the court’s continuing confusion about the proper approach to the interpretation of tax statutes, and present serious problems for the interpretation of the GAAR.

There are two major issues to be considered. First, how should the provisions of taxing statutes and, in particular, the Income Tax Act, be interpreted? And how, if at all, is this different from the proper approach to the interpretation of statutes generally? Second, what is the relationship between the proper approach to the interpretation of tax statutes and the interpretation and application of the GAAR?

Before attempting to answer these questions, a little background is necessary concerning the Supreme Court’s approach to statutory interpretation. In its 1984 decision in the Stubart case, the Supreme Court adopted the so-called modern rule of statutory interpretation, as expressed in the second edition of E.A. Driedger’s Construction of Statutes:

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

The adoption of the modern rule marked the formal end of the strict or literal method of interpretation that was commonly used to construe tax statutes. In the

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1990s, the court—possibly as a result of a significant change in its composition—reverted to literal interpretation in another guise, called the plain-meaning approach. The court continued to espouse the modern rule as a general principle; however, it stated in a number of cases that if the words of the provision in question were clear and unambiguous, they must simply be applied without regard to the purpose of the provision. Some of the Supreme Court justices, often in dissenting opinions, have attempted to reconcile, unsuccessfully in my view, these fundamentally inconsistent methods of statutory interpretation.

Although the court has not explicitly rejected the plain meaning approach, in more recent tax cases it has simply quoted the modern rule or paraphrased it, without any analysis, as the proper approach to statutory interpretation. Finally, it is important to note the Supreme Court’s fondness for labels with respect to statutory interpretation. Since 1995, the court has referred to the proper approach to statutory interpretation in the following terms:

- the modern rule or approach
- the plain meaning rule
- the modern plain meaning rule
- the modern purposive principle
- the teleological approach
- the words-in-total-context approach

As discussed below, to this list we can now add the “textual, contextual, and purposive approach” and the “unified textual, contextual, and purposive approach.”

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21 See, for example, the comments of Major J, one of the co-authors of the Supreme Court’s reasons for judgment in the GAAR cases, in *Friesen v. The Queen*, [1995] 2 CTC 369 (SCC).


24 *Friesen*, supra note 21.

25 Binnie J dissenting in *Will-Kare Paving*, supra note 22. The modern plain meaning rule was identified as not suffering from the deficiencies of the “original ‘plain meaning’ rule” (ibid., at paragraph 57).

26 Major J in *Will-Kare Paving*, ibid.


28 LeBel and Bastarache JJ in *Singleton*, supra note 15.
There is little mention of this background in the court’s two GAAR decisions. The court starts its analysis in the Canada Trustco case by quoting the modern rule and then indicating that statutory interpretation requires a “textual, contextual and purposive analysis.” The most obvious inference is that this phrase is just another label for the modern rule. The court immediately goes on to remind us that “[w]hen the words of a provision are precise and unequivocal, the ordinary meaning of the words play a dominant role in the interpretive process.” Presumably this is not a different (plain meaning or literal) approach to statutory interpretation; it is simply an explanation of how the modern rule should be applied where the text of a provision is relatively clear.

Taken as a whole, the Supreme Court’s statements in the GAAR decisions are inconsistent with respect to the interpretation of tax statutes compared with all other statutes. Sometimes the court states unequivocally that tax statutes are to be interpreted in a textual, contextual, and purposive manner in the same way as all other statutes. At other times, however, the court suggests that tax statutes are different and should receive a literal interpretation.

This inconsistency is apparent in the second paragraph of the court’s comments on interpretation:

As a result of the Duke of Westminster principle (Commissioners of Inland Revenue v. Duke of Westminster, [1936] A.C. 1 (H.L.)) that taxpayers are entitled to arrange their affairs to minimize the amount of tax payable, Canadian tax legislation received a strict interpretation in an era of more literal statutory interpretation than the present. There is no doubt today that all statutes, including the Act, must be interpreted in a textual, contextual and purposive way. However, the particularity and detail of many tax provisions have often led to an emphasis on textual interpretation. Where Parliament has specified precisely what conditions must be satisfied to achieve a particular result, it is reasonable to assume that Parliament intended that taxpayers would rely on such provisions to achieve the result they prescribe.

The second sentence is very clear: tax statutes are not different from other statutes and all statutes must be interpreted with due regard to the words of the provision at issue, the broader context of the statute in which the words are used, and the purpose

29 Canada Trustco, supra note 1, at paragraph 10.
30 Ibid.
31 In my view, however, the court overstates the point. If the ordinary meaning of the words of a provision is clear, that meaning is entitled to more weight than if the meaning is not clear. However, the clear ordinary meaning of the words is not necessarily determinative of the meaning of the statute, and the interpretive exercise always requires consideration of both context and purpose, as the Supreme Court acknowledges in Canada Trustco, ibid., at paragraph 47.
32 Judith Freedman also identifies this inconsistency in her recent article, “Converging Tracks? Recent Developments in Canadian and UK Approaches to Tax Avoidance” (2005) vol. 53, no. 4 Canadian Tax Journal 1038-46, at 1043-44.
33 Canada Trustco, supra note 1, at paragraph 11.
of the provision. This approach, as noted above, is a reiteration of the modern rule. In the next sentence, however, the court seems to resile from this view and suggests that tax provisions, at least those that are detailed and specific or precise, are different and should be given a literal interpretation. Subsequently, the court repeats this position, saying that the Income Tax Act is “dominated by explicit provisions dictating specific consequences, inviting a largely textual interpretation.”

It is possible to read these statements as meaning that all statutes must be interpreted in accordance with the modern rule, but that the application of the modern rule to specific, detailed provisions will often or invariably involve giving the literal meaning of the words more weight than considerations relating to context and purpose. On this view, the Supreme Court’s statements are not inconsistent. The comments about a textual, contextual, and purposive interpretation of statutes are simply a restatement of the modern rule, while the comments about detailed tax provisions receiving a literal interpretation relate only to the application of the general approach in a particular situation. Although this reading of the court’s comments about interpretation is plausible, the court has failed to set out its position clearly, and this is a serious deficiency in its reasons. The Canadian tax community—taxpayers, tax officials, and tax advisers—should not be obliged to speculate about something as fundamental as the Supreme Court’s approach to the interpretation of tax statutes. In my view, the court has an obligation to the public, lower courts, and government officials to articulate clearly how statutes should be interpreted and whether a different interpretive approach is required for tax statutes.

If we accept that the Supreme Court intended to distinguish between the general approach to statutory interpretation and the application of that approach in the case of detailed and specific (or precise or explicit) provisions in tax statutes, it is necessary to assess this distinction. If the court means that such tax provisions are to be interpreted in a purely or largely literal manner, differently from other statutory provisions, in my view the court is wrong.

First, it is not immediately obvious to me that in interpreting relatively detailed tax provisions, the ordinary meaning or text of such provisions should be given more weight than in interpreting other types of provisions. The ordinary meaning of detailed provisions is not necessarily or inevitably clear and unambiguous. Even detailed and specific tax provisions exist in the broader context of the entire statute and have a purpose. The fact that Parliament uses many rather than few words in a particular provision is not a reliable indication that Parliament intends the provision to be interpreted literally. Thus, it is unclear why the Supreme Court would find it necessary to prejudge the interpretation of detailed and specific tax provisions. If detailed tax provisions, like all other tax provisions, are to be interpreted in accordance with the modern rule, then the ordinary meaning of the words, the

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34 Ibid., at paragraph 13. Sometimes the court refers to detailed and specific tax provisions and sometimes to precise and unequivocal or explicit provisions.

context, and the purpose should all be given due consideration. Whether a more or less literal interpretation is appropriate depends on each particular case and cannot, and should not, be decided in advance.

Second, it seems to be an impossible task to try to differentiate between tax provisions that are detailed and specific (or precise and unequivocal) and are to be interpreted literally, and other provisions that are to be interpreted in accordance with the modern rule.

Finally, many other, non-tax statutes also contain detailed and specific rules. The Supreme Court has never suggested that they be interpreted literally. Why are detailed tax rules different?36

The court does not provide any explicit reasons or analysis to justify the requirement that detailed tax rules must be interpreted literally. It states:

The provisions of the Income Tax Act must be interpreted in order to achieve consistency, predictability and fairness so that taxpayers may manage their affairs intelligently. As stated at para. 45 of Shell Canada Ltd. v. Canada, [1999] 3 S.C.R. 622:

[Ab]sent a specific provision to the contrary, it is not the courts’ role to prevent taxpayers from relying on the sophisticated structure of their transactions, arranged in such a way that the particular provisions of the Act are met, on the basis that it would be inequitable to those taxpayers who have not chosen to structure their transactions that way. [Emphasis added.]

See also 65302 British Columbia, at para. 51, per Iacobucci J. citing P.W. Hogg and J.E. Magee, Principles of Canadian Income Tax Law (2nd ed. 1997), at pp. 475-76:

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.37

This statement may suggest that the Supreme Court’s view is that literal interpretation of detailed tax provisions is necessary to provide taxpayers with consistency, predictability, and fairness. The court has suggested this in prior decisions,38 and therefore the statement deserves some analysis.

First, the court sometimes refers to “consistency” and sometimes to “certainty,” as if the two are interchangeable. Obviously they are not. Statutory provisions can be reasonably certain but inconsistent, or uncertain but consistent. On the other hand, certainty and predictability appear to be the same thing.

36 Indeed, the Supreme Court subsequently cites Hogg et al. to the effect that “‘after all, language can never be interpreted independently of its context, and legislative purpose is part of the context.’” Canada Trustco, supra note 1, at paragraph 47, quoting from Peter W. Hogg, Joanne E. Magee, and Jinyan Li, Principles of Canadian Income Tax Law, 4th ed. (Toronto: Carswell, 2002), 563.

37 Canada Trustco, supra note 1, at paragraph 12.

38 See, for example, 65302 British Columbia Ltd., supra note 22, and Duba Printers (Western) Ltd. v. The Queen, [1998] 3 CTC 303 (SCC).
Second, the court’s statement about fairness is meaningless. Fairness for whom? Fairness for the taxpayers who are testing the line between legitimate tax planning and abusive tax avoidance? These appear to be the taxpayers that the court is referring to. Why are these taxpayers especially deserving? Parliament has clearly decided in enacting the GAAR that taxpayers engaging in abusive tax avoidance are to be denied the benefits of their avoidance transactions. And what about fairness for the great bulk of taxpayers who are unable to avoid tax and whose tax burden is greater because of the avoidance of tax by a few? There is no mention of them.

Third, certainty or predictability and fairness as goals of the tax system often conflict, so that one goal can be achieved or advanced only at the expense of the others. The Supreme Court does not clearly indicate that it understands this point. Moreover, the court does not recognize that there may be other goals of the tax system relevant to tax avoidance—the clearest example being the need to raise revenue.

Finally, the court does not provide any analysis or cite any authority to support the proposition that literal interpretation of detailed tax provisions is necessary to provide taxpayers with consistency (or certainty), predictability, and fairness. This assertion is simply presented (six times in the Canada Trustco decision) as self-evident. The court quotes from the Shell Canada case to the effect that it is not the court’s role to prevent tax avoidance, and it repeats a statement from the textbook by Hogg et al. to which it has referred several times, starting with the Friesen case in 1995. However, as I have argued previously, literal interpretation cannot be justified on the basis of certainty or predictability.

In the final paragraph of its comments on interpretation in general, the court suggests that the role of the GAAR is to prevent tax-avoidance arrangements that would be permissible under a literal interpretation of the Act:

To the extent that the GAAR constitutes a “provision to the contrary” as discussed in Shell . . ., the Duke of Westminster principle and the emphasis on textual interpretation may be attenuated.

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39 See Friesen, supra note 21, and the quotation from Hogg and Magee (2d ed.) reproduced above at note 37. The quoted words have remained largely the same in the various editions, with the exception of the insertion of the adverb “routinely.” Thus, the text in the fifth edition reads, “[I]t would introduce intolerable uncertainty into the Act if clear language in detailed provisions were to be routinely qualified by unexpressed exceptions derived from a court’s view of the object and purpose of those provisions.” Peter W. Hogg, Joanne E. Magee, and Jinyan Li, Principles of Canadian Income Tax Law, 5th ed. (Toronto: Carswell, 2005), 568.


41 Canada Trustco, supra note 1, at paragraph 13. The question that arises from this statement is: Why does the introduction of the GAAR have any effect on the approach to the interpretation of the provisions of the Act generally?
The important point here is that the Supreme Court clearly suggests that, in the absence of the GAAR, the provisions of the Act are to be interpreted literally (or, more precisely, with an emphasis on the wording of the relevant provisions)—contrary to the modern rule, which, according to the court, applies to all statutes. The court makes several statements to the same effect throughout its reasons for judgment in Canada Trustco. In the opening paragraph, the court states:

The Act continues to permit legitimate tax minimization; traditionally, this has involved determining whether the taxpayer brought itself within the wording of the specific provisions relied on for the tax benefit. Onto this scheme, the GAAR has superimposed a prohibition on abusive tax avoidance, with the effect that the literal application of provisions of the Act may be seen as abusive in light of their context and purpose.42

The same point is made again later:

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.43

And again:

The Explanatory Notes elaborate that the GAAR is intended to apply where under a literal interpretation of the provisions of the Income Tax Act, the object and purpose of those provisions would be defeated.44

And again:

The starting point for the analysis [under subsection 245(4)] is the assumption that a tax benefit that would be conferred by the plain words of the Act is not abusive.45

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42 Ibid., at paragraph 1 (emphasis added).
43 Ibid., at paragraph 16 (emphasis added).
44 Ibid., at paragraph 49 (emphasis added). The court’s reference to the explanatory notes requires some explanation. The explanatory notes, supra note 9, were prepared in 1987 when the GAAR was enacted. At that time, the Department of Finance was rightly concerned about the proliferation of tax-avoidance schemes resulting from the literal interpretation of the Act by the courts. The modern approach to statutory interpretation had been adopted by the Supreme Court only three years earlier, and it was unclear how the courts would apply that approach. The court seems unaware of the irony of its reliance on the explanatory notes in this regard.
45 Canada Trustco, supra note 1, at paragraph 62 (emphasis added).
And again:

The taxpayer, once he or she has shown compliance with the wording of a provision, should not be required to disprove that he or she has thereby violated the object, spirit or purpose of the provision.46

These quotations suggest that the Supreme Court thinks that the provisions of the Act are to be interpreted literally, and only under the GAAR are context and purpose relevant. In other words, taxing statutes are different from other statutes, which are to be interpreted in accordance with the modern rule. But this conclusion is contrary to the court’s general statements that the modern rule applies to all statutes, including the Income Tax Act. Moreover, it is contrary to the court’s statement that the Stubart decision “rejected a literal approach to interpreting the Act.”47 If the Stubart case, which was decided in 1984, rejected literal interpretation before the introduction of the GAAR, how can the Supreme Court say that the Act is to be interpreted literally in the absence of the GAAR?48

This confusion permeates the court’s decision in Canada Trustco. Consider the following paragraph of the court’s reasons:

The first part of the inquiry under s. 245(4) requires the court to look beyond the mere text of the provisions and undertake a contextual and purposive approach to interpretation in order to find meaning that harmonizes the wording, object, spirit and purpose of the provisions of the Income Tax Act. There is nothing novel in this. Even where the meaning of particular provisions may not appear to be ambiguous at first glance, statutory context and purpose may reveal or resolve latent ambiguities. “After all, language can never be interpreted independently of its context, and legislative purpose is part of the context. It would seem to follow that consideration of legislative purpose may not only resolve patent ambiguity, but may, on occasion, reveal ambiguity in apparently plain language.” See P.W. Hogg and J.E. Magee, Principles of Canadian Income Tax Law (4th ed. 2002), at p. 563. In order to reveal and resolve any latent ambiguities in the meaning of provisions of the Income Tax Act, the courts must undertake a unified textual, contextual and purposive approach to statutory interpretation.49

The first sentence of the paragraph suggests that the Act is interpreted literally until the GAAR is reached, at which point a contextual and purposive interpretation is required. The rest of the paragraph, however, suggests that all statutory language must be interpreted in the context of the statute as a whole and in light of its purpose.

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46 Ibid., at paragraph 65 (emphasis added).
47 Ibid., at paragraph 14.
48 As Judith Freedman asks, rhetorically, “[s]urely there is no question of a literal interpretation, even without the GAAR?” Freedman, supra note 32, at 1044.
49 Canada Trustco, supra note 1, at paragraph 47.
Even where the provisions of the Act appear to be literally clear and unambiguous, recourse to context and purpose may reveal latent ambiguities. But if the provisions of the Act are to be construed textually, contextually, and purposively, the abuse analysis under subsection 245(4) appears to be redundant. This point is discussed further subsequently.

Despite the obvious inconsistencies in the Supreme Court’s statements about interpretation in Canada Trustco, the predominant view of the court that appears to emerge is that taxpayers are entitled to rely on the literal wording of the provisions of the Act in planning their affairs, subject only to a possible finding under the GAAR that the arrangement is abusive, based on a contextual and purposive analysis of the relevant provisions of the Act. Therefore, the interpretation of tax statutes is different from the interpretation of other statutes.

When we examine the Mathew decision, however, the general conclusion is the opposite: all statutes must be interpreted in accordance with the modern rule; tax statutes are not different. In a section of the decision entitled “The Proper Interpretive Approach,” which deals with the interpretation of subsection 18(13) and section 96, the court states:

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.

It is hard to imagine a much clearer statement that all statutes must be interpreted in accordance with the modern rule, that literal interpretation is not appropriate, and that taxing statutes are not different from other statutes. This clarity is reinforced by the following statement:

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.

In other words, all the provisions of the Act must be interpreted in accordance with the modern rule (textually, contextually, and purposively). Subsection 245(4), the abuse provision of the GAAR, simply confirms this approach; it does not mandate a different approach. In contrast, in Canada Trustco the court suggests that the provisions of the Act, other than the GAAR, should be interpreted literally, and only under the GAAR is a court required “to look beyond the mere text of the provisions and undertake a contextual and purposive approach to interpretation.”

50 See Freedman, supra note 32, at 1043.
51 Mathew, supra note 1, at paragraph 42.
52 Ibid., at paragraph 47.
53 Canada Trustco, supra note 1, at paragraph 47.
In conclusion, the Supreme Court’s statements about statutory interpretation are inconsistent and contradictory or, at the very least, confusing. If the court’s position is that the provisions of tax statutes, or at least those provisions that are detailed and specific, should be interpreted literally, the court is wrong. As explained earlier, there is no justification, in my view, for applying literal interpretation to any statutory language. The meaning of all language is dependent on context and purpose. If, on the other hand, the court’s position is, as expressed in the Mathew case, that all statutes, including tax statutes and including detailed provisions in tax statutes, must be interpreted textually, contextually, and purposively, then the question becomes the relevance of the GAAR. Presumably, if the provisions of the Act are interpreted contextually and purposively, they will not apply to transactions that are abusive of the statutory scheme or purpose; in short, the GAAR is unnecessary.

It is unacceptable, in my opinion, for the highest court in the country to make such confusing statements about the fundamental approach to the interpretation of tax statutes. The inconsistencies and contradictions in the Supreme Court’s comments in the two GAAR cases are evident. They represent a continuation of the court’s failure since 1995 to articulate a clear and consistent approach to statutory interpretation.

THE SUPREME COURT’S INTERPRETATION OF THE GAAR

General Comments

The Supreme Court identifies its task in the two GAAR cases as balancing the need for taxpayers to have certainty (or consistency), predictability, and fairness with the necessity to counter abusive tax avoidance:

Despite Parliament’s intention to address abusive tax avoidance by enacting the GAAR, Parliament nonetheless intended to preserve predictability, certainty and fairness in Canadian tax law. Parliament intends taxpayers to take full advantage of the provisions of the Income Tax Act that confer tax benefits. Indeed, achieving the various policies that the Income Tax Act seeks to promote is dependent on taxpayers doing so.

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54 Contra see Duff, supra note 35, at 61-62. Duff commends the court for rejecting “the plain meaning approach in favour of a more pragmatic approach that combines textual, contextual and purposive considerations.”

55 The potential danger arising from the relationship between the modern approach to statutory interpretation and the determination of abuse under subsection 245(4) has been described previously. See Arnold and Wilson, “The General Anti-Avoidance Rule—Part 2,” supra note 4, at 1165-66; and Arnold, “Reflections on the Relationship Between Statutory Interpretation and Tax Avoidance,” supra note 4, at 30-31.

56 Canada Trustco, supra note 1, at paragraph 31. See also paragraphs 1 and 13.
The court repeats this view in slightly different language later in its decision:

A proper approach to the wording of the provisions of the *Income Tax Act* together with the relevant factual context of a given case achieve balance between the need to address abusive tax avoidance while preserving certainty, predictability and fairness in tax law so that taxpayers may manage their affairs accordingly. Parliament intends taxpayers to take full advantage of the provisions of the Act that confer tax benefits. Parliament did not intend the GAAR to undermine this basic tenet of tax law.57

In my opinion, these comments are revealing of the court’s attitude to the GAAR generally and assist in explaining its narrow interpretation of the GAAR.

Any anti-avoidance rule requires a distinction to be made between legitimate tax planning and abusive tax avoidance. That distinction is inherent in the provisions of the GAAR and, in particular, in the misuse and abuse test in subsection 245(4). The explanatory notes to the GAAR, which are quoted by the Supreme Court, state:

> [T]he new rule seeks to distinguish between legitimate tax planning and abusive tax avoidance and to establish a reasonable balance between the protection of the tax base and the need for certainty for taxpayers in planning their affairs.58

However, the court ignores Parliament’s attempt to draw the line and instead establishes, without any analysis or foundation, a hierarchy of rules in which the GAAR is subsidiary to provisions that confer tax benefits—which, construed broadly, would include most of the provisions of the Act. With respect, the court’s position in this regard is wrong. The GAAR itself is a clear indication that Parliament did not intend taxpayers to be able to take full advantage of the tax benefits conferred by the Act if abusive tax avoidance is involved. The court appears to be trying to avoid the conclusion that the GAAR restricts the *Duke of Westminster* principle that taxpayers are entitled to arrange their affairs so as to minimize tax.59

It is notable, but not surprising, that the court never suggests that Parliament intends that taxpayers should meet their full obligations to pay tax under the Act. Yet surely this is what the introduction of the GAAR implies. The GAAR is intended to prevent taxpayers from engaging in abusive tax-avoidance transactions to reduce or avoid their tax obligations, and to ensure that they pay their fair share of tax.

**Tax Benefit**

The GAAR applies only if an avoidance transaction results in a “tax benefit,” which is broadly defined in subsection 245(1) to be a reduction, avoidance, or deferral of

57 Ibid., at paragraph 61. See also paragraphs 42 and 50.

58 Supra note 9, at clause 186, quoted in *Canada Trustco*, supra note 1, at paragraph 15.

59 Even where the court deals with the possible effect of the GAAR on the *Duke of Westminster* principle, it does so almost grudgingly: “To the extent that the GAAR constitutes ‘a provision to the contrary’ as discussed in *Shell* . . . the Duke of Westminster principle . . . may be attenuated.” *Canada Trustco*, supra note 1, at paragraph 13.
tax or other amount payable under the Act. For this purpose, the amount of the tax benefit is irrelevant.\textsuperscript{60} As a theoretical matter, the determination of a tax benefit requires a comparison with the amount of tax that should have been payable or would have been payable if a different transaction had been carried out. As a practical matter, however, the courts have not applied the tax benefit definition in this fashion.\textsuperscript{61} They have considered the definition to establish a very low threshold that is satisfied by any deduction, credit, allowance, rollover, or other amount. And they have rejected attempts by taxpayers to avoid the application of the GAAR by holding up unrealistic comparisons. For example, the argument that if the taxpayer had not engaged in the transactions at all (that is, if the taxpayer had done nothing), even less tax would have been payable, has been rejected.\textsuperscript{62}

The Supreme Court’s analysis of the concept of a tax benefit is brief and consistent with the existing case law. The court indicates that any deduction, allowance, or credit clearly is a tax benefit, although in some cases it may be necessary to compare the tax consequences of the transaction at issue with those of an alternative transaction.\textsuperscript{63} It cites as an example situations where an amount is characterized in a way that results in less tax than would be payable if the amount were characterized differently.

\textsuperscript{60} In the original draft version of the GAAR, the tax benefit had to be “significant,” but the modifier was removed after tax practitioners objected that quantifying the tax benefit involved too much subjectivity. In any event, it seems unlikely that the GAAR would be applied in situations where the tax benefit is not substantial. The amount of the tax benefit does become relevant if the GAAR applies because under subsection 245(5) the tax consequences are to be determined as is reasonable in the circumstances to deny the tax benefit that would otherwise result.

\textsuperscript{61} In only one case has the Tax Court found that there was no tax benefit, and that case must be seen as an aberration. See \textit{Univar Canada Ltd. v. The Queen}, [2006] 1 CTC 2308 (TCC). The case involved a double-dip financing structure. The interest deduction by the taxpayer was clearly a tax benefit. However, the government argued the case on the basis that the transaction should be compared with an alternative transaction whereby the debt between two non-resident companies would have been acquired by the Canadian company. The Tax Court rejected the government’s argument because there was no evidence that the Canadian company ever contemplated acquiring the debt.

\textsuperscript{62} See, for example, \textit{McNichol v. The Queen}, [1997] 2 CTC 2088 (TCC).

\textsuperscript{63} The Supreme Court has been criticized for concluding that a deduction is a tax benefit because it results in a reduction of tax. See Duff, supra note 35, at 63; and Daniel Sandler, “The Minister’s Burden Under GAAR,” in this issue of the \textit{Canadian Tax Journal}. According to Duff and Sandler, the existence of a tax benefit must be determined by comparing the tax consequences of the actual transactions with the notional tax consequences of an alternative transaction that might have been carried out, or of no transaction. Although this view may have some theoretical merit, it would introduce another hurdle involving an unimportant point into the application of the GAAR. It is preferable, in my view, for the courts to consider any deduction, credit, allowance, etc., to be a tax benefit and to determine the applicability of the GAAR on the basis of the really important issues: avoidance transaction and abuse. The \textit{Univar} case, supra note 61, is an example of how the courts might apply the concept of tax benefit under the approach recommended by Duff and Sandler.
Unfortunately, the Supreme Court seems to confuse the defined term “tax benefit” for purposes of the GAAR with the concept of a tax expenditure. The court often uses the term “tax benefit” in the latter sense and then goes on to make the point that Parliament could not have intended the GAAR to deprive taxpayers of these benefits. For example, the court says:

Parliament intends taxpayers to take full advantage of the provisions of the Income Tax Act that confer tax benefits. 65

Parliament recognized that many provisions of the Act confer legitimate tax benefits notwithstanding the lack of a real business purpose. 66

In general, Parliament confers tax benefits under the Income Tax Act to promote purposes related to specific activities. For example, tax benefits associated with business losses, CCA and RRSPs, are conferred for reasons intrinsic to the activities. 67

A tax benefit for the purposes of the GAAR is any reduction, avoidance, or deferral of tax whether or not the tax reduction, avoidance, or deferral represents a tax expenditure. For example, deductions in computing income under section 9 are tax benefits but are not tax expenditures because, being restricted to expenses incurred in earning income, they are part of a benchmark income tax system. Transactions designed to take advantage of tax expenditures will generally be avoidance transactions because such transactions are not commercially viable without the tax benefits. This is one of the reasons why subsection 245(4) is a necessary part of the GAAR. If Parliament intends to stimulate certain behaviour by taxpayers by providing tax benefits, such behaviour should not be considered abusive just because it is primarily tax-motivated. Transactions designed to take advantage of tax expenditures may be abusive under subsection 245(4), but the analysis should be different from the analysis of avoidance transactions involving other tax benefits. For example, the absence of any possible pre-tax profit from a transaction should not be an important factor in determining the abusive nature of the transaction if it involves a tax expenditure. In other cases, however, the absence of any reasonable prospect of a pre-tax profit or the presence of tax benefits in excess of any anticipated pre-tax profit should be an important factor. The problem is that it is necessary to have knowledgeable judges to understand that the nature of the tax benefit affects the analysis of abuse under the GAAR.

64 A tax expenditure is an aspect of the tax system that represents a departure from an ideal tax system. Often tax expenditures represent government spending programs delivered through the tax system. See Canada, Department of Finance, Tax Expenditures and Evaluations 2005 (Ottawa: Department of Finance, 2005).
65 Canada Trustco, supra note 1, at paragraph 31. See also paragraph 61.
66 Ibid., at paragraph 33.
67 Ibid., at paragraph 52.
It is difficult to evaluate the impact of the Supreme Court’s confusion about the meaning of the term “tax benefit” on its decisions. My sense is that the court’s view of tax benefits as tax expenditures underlies its fundamental view of the balance between the GAAR and the Duke of Westminster principle.68 If Parliament intends taxpayers to take full advantage of tax benefits, then the role of the GAAR must be quite narrow; it must not be allowed to interfere with taxpayers’ entitlement to certainty (or consistency), predictability, and fairness. I acknowledge that there is little evidence in the decisions to support my view concerning the impact of the court’s confusion about the concept of a tax benefit. However, there can be no dispute that the court’s use of the term is confusing.

Avoidance Transaction

The definition of an avoidance transaction in subsection 245(3) includes a transaction that is part of a series of transactions that results in a tax benefit unless the primary purpose of the transaction is other than to obtain the tax benefit. In OSFC, the Federal Court of Appeal adopted the House of Lords’ meaning of the term “series of transactions,” namely, a preordained series in respect of which there is no practical likelihood that the transactions will not take place in the order planned.69 The Supreme Court confirms this aspect of the Federal Court of Appeal decision, without reasons.70 Importantly, however, the court takes a broad view of subsection 248(10), which deems a series of transactions to include any “related transactions or events carried out in contemplation of the series.” As discussed earlier, in OSFC, the Federal Court of Appeal held that subsection 248(10) applied to a transaction where the parties knew of the prior series and took it into account in entering into the transaction. This backward-looking approach to the interpretation of subsection 248(10) left it unclear whether the provision could also include a transaction prior to the series, or a transaction subsequent to the series where the parties to the transaction did not know of the series or take it into account, but the series would not have made sense without the occurrence of the subsequent transaction.71 The Supreme Court clarifies that the words “in contemplation of” in subsection 248(10) mean “because of” or “in relation to” the series and that the provision can apply to transactions both before and after a series.72

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68 Ibid., at paragraph 31.
70 Canada Trustco, supra note 1, at paragraph 25.
71 In other words, in the case of a subsequent transaction, at the time the series began, the parties to the series contemplated that the subsequent transaction would take place but that transaction was not preordained.
72 Canada Trustco, supra note 1, at paragraph 26. Duff criticizes this aspect of the court’s analysis on the basis that the dictionary meaning of “contemplation” requires the series to have been “intended,” “regarded as possible,” or “considered” when the related transaction was carried out. Duff, supra note 35, at 64.
Unfortunately, the Supreme Court’s clarifications do not address the real problem. The problem is not whether subsection 248(10) applies to transactions before and after a preordained series; that much is clear. The problem is whether the question of a connection between the transaction and the series is judged from the perspective of the persons carrying out the transaction or the persons carrying out the series, or both. If a transaction subsequent to a series is carried out by a person who did not know of the prior series, from that person’s perspective there is no causative relation between the subsequent transaction and the series. From the perspective of the persons carrying out the series, however, the subsequent transaction may have been essential in obtaining the tax benefit of the series even though it was not part of the preordained series.

The Supreme Court also confirms two other points about the meaning of the term “avoidance transaction.” First, a non-tax purpose test is much broader than a business purpose test. Second, the non-tax purpose test in subsection 245(3) requires an objective assessment of the relative importance of the various purposes of the transactions because the provision requires the purposes to be reasonably considered. According to the Supreme Court, this is a question of fact.

The Supreme Court acknowledges that subsection 243(3) applies if only one transaction in a series is an avoidance transaction; it is not necessary for each transaction in a series to be an avoidance transaction. Thus, only if each and every transaction in a series, including related transactions, is carried out primarily for non-tax purposes does the GAAR not apply. The court does not, however, explicitly reject the approach adopted by the Federal Court of Appeal in *Canadian Pacific*, in which it held that, if the overall purpose of a series as a whole is a legitimate non-tax purpose, each transaction in the series must be considered to have the same purpose. The *Canadian Pacific* decision is clearly incorrect. Subsection 245(3) requires the purpose of each transaction in a series to be determined separately. Although this point did not arise on the facts of either *Mathew* or *Canada Trustco*, it would have been helpful if the Supreme Court had clarified this point.

**Misuse or Abuse Test**

The key aspect of the GAAR is the misuse or abuse test in subsection 245(4). Virtually all of the GAAR cases in the lower courts have been resolved on the basis of this factor rather than the existence of a tax benefit or an avoidance transaction. Appropriately, the Supreme Court focuses most attentively on this aspect of the GAAR.

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73 *Canada Trustco*, supra note 1, at paragraph 33. For example, a family or investment purpose may be a legitimate non-tax purpose.

74 Ibid., at paragraph 28.

75 Ibid., at paragraph 29. It is more accurate to describe the issue as a mixed question of fact and law because the determination of whether a transaction is an avoidance transaction is a legal conclusion based on an assessment of the facts.

76 Supra note 8, at paragraph 27.
The court begins by rejecting any distinction between misuse of a statutory provision and abuse of the Act as a whole:

Parliament could not have intended this two-step approach, which on its face raises the impossible question of how one can abuse the Act as a whole without misusing any of its provisions.77

Both the Federal Court of Appeal and the Tax Court had considered the questions of misuse and abuse to be separate. In my view, the Supreme Court is incorrect in suggesting that it is impossible to distinguish between misuse and abuse. The concept of misuse is intended to deal with the situation where a taxpayer makes use of a statutory provision in a way that can be considered contrary to Parliament’s intention—for example, the use of an anti-avoidance rule to produce a tax benefit (as in the Mathew case) or perhaps the use of a rollover to transfer property for a temporary period. On the other hand, where transactions are designed to avoid the application of a specific anti-avoidance rule, it is inappropriate to consider that rule to have been misused; it has not been used at all. To bring this type of situation within the scope of the GAAR, subsection 245(4) refers to an abuse of the Act read as a whole. Therefore, the distinction between misuse and abuse is appropriate and sensible.

However, the court’s rejection of the distinction is not troublesome, for two reasons. First, the distinction is non-existent in the French version of the GAAR because the French translation of both “misuse” and “abuse” is « abus ». Second, the concept of abuse is broad enough to include misuse of a provision.

The Supreme Court’s reasons for rejecting the distinction between misuse and abuse are difficult to understand. The court suggests that specific provisions of the Act must be interpreted in the context of the Act as a whole and that the “policy analysis” suggested in the OSFC decision is “properly incorporated into a unified, textual, contextual, and purposive approach to interpreting the specific provisions that give rise to the tax benefit.”78 The court then states that “[t]he courts cannot search for an overriding policy of the Act that is not based on a unified textual, contextual and purposive interpretation of the specific provisions in issue.”79 This statement appears to be unrelated to the court’s rejection of the distinction between misuse and abuse; instead, it appears to be related to the clear-and-unambiguous-policy test adopted by the Federal Court of Appeal in OSFC. As discussed earlier, the lower courts had interpreted that test as requiring the identification of a policy underlying or overarching the words of the Act to justify a finding of abuse. It will be recalled that Rothstein JA had suggested that the GAAR involved “an invoking of

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77 Canada Trustco, supra note 1, at paragraph 39.
78 Ibid., at paragraph 40.
79 Ibid., at paragraph 41.
a policy to override the words Parliament has used.” As argued previously,80 if the clear-and-unambiguous-policy test as applied by the lower courts had been approved by the Supreme Court, the GAAR would have been rendered largely ineffective.

The reasons for the court’s position are quite interesting. First, the court states that it is incompatible with the role of judges for them to determine overarching tax policy and then use that policy to override the provisions of the Act.81 Second, it is inappropriate for the courts to override the provisions of the Act on the basis of policy because that would interfere with taxpayers’ entitlement to certainty, predictability, and fairness.82 Therefore, the court has rejected the underlying or overarching policy approach in part because it is unfavourable to taxpayers. On the other hand, the Federal Court adopted that approach because it would protect taxpayers from the application of the GAAR except in cases where the policy was clear and unambiguous. Whatever the reasons, it is a good thing that the abuse analysis under the GAAR will no longer require the government to prove and the courts to determine the underlying policy of the provisions of the Act.

Having rejected the Federal Court’s interpretation of subsection 245(4), the Supreme Court enunciates a two-stage test for determining abuse:83

1. determine the purpose of the provisions of the Act that confer the tax benefit, and
2. determine whether the avoidance transaction abuses or frustrates that purpose.

With respect to the first stage, the court confirms that the purpose of the relevant provisions is determined by reference to the wording of the provisions, the broader context of the Act as a whole, and extrinsic aids.84

The Supreme Court suggests that the first stage is a question of law but the second is one of fact. This distinction is artificial and unconvincing. Whether a

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80 See Arnold, “Demise of the GAAR,” supra note 4, at 498-503.
81 Canada Trustco, supra note 1, at paragraph 41: “To send the courts on the search for some overarching policy and then to use such a policy to override the wording of the provisions of the Income Tax Act would inappropriately place the formulation of taxation policy in the hands of the judiciary.” This statement is clearly directed at Rothstein JA’s statement quoted above (“an invoking of a policy to override the words Parliament has used”). In fairness to Rothstein JA, he made it clear that the term “policy” was used to refer to the object, spirit, scheme, and purpose of the provisions, the determination of which is within the normal judicial function (see supra note 14 and the accompanying text).
82 Canada Trustco, supra note 1, at paragraph 42.
83 Ibid., at paragraphs 44 and 49. The Federal Court of Appeal adopted the same two-stage approach in OSFC, supra note 11, at paragraph 67: “The first stage involves identifying the relevant policy of the provisions or the Act as a whole. The second is the assessment of the facts to determine whether the avoidance transaction constituted a misuse or abuse having regard to the identified policy.” The Supreme Court did not acknowledge that it was adopting the Federal Court’s approach in this regard.
84 Canada Trustco, supra note 1, at paragraph 55.
particular transaction is abusive is a legal conclusion; indeed, it is hard to imagine any question that is more clearly a question of law. The court assumes that the determination of the purpose of statutory provisions, which is part of the interpretive exercise, takes place in the abstract without reference to the facts of any particular transaction. In my view, this is unlikely to be true in the context of particular cases in which the tax authorities are challenging a particular transaction as abusive. The question in all such cases is whether the particular transaction involved falls within or outside the purpose of the relevant statutory provisions.

The Supreme Court appears to be reluctant to hear future GAAR cases. By making the characterization of a particular transaction as abusive or not a question of fact, the court puts the responsibility on the Tax Court, and it cautions appeal courts not to interfere:

> Once the provisions of the *Income Tax Act* are properly interpreted, it is a question of fact for the Tax Court judge whether the Minister, in denying the tax benefit, has established abusive tax avoidance under s. 245(4). Provided the Tax Court judge has proceeded on a proper construction of the provisions of the Act and on findings supported by the evidence, appellate tribunals should not interfere, absent a palpable and overriding error.85

It remains to be seen whether the Federal Court of Appeal will hesitate to review GAAR decisions of the Tax Court or whether the Supreme Court will heed its own advice in this regard.86 In my opinion, limiting the role of the appeal courts with respect to the GAAR is unwise. Although the Tax Court is a specialized court in terms of its jurisdiction, many of the Tax Court judges are not tax specialists. Although it is clearly undesirable for the government to appoint Tax Court judges who lack tax expertise, that is currently the case. As a result, there is no reason to suppose that the Tax Court is more likely to get to the right answer than the Federal Court of Appeal. More fundamentally, the application of the GAAR and the issue of tax avoidance generally are important questions that go to the heart of any income tax system and the underlying values of society. The Supreme Court should be the court that decides these issues, despite its less than exemplary record in tax cases.

The interpretation of the provisions relied on for the tax benefit requires the court to consider the text, context, and purpose of those provisions. As the court says, “[t]here is nothing novel in this.”87 It is what the modern approach to statutory interpretation requires, as described earlier. Of course, the problem with the court’s analysis is that if the provisions on which the taxpayer relies for the tax benefits are interpreted in accordance with the modern rule and the transaction is found to be contrary to or outside the purpose of the provision, then presumably the tax benefits

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85 Ibid., at paragraph 46.
86 The appeal courts have considerable scope to overturn the Tax Court on the basis that it has not construed the relevant provisions of the Act properly.
87 *Canada Trustco*, supra note 1, at paragraph 47.
will not be available. In such a case, it would be unnecessary to apply the GAAR.\textsuperscript{88} On the other hand, if the transaction is considered to be within the purpose of the provision, the tax benefits will be available, subject to the application of the GAAR. But the GAAR could never apply in such circumstances because a transaction falling within the purpose of the relevant provision cannot be abusive under subsection 245(4). As discussed earlier, the only way that the court's interpretation of subsection 245(4) makes sense is if the provisions that produce the tax benefits are interpreted literally. The problem with that approach is that first, it requires tax provisions to be interpreted differently from other statutory provisions, contrary to the court's position, and second, literal interpretation has been rejected by the Supreme Court.

After referring to the explanatory notes, the court restates the abuse test to be applied under subsection 245(4):

\begin{quote}
[T]he central question is, having regard to the text, context and purpose of the provisions on which the taxpayer relies, whether the transaction frustrates or defeats the object, spirit or purpose of those provisions.\textsuperscript{89}
\end{quote}

The court points out that, although the notes use the terms “exploit,” “misuse,” and “frustrate,” “their sense [is] most adequately captured by the word ‘frustrate.’”\textsuperscript{90} This is curious because the court uses the term “defeats” as well as “frustrates,” and also because these terms are all synonyms used in place of the statutory term “abuse.” None of these terms provides any clarification or explanation of the term “abuse.”

After some further comments on the explanatory notes, the court states out of the blue that, because Parliament intended to preserve consistency, predictability, and fairness in spite of the introduction of the GAAR, “the GAAR can only be applied to deny a tax benefit when the abusive nature of the transaction is clear.”\textsuperscript{91} As pointed out earlier, the court has established a hierarchy of rules, without any explanation or justification, in which the GAAR is subsidiary to the rules of the Act conferring tax benefits. The GAAR can apply only where the abuse is clear; otherwise, that hierarchy would be upset. There is no justification for such an approach, which will obviously have the effect of restricting the application of the GAAR. The alternative approach would have been for the court to treat the GAAR like any other provision of the Act.\textsuperscript{92} If two provisions of a statute conflict, resolution of the conflict is usually

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\textsuperscript{88} & See the text accompanying note 55, supra. \\
\textsuperscript{89} & \textit{Canada Trustco}, supra note 1, at paragraph 49. \\
\textsuperscript{90} & Ibid., at paragraph 49. \\
\textsuperscript{91} & Ibid., at paragraph 50. \\
\textsuperscript{92} & Although it is not completely clear, paragraph 51, ibid., suggests that the court recognized this point. In that paragraph, the court indicates that the provisions giving rise to the tax benefit must be interpreted in their context in light of their purpose because subsection 245(4) requires the issue of abuse to be determined having regard to the provisions of the Act read as a whole. The court then cautions that “it should not be forgotten that the GAAR itself is part of the Act.”
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based, not on predetermined presumptions, but on a contextual and purposive analysis to determine which provision should prevail on balance. That said, I have no difficulty with the establishment of a higher threshold for the application of a GAAR as long as that threshold is applied reasonably93 and is not used as a means to render the rule ineffective.

In my view, the Supreme Court’s analysis of the concept of economic substance or economic realities is the most disappointing aspect of its decisions.94 Without consideration of the economic substance of a transaction, the GAAR will be ineffective. The explanatory notes state unequivocally that “[s]ubsection 245(4) recognizes that the provisions of the Act are intended to apply to transactions with real economic substance,”95 and the court both quotes and refers to this aspect of the notes. However, the court goes on to render any reference to economic substance in the context of the GAAR virtually meaningless. The court interprets the statement in the notes as recognizing “that the provisions of the Act were intended to apply to transactions that were executed within the object, spirit and purpose of the provisions that are relied on for the tax benefit.”96 This is a perverse reading of the notes. It forms the basis for the court’s assertion that economic substance is relevant only where the text of the relevant provisions justifies its consideration:

We should reject any analysis under s. 245(4) that depends entirely on “substance” viewed in isolation from the proper interpretation of specific provisions of the Income Tax Act or the relevant factual context of a case.97

According to the court, unless a provision of the Act on which the taxpayer is relying refers to economic substance, lack of economic substance is not an indication of abuse. If the provision does not require economic substance, an economic substance requirement cannot be imposed by a court under the GAAR. In effect, the court has accepted the taxpayer’s argument in Canada Trustco to the effect that economic substance is relevant under subsection 245(4), but only where the provision at issue contemplates economic substance. In the case of the CCA provisions of the Act, the cost of depreciable property is its legal cost, not its economic cost; therefore, economic

93 My position was the same with respect to the Federal Court of Appeal’s requirement that the policy of the Act under subsection 245(4) had to be clear and unambiguous. See Arnold, “Demise of the GAAR,” supra note 4, at 498.
94 For a detailed examination of the economic substance doctrine, including a comparative analysis and a critical view of the Supreme Court’s interpretation in the context of the GAAR, see Jinyan Li, “‘Economic Substance’: Drawing the Line Between Legitimate Tax Minimization and Abusive Tax Avoidance,” in this issue of the Canadian Tax Journal.
95 Supra note 9, at clause 186.
96 Canada Trustco, supra note 1, at paragraph 56.
97 Ibid., at paragraph 60.
substance is irrelevant under the GAAR. The difficulty with this argument is that very few provisions refer explicitly to economic substance.\footnote{For an example of such a provision, see subsection 16(1), which requires the interest component of a contract providing for blended payments of income and capital to be determined “irrespective of when the contract or arrangement was made or the form or legal effect thereof.”}

Even in the rare cases where economic substance may be relevant,\footnote{It may be that the court did not recognize how few provisions of the Act contemplate economic substance or that it did not appreciate the implications of its position on economic substance.} the court is quick to point out that an absence of economic substance or a lack of business purpose is not sufficient in itself to justify a finding that the transaction is abusive:

> Whether the transactions were motivated by any economic, commercial, family or other non-tax purpose may form part of the factual context that the courts may consider in the analysis of abusive tax avoidance allegations under s. 245(4). However, any finding in this respect would form only one part of the underlying facts of a case, and would be insufficient by itself to establish abusive tax avoidance. The central issue is the proper interpretation of the relevant provisions in light of their context and purpose. When properly interpreted, the statutory provisions at issue in a given case may dictate that a particular tax benefit may apply only to transactions with a certain economic, commercial, family or other non-tax purpose. The absence of such considerations may then become a relevant factor towards the inference that the transactions abused the provisions at issue, but there is no golden rule in this respect.\footnote{Canada Trustco, supra note 1, at paragraph 58.}

Note that the court does not indicate in this paragraph what else is necessary to establish abuse. Subsequently, it articulates the test for abuse as follows:

> [A]busive tax avoidance may be found where the relationships and transactions as expressed in the relevant documentation lack a proper basis relative to the object, spirit or purpose of the provisions that are purported to confer the tax benefit, or where they are wholly dissimilar to the relationships or transactions that are contemplated by the provisions.\footnote{Ibid., at paragraph 60.}

The court repeats this test in the summary of its holdings.\footnote{Ibid., at paragraph 66.}

The court’s test fails to provide any clear guidance to taxpayers, tax officials, and the courts. In referring to relationships or transactions that “lack a proper basis,” the court does not provide any standard that can be applied to determine abuse; it simply restates the issue. When will relationships or transactions have “a proper basis”? The reference to relationships is also difficult to understand, and the court provides no explanation of why such a reference is necessary. The GAAR refers only to transactions. I suspect that, given the Supreme Court’s rigid adherence to the
legal form of transactions and its preference for applying a literal interpretation of
tax statutes, this aspect of the abuse test will be easy for taxpayers to satisfy. If the
transaction is legally effective and not a sham, and it complies with the literal
requirements of the relevant provisions, it will not be considered abusive.

The other aspect of the Supreme Court’s abuse test is equally problematic, but
for different reasons. A transaction may be considered abusive if it is “wholly
dissimilar” to the relationships or transactions contemplated by the relevant provi-
sions. The court does not provide any basis for making this determination. That
said, it appears that a “wholly dissimilar” standard will be difficult for the govern-
ment to meet—certainly, more difficult than a “dissimilar” standard. If a transaction
is wholly dissimilar to those contemplated by the statutory provisions, it is difficult
to see how the transaction qualified for the tax benefits contained in the provisions
in the first place. More fundamentally, there is no basis in the text or the legislative
history of the GAAR for a test based on the artificiality of a transaction. The
Supreme Court has read an artificiality test into the GAAR without any justification.

Former subsection 245(1), which was repealed when the GAAR was enacted,
denied the deduction of any amount if it would artificially or unduly reduce the
taxpayer’s income. The heading of former subsection 245(1) was “Artificial Trans-
actions,” and it was often discussed and applied as a provision that dealt with such
transactions. The legislative history of the GAAR indicates clearly that artificiality
was rejected as an appropriate test for identifying unacceptable tax avoidance. Such a test may penalize legitimate tax planning merely because it is innovative.

Moreover, just because a particular type of tax-avoidance scheme has become
widely used, it should not therefore be insulated from attack under the GAAR.

In general terms, the GAAR applies to an avoidance transaction that is abusive
within the meaning of subsection 245(4). What is tested under subsection 245(4) is
the particular avoidance transaction, not the series of which it is a part. This point
has been ignored in most of the GAAR cases, and it is ignored by the Supreme Court
in these cases. In Canada Trustco, the court did not identify any particular step in the
series of transactions as an avoidance transaction, and it analyzed the issue of abuse
under subsection 245(4) as if the entire series were a single avoidance transaction.

103 In Canada Trustco, the Supreme Court accepted the Tax Court’s finding that the transactions
involved were similar to an ordinary sale-leaseback. Canada Trustco, supra note 1, at paragraphs
78-80. In Mathew, the abusive nature of the transactions was confirmed by the “artificiality” of
the non-arm’s-length relationship between Standard Trust and the first partnership. Mathew,
supra note 1, at paragraph 62.

104 The version of the GAAR originally proposed in the white paper on tax reform contained a
purpose clause indicating that the purpose of the GAAR was “to counter artificial tax avoidance.”
Canada, Department of Finance, Tax Reform 1987: Income Tax Reform (Ottawa: Department of
Finance, June 18, 1987), 143-44. Also, the Finance Committee of the House of Commons
recommended that the GAAR should be based on “artificial or undue” wording. Canada,
Standing Committee on Finance and Economic Affairs, Report on the White Paper on Tax Reform
(Stage 1) (Ottawa: Queen’s Printer, November 1987), 123. See Arnold and Wilson, “The
In *Mathew*, although the Supreme Court agreed with the Federal Court of Appeal that all of the transactions in the series were avoidance transactions, for purposes of the abuse analysis under subsection 245(4), the court examined the series as a whole.\(^{105}\)

The implications of applying subsection 245(4) to a series as a whole, rather than to particular avoidance transactions, are unclear. It may be that there will be a tendency to apply the GAAR only in cases, such as *Mathew*, where the series as a whole can be viewed as abusive. Such an approach would significantly narrow the effectiveness of the GAAR. The GAAR would not apply to an abusive avoidance transaction inserted into a series that has an overall legitimate commercial purpose, such as an arm’s-length sale of property or a financing. It may be that this is the view that the Supreme Court took of the *Canada Trustco* case, where it accepted the Tax Court’s finding that the series of transactions was a profitable commercial investment similar to an ordinary sale-leaseback. In any event, if the GAAR applies only to a series of transactions as a whole, rather than to individual transactions forming part of a series, its effectiveness will be significantly limited.\(^{106}\)

On the other hand, it may be that the GAAR is deficient in not allowing the entire series of transactions to be tested as abusive. This point can be seen with reference to the facts in the *Canada Trustco* case, discussed below, and the weak-currency borrowing in the *Canadian Pacific* case. In the latter case, the primary purpose of the overall series was the legitimate commercial purpose of raising funds to be used in the taxpayer’s business to earn income. Similarly, the specific transactions resulting in the tax benefits—the payment of interest and the repayment of the loan—had the same primary commercial purpose. Even if the remaining transactions—swapping the weak currency for a stronger currency and swapping that currency for Canadian dollars—could be considered to be avoidance transactions, it is unlikely that those swaps, viewed in isolation from the rest of the series, would be considered abusive. It was the deduction of excessive interest and the realization of a capital gain on the repayment of the loan that frustrated the statutory scheme. These issues will be confronted only if the entire series of transactions, not its constituent parts, is scrutinized to determine abuse under subsection 245(4).

**MISCELLANEOUS ISSUES**

In *Canada Trustco*, the Supreme Court refers extensively to the explanatory notes to the GAAR prepared by the Department of Finance. Those notes appear to have

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\(^{105}\) “The only reasonable conclusion is that the series of transactions frustrated Parliament’s purpose of confining the transfer of losses such as these to a non-arm’s length partnership.” *Mathew*, supra note 1, at paragraph 62.

\(^{106}\) In fact, the result would be the same as that under the Federal Court of Appeal’s approach to the interpretation of the series aspect of the definition of “avoidance transaction” in *Canadian Pacific*, supra note 8. As noted earlier, under that approach, if a series has a primary non-tax purpose, all of the transactions forming part of the series must be considered to have the same purpose. As a result, none of the transactions are avoidance transactions and the question of abuse under subsection 245(4) does not even arise.
been prepared with the intention of providing guidance to taxpayers and tax officials and to influence the interpretation of the GAAR by the courts. They are different from most other explanatory notes to income tax legislation, which often merely parrot the language of the legislation. In contrast, the notes to the GAAR discuss the purpose, meaning, and intended application of the provision.

The court refers to the explanatory notes with respect to the purpose of the rule, the prohibition against recharacterizing transactions, what constitutes abusive tax avoidance, and the relevance of economic substance. Although I have been critical of the way in which the court has construed the explanatory notes, it is clearly desirable, in my view, for the courts to refer to those notes. If, as the Supreme Court says, the ultimate goal for a court is to determine the intention of the legislature, the notes may provide some evidence—perhaps even the best evidence—of that intention. Explanatory notes are not determinative of the meaning of the statute; but they are relevant and should not be ignored. Although the notes are prepared by the Department of Finance rather than Parliament, realistically it is the officials of the Department of Finance who develop tax policy and draft the legislation that is enacted by Parliament. Despite the adage that the worst person to interpret legislation is the person who drafted it, the explanatory notes may provide important guidance as to the meaning of legislation and, if so, they should be given significant weight in the interpretive process.

In 2005, the GAAR was amended in several respects. Most importantly, subsection 245(4) was amended to clarify that the GAAR applies to a misuse or an abuse of the Act, the Regulations to the Act, the Income Tax Application Rules, a tax treaty, or any other relevant statute. The amendment also removed the words “for greater certainty” and the double negative in the former version. The 2005 amendments are retroactive to the original date of enactment of the GAAR.

The Supreme Court deals with the amendments summarily, indicating that they have no application to the cases at bar and that, even if they were to apply, they would

107 Canada Trustco, supra note 1, at paragraphs 15 and 31.
108 Ibid., at paragraph 30.
109 Ibid., at paragraphs 48 and 49.
110 Ibid., at paragraph 56.
111 Ibid., at paragraph 40.
112 See the statement by the Earl of Halsbury in Hilder v. Dexter, [1902] AC 474, at 477 (HL). The adage may have been appropriate in Halsbury’s time because a century ago statutes were interpreted literally. Only the words that were used in the statute were considered to be reliable indicators of Parliament’s intention. The adage is invalid today, when statutes are interpreted in accordance with their purpose. Recourse to extra-statutory indications of statutory purpose, such as explanatory notes, is clearly appropriate.
113 The Income Tax Application Rules are transitional rules that were adopted in connection with the 1972 tax reform.
114 See supra note 6 for the text of amended subsection 245(4).
not warrant a different approach to the issues. The court is probably correct in its conclusions, the issues merit analysis. The words “for greater certainty” were originally added to subsection 245(4) to make it appear to be a rule of construction rather than an exception to subsection 245(2), the charging provision. However, the CRA and the courts have consistently viewed subsection 245(4) as an exception. Therefore, the deletion of those words seems to be an acknowledgment that they failed to have the desired effect. The new wording of subsection 245(4) suggests that the abusive nature of the transaction is an additional condition that must be met in order for subsection 245(2) to apply. This raises the issue of who has the burden of proof with respect to the establishment of the abusive nature of the transaction. If the existence of abuse is a condition precedent for the application of the GAAR, then it seems appropriate for the government to have the burden of establishing the abuse. On the other hand, if subsection 245(4) is an exception for non-abusive transactions, it seems appropriate for the burden to be on the taxpayer to show that the transaction is benign. As discussed earlier, however, the Supreme Court holds that the burden is on the government to establish abuse even under the former wording of subsection 245(4). The courts’ interpretation of amended subsection 245(4) is unlikely to be any different.

There is an argument that the elimination of the double negative in subsection 245(4) fundamentally alters the meaning of the provision. Under the former wording, it was necessary—whoever has the burden of proof—to show that the avoidance transaction would not result in abuse: in other words, that the transaction was benign. Under the new wording, however, it is necessary to show that the avoidance transaction is abusive. Given that the Supreme Court has clearly placed the burden of establishing abuse on the government, it is extremely unlikely that future courts will interpret the amended version of subsection 245(4) to alter that result.

APPLICATION OF THE GAAR TO THE TRANSACTIONS IN CANADA TRUSTCO AND MATHEW

In this section of the article, I discuss how the Supreme Court applied the GAAR to the transactions in Canada Trustco and Mathew. The transactions involved in the two cases are first briefly described. I have attempted to capture the essential elements of the transactions, at the risk of ignoring important minor details, so

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115 Canada Trustco, supra note 1, at paragraph 7. The Tax Court expresses a similar view of the amendments in the recent Evans case, supra note 10 and discussed below.

116 For a detailed analysis of the retroactivity issue, see Benjamin Alarie, “Retroactivity and the General Anti-Avoidance Rule,” paper presented at a symposium held on November 18, 2005 at the University of Toronto, Faculty of Law, “The Supreme Court of Canada and the General Anti-Avoidance Rule: Tax Avoidance After Canada Trustco and Mathew.”


118 See Duff, supra note 35, at 68.
that the Supreme Court’s application of the GAAR to the transactions at issue can be properly evaluated. I have also added some editorial comments on the question of economic substance. In my opinion, the economic substance of a series of transactions is revealed by a comparison of the pre-tax profit actually or potentially derived from the transactions with the tax benefits and by an examination of the changes, if any, in the financial or commercial positions of the parties as a result of the transactions.\(^{119}\) An appreciation of the economic substance of the transactions is essential, in my view, to any assessment of the propriety of the transactions for tax purposes. The relevance of economic substance under the GAAR is one of the important issues in the \textit{Canada Trustco} case.

\section*{The Transactions}

The \textit{Canada Trustco} case involved a complicated series of transactions whereby the taxpayer acquired depreciable property giving rise to significant CCA deductions. Canada Trustco, a financial institution, had leasing income on which it wanted to reduce the tax payable. Because of the specified leasing property rules, CCA in respect of such property is restricted. Certain property, however, including tractor-trailers, is exempt from those rules.\(^{120}\) Pursuant to an arrangement structured by a merchant bank, the following transactions were carried out on the same day:

- Canada Trustco acquired tractor-trailers from a US company with a combination of its own funds and a non-recourse borrowing from a Canadian bank.
- Canada Trustco leased the trailers to a UK subsidiary of the Canadian bank that supplied the acquisition funding.
- The UK subsidiary subleased the trailers back to their original US owner. (At this stage, the transactions resemble an ordinary sale-leaseback, a standard form of financing.)
- The US company prepaid all of its obligations under the sublease.
- The UK subsidiary used the prepayment to make a deposit with the parent bank equal to the amount of the original loan to Canada Trustco and with the balance acquired a government bond maturing in nine years at the same time as the termination of the lease.
- After nine years, the UK subsidiary exercised an option under the lease to buy out the lease for an amount equal to the amount received on the maturity of the bond.
- The interest rate on the loan to Canada Trustco, the rental rate on the lease, and the interest rate on the deposit were set so that the payments required could be set off against one another.

\(^{119}\) The Tax Court refers to the latter criterion as indicative of economic substance in the recent \textit{Evans} case, supra note 10.

\(^{120}\) See the definition of “exempt property” in regulation 1100(1.13)(a).
In effect, the flow of funds—both the original loan and the ongoing lease and interest payments—was circular. The bank was not at risk because it received back the amount of its loan to Canada Trustco in the form of the deposit from its UK subsidiary. The only non-circular aspect of the arrangement was the equity provided by Canada Trustco. These funds were not immediately returned to Canada Trustco but were invested in a government bond, which was paid with accrued interest to Canada Trustco nine years later on the termination of the arrangement. Although Canada Trustco did earn a profit equal to the interest on the bond, it would have earned more if it had simply acquired the bond with its original equity contribution.\textsuperscript{121}

The tax consequences of the arrangement for Canada Trustco were quite straightforward. The rental payments receivable on the lease to the UK company were included in income but were offset by the deduction of the interest payable to the bank on the loan. Thus, the CCA claimed in respect of the ownership of the trailers could be used to offset Canada Trustco’s other leasing income.

The Tax Court found that the scheme was “a profitable commercial investment” for Canada Trustco and similar to an ordinary sale-leaseback transaction.\textsuperscript{122} These findings are without foundation. In an ordinary sale-leaseback, there is usually no prepayment of the entire amount of periodic payments required under the lease on the same day that the sale-leaseback is entered into. Canada Trustco had no possibility of realizing any pre-tax profit from the transactions other than the return from the investment in the government bond, which, as noted earlier, would have been greater if Canada Trustco had used its equity to acquire the bond and not carried out the other transactions. Apart from the fees and transaction costs, the financial and commercial positions of all of the parties to the transactions remained unchanged. Both the Tax Court and the Federal Court of Appeal found for the taxpayer, holding that, although the series involved an avoidance transaction, it was not abusive.\textsuperscript{123}

The Mathew case involved the transfer of losses by a taxpayer that could not benefit from them to unrelated taxpayers who were able to use them. Standard Trust owned a portfolio of mortgages with an accrued loss of approximately $50 million. Because Standard Trust was insolvent, it could not benefit from deduction of the loss. As a result, Standard Trust formed a partnership with a wholly owned subsidiary created for that purpose and transferred the mortgages to the partnership. By virtue of subsection 18(13) of the Act, the deduction of the loss that otherwise would

\textsuperscript{121} The amount invested by the UK subsidiary in the government bond was equal to the amount of Canada Trustco’s original equity contribution less the amount of the fees paid to the US company for entering into the transaction.

\textsuperscript{122} Canada Trustco Mortgage Co. v. The Queen, [2003] 4 CTC 2009, at paragraphs 57 and 89 (TCC).

\textsuperscript{123} Ibid., at paragraph 93; and The Queen v. Canada Trustco Mortgage Company, [2004] 2 CTC 276, at paragraph 1 (FCA).
have arisen on the transfer was disallowed and the loss was added to the cost of the mortgages to the partnership. Standard Trust then sold its partnership interest to an unrelated company, OSFC Holdings Ltd. (“OSFC”). OSFC syndicated part of its interest by forming a second-tier partnership in which several individual investors, including the partners of a prominent tax law firm, acquired interests. The first-tier partnership wrote down the mortgages to their fair market value at the end of its first fiscal period, triggering the realization of the accrued loss. The partners of the two partnerships claimed their proportionate shares of the loss against their other income. The economic substance of the transactions was a sale of the loss for approximately 10 percent of the face amount.

The minister assessed OSFC and the other members of the two partnerships on the basis that the GAAR applied to deny the deduction of the loss. OSFC’s appeal was rejected by both the Tax Court and the Federal Court of Appeal. As noted earlier, the Federal Court’s decision in OSFC was the leading GAAR case until the Supreme Court’s decisions. OSFC’s application for leave to appeal to the Supreme Court was denied. The other partners launched a separate appeal, which—not surprisingly, given the decisions in OSFC’s case—was also rejected by both the Tax Court and the Federal Court of Appeal.124 Surprisingly, the Supreme Court granted leave.

**Application of the GAAR**

In both cases, the taxpayers effectively conceded that there was an avoidance transaction, so that the only issue was whether the avoidance transaction constituted an abuse of the relevant provisions of the Act. In both cases, the Supreme Court followed its two-stage approach of first determining the purpose of the relevant provisions and then determining whether the avoidance transaction frustrated that purpose. In *Canada Trustco*, the court found that the purpose of the CCA provisions was to allow deductions based on the legal rather than the economic cost of assets:

Textually, the CCA provisions use “cost” in the well-established sense of the amount paid to acquire the assets. Contextually, other provisions support this interpretation. Finally, the purpose of the CCA provisions of the Act, as applied to sale-leaseback transactions, was, as found by the Tax Court judge, to permit deduction of CCA based on the cost of the assets acquired.125

This is pretty thin reasoning. In effect, the court is saying that the purpose of the CCA provisions is what their literal meaning permits.126

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125 *Canada Trustco*, supra note 1, at paragraph 74.
126 The court’s reasons are directed very narrowly at the meaning of “cost” rather than at the purpose of the CCA system. The purpose of the system is to provide for the amortization of the cost of capital property over the period during which the property is used to earn income. As Hogg et al. put it, “[t]he idea is to match the cost of the asset against the revenues which it
Further, the court rejected the government’s argument based on the economic substance of the transactions because economic substance is irrelevant in the context of the CCA provisions:

The applicable CCA provisions of the Act do not refer to economic risk. They refer only to “cost.”

As indicated above, cost means legal cost. Therefore, according to the court, “we see nothing in the GAAR or the object of the CCA provisions that permits us to rewrite them to interpret ‘cost’ to mean ‘amount economically at risk.’”

Because economic substance is irrelevant for purposes of the CCA provisions, it is very unlikely that the GAAR can ever apply to transactions that abuse those provisions. This is an unwarranted restriction of a GAAR that Parliament intended to be of broad application. Moreover, it contradicts prior Supreme Court jurisprudence dealing with former subsection 137(1) (subsequently, former subsection 245(1)), which prohibited the deduction of amounts that would artificially reduce a taxpayer’s income. In *Harris v. MNR*, the taxpayer attempted to claim huge CCA deductions on the basis that the cost of the property in question was equal to the aggregate lease payments required over the term of a 200-year lease. At the time, the provisions of the Act required a lease with an option to purchase to be treated as a sale, with the cost of the property being equal to the aggregate payments over the term of the lease less the value of the land. The Supreme Court held that, on the “true construction” of the 200-year lease, it was not within the scope of those provisions; and further, even if it was, the court “would have had no hesitation” in holding that

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127 *Canada Trustco*, supra note 1, at paragraph 75.
128 Ibid. It should be noted that the effect of the GAAR is not to rewrite other provisions of the Act but to deny tax benefits from abusive transactions. If the court had concluded that the transactions were abusive, that finding would not have resulted in amendment of the CCA provisions. The provisions would continue to allow deductions based on the legal cost of assets unless that cost was produced by virtue of an abusive avoidance transaction.
the deduction of CCA was denied by former subsection 137(1). The Supreme Court’s attitude to abusive tax avoidance 40 years ago contrasts sharply with its attitude in the Canada Trustco case.

The Supreme Court puts great emphasis on the findings of the Tax Court that the transactions were similar to an ordinary sale-leaseback and represented a profitable commercial investment for Canada Trustco. As explained earlier, the Tax Court was wrong on both counts. If Canada Trustco had purchased the trailers from the US company for $120 million, leased them back directly to the US company, and received a prepayment of the lease of $117 million on the same day, leaving the US company with its fee for doing the transaction, the substance of the transaction would be more obvious. There is no financing. There is a sale-leaseback in legal form, but the effect is a sale with repayment of the purchase price to the buyer—or no sale at all. In my opinion, this transaction could be properly characterized as a sham. It is intended to give the appearance of legal rights and obligations (sale-leaseback), different from the actual legal rights and obligations between the parties. However, I can see no rational distinction between this transaction and the more complicated transactions blessed by the Supreme Court in the Canada Trustco decision. If there is none, then the court’s rigid adherence to legal form has been taken to a new level, despite the existence of the GAAR. As a result of the Supreme Court’s decision in Canada Trustco, the payment of tax by corporations engaged in the business of leasing has become effectively voluntary. For a fee, such corporations can easily reduce their tax payable by CCA deductions generated through similar transactions. It is difficult to believe that Parliament could possibly have intended this result.

An alternative way to view the Canada Trustco case is to consider it as limited by the factual findings of the Tax Court judge that the transactions were similar to an ordinary sale-leaseback and represented a profitable commercial investment. On this basis, the result might arguably be different in another case involving the same series of transactions if the Tax Court judge made different findings. In my view, given the Supreme Court’s decision, it is unlikely that another Tax Court judge would make different findings concerning the same transactions. This is why it is necessary for the government to enact specific anti-avoidance rules to prevent these types of transactions from generating artificial CCA deductions. Further, even if another judge might draw different conclusions about the transactions in Canada Trustco, such inconsistency in the courts is hardly something to be encouraged and is one of the reasons why appeal courts exist.

In Mathew, a literal reading of the partnership provisions relied on by the taxpayer would have permitted the taxpayer to deduct his share of a loss that had accrued while the property was owned by Standard Trust, an unrelated person. However, unlike Canada Trustco, where the policy of the CCA rules was their literal application...
meaning, in *Mathew* the broader context of the Act disclosed a general policy of prohibiting the transfer of losses between taxpayers, subject to specific exceptions. According to the Supreme Court, this broader policy is not conclusive as to the purpose of subsection 18(13) and section 96, the provisions relied on by the taxpayer for the tax benefits. With respect to the purpose of section 96, the court says:

The partnership rules under s. 96 are predicated on the requirement that partners in a partnership pursue a common interest in the business activities of the partnership, in a non-arm’s length relationship. Although, on its face, s. 96(1) imposes no restriction on the flow of losses to its partners, except for the treatment of foreign partnerships under s. 96(8), it is implicit that the rules are applied when partners in a partnership carry on a business in common, in a non-arm’s length relationship.

The court cites no authority for this startling proposition; indeed, no authority could be found for it because it is patently false. The rules in section 96 apply generally to partnerships, including professional partnerships and commercial partnerships, in which the partners clearly deal with one another at arm’s length. As to subsection 18(13), the court states that its purpose is restricted to non-arm’s-length transferees:

To allow a new arm’s length partner to buy into the transferee partnership and thus to benefit from the loss would violate the fundamental premise underlying s. 18(13) that the loss is preserved because it essentially remains in the transferor’s control.

The court cites no authority for this view of the purpose of subsection 18(13). It is certainly not derived from the text of the provision, because the text is silent on the point. Therefore, it must be derived from the broader context of the Act—namely, the general prohibition against the transfer of losses—combined with the mistaken view that the rules of section 96 are limited to partnerships in which the partners deal not at arm’s length. It is impossible to know whether the court’s view of the purpose of subsection 18(13) would have been different if it had properly understood that section 96 applies to partnerships in which the partners deal at arm’s length.

Having determined the purpose of subsection 18(13) and section 96, the court concludes that the transactions frustrate the purpose of those provisions, and therefore the GAAR applies. This conclusion seems obvious because the transactions resulted in the loss being claimed by persons dealing at arm’s length with the company that incurred the loss, and they were planned for that purpose. However, the court had to apply the test of abuse it adopted in the *Canada Trustco* decision; that is, abuse will be found “where the relationships and transactions as expressed in the relevant documentation lack a proper basis relative to the object, spirit or purpose of the provisions that are purported to confer the tax benefit, or where they are wholly dissimilar to the relationships or transactions that are contemplated

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132 *Mathew*, supra note 1, at paragraph 51.

133 Ibid., at paragraph 54.
by the provisions.”134 In this regard, the court points to “the vacuity and artificiality of the non-arm’s length aspect of the initial relationship between Partnership A [the first-tier partnership] and STC [Standard Trust]” and suggests that the absence of “shared control of the assets in a common business activity,” which is the premise of subsection 18(13) and section 96, “leads to an inference of abuse.”135 It bears reiteration that if, on a textual, contextual, and purposive interpretation, subsection 18(13) does not permit the transfer of losses to new arm’s-length partners, then the GAAR is unnecessary.

The key question at this point is: What is the distinction between the two cases? Why did the GAAR apply in Mathew and not in Canada Trustco? Or, more precisely, why was the series of transactions in Mathew abusive and the series in Canada Trustco not abusive? We should be able to determine, in terms of the Supreme Court’s articulation of the test of abuse, some rational basis for the different results that can then be applied to future cases. In my view, however, it is impossible to identify a principled basis to distinguish between the two cases. If the court had concluded (which it could and should have done, in my view) that the purpose of the CCA provisions—indeed, of any deduction provisions of the Act—was limited to real costs or expenditures and did not include costs and expenditures that were effectively eliminated by offsetting circular transactions, the court would have found the transactions to be abusive. It would have pointed to the vacuity and artificiality of the circular transactions and stated that Parliament could not have intended that CCA be deductible in such a situation. Equally, if the court had concluded that the purpose of subsection 18(13) and section 96 was reflected in their literal wording, then it would have found the transactions in Mathew not to be abusive. It would have pointed out that the transactions were not wholly dissimilar to other transfers to partnerships; that the GAAR cannot be used to rewrite subsection 18(13) and section 96; that the relationships and transactions expressed in the documentation were the essence of the transaction and complied with the literal wording and the object, spirit, and purpose of those provisions; and that where Parliament wishes to restrict the deduction of losses, it does so expressly, as in subsection 111(5). It might also have pointed out that, in contrast to Canada Trustco, where the CCA deduction was artificially created, in Mathew the loss was real.

To repeat, I am unable to articulate a principled basis for distinguishing between the two cases. I readily acknowledge that this may be my shortcoming and that others will reveal the distinction that I have failed to find. The key appears to be the identification of the purpose of the relevant provisions. Once the courts have determined the legislative purpose, it will usually be obvious whether the transaction fits within or falls outside that purpose. Arguably, this does not amount to a smell test, because it is grounded in the interpretation of the relevant provisions to determine their purpose. As noted earlier, however, the modern approach to statutory

134 Canada Trustco, supra note 1, at paragraph 60.
135 Mathew, supra note 1, at paragraph 62.
interpretation requires all statutes, including the Income Tax Act, to be interpreted in this fashion. If the courts actually interpret the Act in this way, and a transaction is abusive only when it is not in accordance with the purpose of the relevant provisions, then the GAAR is superfluous. Another problem is that identifying the purpose of provisions of a statute as complicated as the Income Tax Act requires judges who are knowledgeable about the tax system. Following the lead of the Supreme Court, Canadian tax courts have tended to rely on a literal interpretation of the Act except when a more expansive interpretation benefits the taxpayer. They have not embraced purposive interpretation as a means of controlling abusive tax avoidance. That is why the GAAR was enacted.

**IMPLICATIONS OF THE SUPREME COURT’S DECISIONS**

While it may be idle to speculate about the implications of the Supreme Court’s GAAR decisions, it must be recognized that their importance lies in the future reactions of taxpayers and their advisers, the CRA, the lower courts, the Department of Justice, and the Department of Finance. My view is that the CRA and tax advisers will continue to behave much as they did before these decisions. The CRA will still challenge the kinds of transactions that it previously considered abusive, with the obvious exception of transactions similar to those in the Canada Trustco case. Despite some initial concern expressed by some tax practitioners that the Supreme Court has lowered the threshold for the application of the GAAR,136 I suspect that the bottom line for GAAR opinions will remain the same. In other words, transactions that were the subject of positive opinions (that is, that the GAAR would not apply) in the past will remain positive. If anything, taxpayers and their advisers are likely to become more aggressive, particularly after the Canada Trustco decision.137 The fundamental reason for my view that the decisions will not otherwise alter the behaviour of the CRA and tax advisers is that the Supreme Court has not provided any clear principled guidance concerning the application of the GAAR that would justify a change.

The Supreme Court’s holding that the findings of the Tax Court judge concerning the issue of abuse are questions of fact that should not be interfered with by a higher court, except in the case of a palpable and overriding error, raises an important issue for the Department of Justice. If the Federal Court of Appeal and the Supreme Court adhere to this admonition, they will have a very limited role with respect to the interpretation and application of the GAAR. This suggests that all GAAR cases in the Tax Court should be handled by the most senior Justice litigators.

For the Department of Finance, the implications of the Supreme Court’s decisions—in particular, the decision in Canada Trustco—are clear. First, it is imperative

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137 On the basis that, if the transactions in Canada Trustco were not abusive, then other similar tax planning has at least a decent chance of being effective.
that amendments to the CCA provisions be made as soon as possible, to prevent other taxpayers from engaging in similar transactions in order to manufacture CCA deductions. Since (according to the Supreme Court) economic substance is irrelevant in the interpretation and application of the CCA provisions, the GAAR will not apply and specific anti-avoidance rules will be necessary. Second, and more important, the Department of Finance must seriously consider recommending that the GAAR be amended to require (not permit) the courts to consider the economic substance of a transaction in assessing whether a transaction is abusive under subsection 245(4). It may even be necessary, given the demonstrated reluctance of the Supreme Court in this regard, to deem certain transactions that lack economic substance to be abusive for the purposes of subsection 245(4). However, considering how long it took Finance to respond to the deficiencies in the relationship between the GAAR and tax treaties and regulations, a swift response to this issue seems unlikely.

How will the Tax Court react to the Supreme Court’s GAAR decisions? Although the Tax Court’s reaction will play out over time, we have some preliminary indications from a few cases that have been decided in the four months following those decisions. Two cases involved the application of specific anti-avoidance rules in addition to the GAAR. In one case, the Tax Court held that section 103 dealing with unreasonable allocations of income or losses to partners applied to the transactions, so that the application of the GAAR was unnecessary. In the other case, the Tax Court held that neither subsection 95(6) nor the GAAR applied to a scheme to import debt into Canada as part of a double-dip financing arrangement. These cases may demonstrate that, where there are specific anti-avoidance rules, the GAAR is either superfluous because the specific rule applies or ineffective because a transaction that is not subject to the specific rule cannot be considered to be abusive.

The most revealing GAAR case decided by the Tax Court since the Supreme Court’s decisions is Evans v. The Queen, a surplus-stripping case in which Bowman CJ

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138 The GAARs of Australia, Hong Kong, and Ireland require the courts to consider a list of several factors, including economic substance, in determining whether a transaction is offensive.

139 The legislation could spell out the circumstances in which a transaction would be considered to lack economic substance—for example, if the transaction did not have any reasonable prospect of a pre-tax profit at least equal to the amount of the expected tax benefit.

140 Evans, supra note 10; West Topaz Property Ltd. v. The Queen, 2005 TCC 655 (sub nom. XCO Investments Ltd. v. The Queen); Overs v. The Queen, 2006 TCC 26; Univar, supra note 61; and Desmarais v. The Queen, docket no. 2003-2952(IT)G (TCC).

141 West Topaz Property Ltd., supra note 140. Bowman CJ indicated that if section 103 had not applied, he would have reached the same result under the GAAR. He also indicated that the economic realities of the transactions were “an important ingredient” in determining what were reasonable partnership allocations under section 103. Ibid., at paragraph 35.

142 Supra note 10. A professional corporation issued to the taxpayer, its major shareholder, a stock dividend consisting of 487 class B shares, redeemable and retractable for $1,000 each. The shares were sold the next day to a partnership, the partners of which were the taxpayer’s wife and three children, for a promissory note in the amount of $487,000. The taxpayer claimed the capital gains exemption with respect to the gain realized on the sale. In the following three years, the
applied the analytical approach adopted by the Supreme Court. First, he found on
the facts that there was no avoidance transaction. According to the chief justice, the
primary purpose of the series of transactions was to distribute funds in a professional
corporation to its major shareholder (a legitimate commercial purpose) rather than
to generate a tax benefit, despite the fact that the commercial purpose could have
been achieved more simply and at less cost by simply paying dividends. This is taking
the so-called choice principle to its extreme limits. This was not mandated by the
Supreme Court, and it renders the GAAR virtually meaningless. As long as there is a
legitimate commercial objective, the taxpayer can achieve that objective in a way
that minimizes tax, no matter how abusive. In effect, the Tax Court has ignored the
series aspect of the definition of “avoidance transaction,” which requires each trans-
action forming part of a series to be tested to determine whether it was carried out
primarily to obtain a tax benefit or for other reasons. If each step in the surplus-
stripping series in the *Evans* case is assessed separately, it is apparent that at least
some of the steps were executed primarily for tax reasons. For example, the sale of
the shares to the partnership in which the taxpayer’s spouse and children were
partners was arranged primarily to trigger the capital gains exemption.

Bowman CJ went on to consider the question of abuse, even though it was
unnecessary to do so. On the basis of his understanding of the Supreme Court’s
approach, he found that there was no abuse:

I do not think that it can be said that there is an abuse of the provisions of the Act
where each section operates exactly the way it is supposed to. . . .

The only basis upon which I could uphold the Minister’s application of section 245
would be to find that there is some overarching principle of Canadian tax law that
requires that corporate distributions to shareholders must be taxed as dividends, and
where they are not the Minister is permitted to ignore half a dozen specific sections of
the Act. This is precisely what the Supreme Court of Canada has said we cannot do.

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143 A similar conclusion was reached in the *Overs* case, supra note 140, on the basis of the plain
meaning of the relevant provisions and a factual determination (without reasons).

144 The choice principle maintains that if there are two or more reasonable ways for a taxpayer to
achieve a commercial purpose, the taxpayer is free to choose the way that results in the least
amount of tax. A classic example is the choice for a majority shareholder to sell the assets or the
shares of the corporation.

145 *Evans*, supra note 10, at paragraphs 29-30. In the *Overs* case, the Tax Court concluded that
there was no abuse, without giving any reasons. The court simply referred to the Supreme
Court’s statements that the GAAR “was not intended to introduce uncertainty in tax planning”
and that “Parliament sought to address abusive tax avoidance while preserving consistency,
predictability and fairness in tax law,” and concluded that the evidence did not support a finding
of abuse. *Overs*, supra note 140, at paragraphs 9 and 22. This is a perverse application of the
GAAR, quite apart from the merits of the case.
This approach will render the GAAR virtually meaningless. In Evans, the individual sections operated as they were intended to when the transactions were viewed in isolation; however, when the series of transactions is viewed in the context of the Act as a whole, it frustrates the clear statutory scheme to tax corporate distributions as dividends, deemed dividends, or shareholder benefits. The identification of this statutory scheme is not the identification of an overarching policy, which the Supreme Court has condemned; it is the determination of the purpose of the provisions of the Act based on a textual, contextual, and purposive analysis, corresponding to the Supreme Court’s identification of a legislative scheme prohibiting loss transfers between arm’s-length taxpayers in the Mathew case.

The more disturbing aspect of the Evans decision is the chief justice’s comment that the results in earlier Tax Court cases applying the GAAR to surplus-stripping transactions would be different in light of the Supreme Court’s GAAR decisions. In those earlier cases, the Tax Court found that sales of shares to accommodation parties were used to effect a distribution of the surplus of corporations in violation of a clear statutory scheme to tax corporate distributions irrespective of the form of the distributions. Former subsection 247(1) also provides an indication of this statutory purpose; it was repealed in 1987 when the GAAR was introduced on the basis that the GAAR would apply to prevent any surplus-stripping transactions that would have been prevented by subsection 247(1). With the benefit of hindsight, the repeal of former subsection 247(1) may have been unwise because, arguably, there is no longer any clear statutory scheme that prohibits surplus stripping.

The Supreme Court’s treatment of economic substance in the GAAR cases also suggests that the results in the earlier Tax Court surplus-stripping cases might be different. Although the sales of shares in those cases were not disregarded as shams, the Tax Court found the transactions to be abusive because in substance they resulted in the distribution of corporate surplus. According to the Supreme Court, reference to the economic substance of transactions is warranted under subsection 245(4) only if the relevant statutory provisions justify it. It is difficult to identify any wording in the capital gains provisions of the Act that justify ignoring a legal sale of shares, any more than the CCA provisions justified ignoring the legal cost of the trailers in Canada Trustco.

CONCLUSION
Irrespective of the results in Canada Trustco and Mathew, the Supreme Court’s decisions should be unanimously condemned by the tax community. They leave the proper approach to the interpretation of tax statutes in a state of confusion. A fair

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146 However, in Desmarais, supra note 140, which was heard after Evans, the Tax Court applied the GAAR to a surplus-stripping transaction.

147 Nevertheless, former subsection 247(1) and the circumstances of its repeal form part of the legislative history of the Act and can be used by a court to assist in the interpretation of current provisions. See Ruth Sullivan, Driedger on the Construction of Statutes, 3d ed. (Markham, ON: Butterworths, 1994), 449-59. This legislative history was referred to in Desmarais, supra note 140.
and careful reading of the court’s reasons for judgment does not provide a clear answer to the straightforward question of how the Income Tax Act should be interpreted—the same as other statutes, or differently? Nor does the court provide any clear guidance with respect to the crucial question of how taxpayers, tax officials, and lower courts are to determine whether an avoidance transaction is abusive under the GAAR. Further, the Supreme Court fails to clarify the relationship between the interpretation of other provisions of the Act and the determination of abuse under the GAAR. If the provisions of the Act are to be interpreted textually, contextually, and purposively, and if the determination of abuse is based on a textual, contextual, and purposive analysis of the provisions of the Act, as the court suggests, why is the GAAR necessary? Finally, and most importantly, the court fails to provide a principled basis to justify the different results in the *Canada Trustco* and *Mathew* cases.

From a broader perspective, in several other cases over the past decade, the Supreme Court has shown a steadfast aversion to playing any role in controlling abusive tax avoidance. Now, in the first cases involving the GAAR, the court has taken the position—despite the result in the *Mathew* case—that the introduction of the GAAR changes nothing. The court has rendered the GAAR virtually meaningless by restricting the significance of economic substance and by elevating the necessity for certainty (or consistency), predictability, and fairness for taxpayers above the GAAR and the need to control abusive tax avoidance. Moreover, the court has clearly indicated its unwillingness to hear future cases involving the GAAR, by characterizing the issue of whether an avoidance transaction is abusive as a question of fact for the Tax Court to decide, and by cautioning that the Tax Court’s decision should be overturned on appeal only in the event of a palpable and overriding error.

In my view, this is unfortunate. The courts have an important role to play in combatting tax avoidance. Parliament cannot deal effectively with the problem by itself. In enacting the GAAR, Parliament tried to send a clear signal to the public and the courts about the necessity of controlling abusive tax avoidance. For reasons that I cannot fathom, the Supreme Court has chosen to ignore that signal.148

In the end, if Parliament is serious about eliminating abusive tax avoidance, it has the authority to take the necessary steps to do so. If the government chooses not to act, then in time the attitude of the courts will inevitably change as they are faced with the obvious consequences of their decisions—increasingly outrageous and widespread tax-avoidance schemes. In the meantime, tax planners will continue to laugh, tax officials will continue to shake their heads in disbelief, and the public will suffer in ignorance.

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148 The reason for the court’s failure in this regard is not apparent, especially when the highest courts of the United Kingdom and the United States have clearly chosen to play an active role in combatting tax avoidance, even in the absence of any GAAR.