The Minister's Burden Under GAAR

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PRÉCIS

Les jugements tant attendus de la Cour suprême du Canada dans Hypothèques Trustco Canada et Mathew, décrits par certains comme les plus importants jugements en impôt depuis une génération, ont donné lieu à de vives discussions et suscité la controverse. Cet article porte sur un aspect particulier des lignes directrices formulées par la Cour suprême dans le cadre de l'analyse de l'application de l'article 245 (la règle générale anti-évitement ou RGAE) : le fardeau qui incombe au ministre. En énonçant les trois éléments qui doivent exister pour que la RGAE s'applique — un « avantage fiscal », une « opération d'évitement » et un évitement fiscal abusif —, la Cour suprême indique que c'est au contribuable qu'il revient de réfuter les deux premiers et que le ministre a le fardeau d'établir le troisième.

Bien qu'il n'y ait pas de fardeau précis imposé au ministre en vertu des deux premières exigences, l'auteur laisse entendre que les hypothèses sur lesquelles se fonde le ministre pour appliquer la RGAE doivent établir une preuve prima facie. L'auteur laisse entendre que cette première exigence, à savoir l'existence d'un avantage fiscal, ne devrait pas poser de difficulté au ministre, compte tenu de l'interprétation de ce terme par la Cour suprême. Dans la plupart des cas, si le contribuable a bénéficié de certaines déductions lors du calcul de son revenu ou de son revenu imposable, il suffit simplement d'identifier cette déduction. Ce n'est que dans d'autres cas — par exemple, si l'avantage fiscal résulte d'un report ou d'une nouvelle qualification du revenu — que le ministre doit identifier « un autre mécanisme » pour fins de comparaison. La deuxième exigence, l'établissement de l'existence d'une opération d'évitement, ne devrait pas non plus poser de difficultés au ministre si ses arguments sont fondés sur une taxinomie des opérations d'évitement de l'impôt. L'auteur prétend que toutes les opérations d'évitement de l'impôt font partie de l'une des trois catégories suivantes : opérations substituables, échange d'attributs fiscaux et création d'attributs fiscaux. Dans le cadre de cette taxinomie, tous les cas d'évitement de l'impôt devraient satisfaire facilement les deux premières exigences d'une analyse de la RGAE : c'est sur la

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troisième que les tribunaux devraient mettre l’accent. Le ministre devrait choisir les cas appropriés à contester en conséquence.

La troisième exigence d’une analyse de la RGAE, l’évitement fiscal abusif, comporte à la fois des questions de fait et des questions de droit. L’auteur laisse entendre qu’en discutant du paragraphe 245(4), la Cour suprême semble confondre le « fardeau de la preuve » — le fardeau de présentation de questions de fait — d’un litigant, plus particulièrement le ministre, avec l’obligation du tribunal de répondre aux questions de droit. Selon l’auteur, le paragraphe 245(4) comporte un examen en deux étapes : le premier, qui est purement une question de droit, consiste à interpréter l’intention du législateur dans les dispositions en cause; le second, à la fois une question de fait et une question de droit, consiste à déterminer si l’opération d’évitement est contraire à l’intention du législateur telle qu’elle a été établie. L’auteur est d’avis qu’il est inapproprié pour le tribunal de combiner ces deux étapes en une seule qui porte sur une question combinée de fait et de droit. De plus, l’auteur estime que le ministre n’a aucun fardeau de preuve au stade de la première étape. C’est au tribunal qu’il revient de se prononcer sur l’intention du législateur. Finalement, compte tenu des importantes questions de droit à examiner dans toute cause portant sur la RGAE, l’auteur s’interroge sur la réticence manifeste de la Cour suprême à entendre d’autres causes sur la RGAE et sur l’avertissement qu’elle semble servir à la Cour fédérale de ne pas intervenir dans les jugements de la Cour canadienne.

**ABSTRACT**

The long-awaited Supreme Court of Canada decisions in *Canada Trustco* and *Mathew*, described by some as the most important Supreme Court tax cases in a generation, have provoked significant discussion and controversy. This article examines one particular aspect of the guidelines provided by the Supreme Court in analyzing the application of section 245 (the general anti-avoidance rule [GAAR]): the minister’s burden under GAAR. In setting out the three requirements for GAAR to apply—a “tax benefit,” an “avoidance transaction,” and abusive tax avoidance—the Supreme Court indicated that it is the taxpayer’s burden to refute the first two, and the minister’s burden to establish the third.

While there is no specific burden imposed on the minister under the first two requirements, the author suggests that the assumptions upon which the minister’s GAAR assessment is based must set out a prima facie case. The author suggests that the first requirement, a tax benefit, should not pose any difficulty for the minister, in light of the Supreme Court’s interpretation of this term. In most cases, where the taxpayer has benefited from some deduction in determining income or taxable income, it is simply a matter of identifying that deduction. It is only in other cases—for example, where the tax benefit results from a deferral or a recharacterization of income— that the minister must identify an “alternative arrangement” for comparison. The second requirement, an avoidance transaction, similarly should not pose difficulties for the minister if the minister’s arguments recognize and are shaped by a taxonomy of tax-avoidance transactions. The author suggests that all tax-avoidance transactions fit one of three fact patterns: substitutable transactions, tax attribute trading, and tax attribute fabrication. Within this taxonomy, all tax-avoidance cases should easily meet the first two requirements of a GAAR analysis; it is on the third requirement that the courts should focus. The minister should choose the appropriate cases to litigate accordingly.
The third requirement in a GAAR analysis, abusive tax avoidance, involves both questions of fact and questions of law. The author suggests that in discussing subsection 245(4), the Supreme Court appears to confuse a litigant’s, specifically the minister’s, “burden of proof”—an evidentiary burden in questions of fact—with the court’s obligation to answer questions of law. The author suggests that subsection 245(4) involves two distinct inquiries: the first, a question purely of law, is to interpret the legislative intent of the statutory provisions in issue; the second, a mixed question of fact and law, is to determine whether the avoidance transaction frustrates the legislative intent so established. In the author’s view, it is inappropriate for the court to combine these two distinct inquiries into one “overall inquiry” involving a mixed question of fact and law. Furthermore, the author maintains that the minister has no burden of proof in the first inquiry. Legislative intent is a matter for the court to decide. Finally, given the important questions of law that must be considered in any GAAR case, the author questions the Supreme Court’s obvious reluctance to hear further GAAR cases and its apparent admonishment of the Federal Court not to interfere with Tax Court decisions.

KEYWORDS: GENERAL ANTI-AVOIDANCE RULE ■ EVIDENCE ■ LITIGATION ■ TAX AVOIDANCE

INTRODUCTION

The Supreme Court of Canada released its long-awaited decisions in its first two GAAR (general anti-avoidance rule) cases, The Queen v. Canada Trustco Mortgage Co.\(^1\) and Mathew v. The Queen,\(^2\) on October 19, 2005. The results themselves were not surprising to most tax pundits: both appeals were dismissed. However, the guidelines that the Supreme Court laid down for interpreting GAAR\(^3\) (indeed, for interpreting any provision of the Income Tax Act) have done little to clarify when section 245 will apply. One thing the court did make clear, though, is that it is not prepared to entertain another GAAR case for some time. Indeed, the Supreme Court implies—and many commentators on these two cases agree—that the Federal Court of Appeal should be loath to interfere with Tax Court decisions in GAAR cases. According to the court,

2. 2005 DTC 5538; [2005] 5 CTC 244 (SCC).
3. Section 245 of the Income Tax Act, RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as “the Act”). Unless otherwise stated, statutory references in this article are to the Act.
Given the apparent consequences of a loss at trial, the burdens of proof (theoretical or practical) imposed on the taxpayer and on the minister under GAAR are particularly important. However, as elaborated below, there are also important questions of law that a Tax Court judge must answer when applying section 245, and the judge’s answers to these questions must always be open to reconsideration by the Federal Court of Appeal. An error of law need not be “palpable and overriding” in order for an appellate tribunal to interfere with a lower court decision, and I cannot imagine that the Supreme Court was suggesting otherwise.

This article considers precisely what burden of proof the minister must satisfy in order to substantiate a reassessment under GAAR. As stated by the Supreme Court in Canada Trustco, there are three requirements that must be met for GAAR to apply:

1. [that there is a] tax benefit resulting from a transaction or part of a series of transactions (s. 245(1) and (2));
2. that the transaction is an avoidance transaction in the sense that it cannot be said to have been reasonably undertaken or arranged primarily for a bona fide purpose other than to obtain a tax benefit; and
3. that there was abusive tax avoidance in the sense that it cannot be reasonably concluded that a tax benefit would be consistent with the object, spirit or purpose of the provisions relied upon by the taxpayer.

According to the court, “[t]he burden is on the taxpayer to refute (1) and (2), and on the Minister to establish (3).” While the minister’s primary burden is thus located in the third requirement, the minister does have obligations under the first and second requirements to establish a prima facie case.

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Little was said by the court about the first two requirements, perhaps because in both cases (at least according to the court), these points were conceded. In both

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4 Supra note 1, at paragraph 66; see also paragraph 46.
5 Supra note 1, at paragraph 66 (emphasis in original).
6 Ibid.
7 In Mathew, the taxpayer conceded the first two requirements (appellant’s factum, at paragraph 14). However, the taxpayer’s factum in Canada Trustco suggested that all three points were in dispute (respondent’s factum, at paragraph 23). In Canada Trustco, the Supreme Court stated (supra note 1, at paragraph 67) that the Crown agreed with the finding of the trial judge that there was a tax benefit and an avoidance transaction and therefore the only issue on appeal was whether there was abusive tax avoidance under subsection 245(4). Since the onus is on the taxpayer to refute the first two requirements, surely only the taxpayer can concede them.
cases, the court indicates that the existence of a tax benefit and an avoidance transaction are questions of fact and, as noted above, the burden is on the taxpayer to refute these requirements. I agree with the court that these are primarily questions of fact (for the taxpayer to refute), although there are questions of law—for example, the interpretation of “tax benefit” in subsection 245(1) and the interpretation of subsection 245(3), particularly paragraph 245(3)(b)—that can affect a trial judge’s decision and that should be open for review on appeal without the necessity of a palpable error. Furthermore, in terms of the minister’s “burden” regarding these two requirements, obviously the assumptions upon which the minister reassessed the taxpayer under GAAR must indicate the tax benefit derived by the taxpayer and the transaction or series of transactions that resulted in the tax benefit.

**Tax Benefit**

According to the court, any deduction against taxable income is a tax benefit “since a deduction results in a reduction of tax.”\(^8\) In other cases, presumably where there is not a deduction against taxable income—for example, where there has been a deferral of tax or where income has been recharacterized in a manner that reduces the tax payable—the court indicates that a tax benefit can be established only by comparison “with an alternative arrangement.”\(^9\) No guidance is given by the court as to what an alternative arrangement might be, other than two simple examples. The implication, though, is that if, by using some other arrangement, the taxpayer could have achieved the same end result but would have paid more tax along the way (or accelerated the tax payable), then there has been a tax benefit. The minister’s only obligation is to identify in his assumptions the “reduction, avoidance or deferral of tax or other amount payable under [the Act]” that the taxpayer achieved. This stage in the GAAR analysis should not pose any difficulty for the minister.

In this respect, consider *Univar Canada Ltd. v. The Queen*,\(^10\) the first GAAR case decided by the Tax Court after the two Supreme Court decisions. Univar Canada was the wholly owned subsidiary of a US parent company (“Univar US”). Univar US had loaned a substantial amount—at interest, to another of its wholly owned subsidiaries (“Univar EU”), resident in the Netherlands, which in turn lent funds to its operating subsidiaries in Europe. Univar Canada incorporated a new wholly owned subsidiary resident in Barbados (“Barbadosco”) and used a combination of cash on hand (approximately $12 million) and borrowed money (approximately $25 million) to buy 10,000 shares of Barbadosco. Barbadosco used this money to purchase the Univar EU loan from Univar US. The structure created was a classic “double dip”: Univar Canada was able to deduct interest on the money borrowed in Canada;

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8 Supra note 1, at paragraph 20.
9 Ibid.
10 2005 TCC 723.
Univar EU was able to deduct the interest it paid to Barbadosco; Barbadosco paid little tax in Barbados (2.5 percent) on its interest income; and Barbadosco paid the balance to Univar Canada as exempt surplus dividends, thus avoiding Canadian tax liability on the income. The minister reassessed the taxpayer on two primary grounds: paragraph 95(6)(b) and GAAR. In the Tax Court, Bell J concluded that neither provision applied. According to Bell J, the flaw in the minister’s argument, under both provisions, was that he “clung to the hypothetical situation of the [taxpayer] having acquired the debt owing by [Univar EU] to [Univar US] as ‘an alternative arrangement’” despite the clear evidence of three witnesses for the taxpayer and the documentation presented by them that “there was never any intent for Univar [Canada] to acquire that debt and, in fact, Univar [Canada] did not acquire that debt.”

Bell J is correct that the Crown cannot recharacterize the transaction for the purpose of determining whether there was a tax benefit. But with respect, since the taxpayer claimed an interest expense on money borrowed to buy the shares of Barbadosco and that expense resulted in a reduction of tax, there was no need to consider any alternative arrangement. According to the Supreme Court, any deduction from taxable income is a tax benefit. Thus, Bell J misconstrued the meaning of “tax benefit.” Where the taxpayer has clearly benefited from a deduction of income, it is not necessary—indeed, it is an error in law—to consider alternative arrangements.

Avoidance Transaction

As to the second requirement, the minister’s only obligation is to identify in his assumptions the impugned transaction—including any of the transactions in a series of transactions that gives rise to a tax benefit—that is considered to be an avoidance transaction and to assert that the primary purpose of such transaction was not a bona fide non-tax purpose. It is then for the taxpayer to lead sufficient evidence to refute this assumption. This is made clear by the wording of subsection 245(3) itself: a transaction is an avoidance transaction unless it may reasonably be considered that the transaction was undertaken primarily for bona fide purposes other than to obtain a tax benefit. The Supreme Court rightly indicates that the existence of a tax benefit, in and of itself, is not sufficient to impugn a transaction as an avoidance transaction. In other words, the fact that the taxpayer could otherwise have achieved the same end result but with a greater (or accelerated) tax liability is not sufficient to make the transaction an avoidance transaction—although, as indicated above, it should be sufficient to conclude that there was a tax benefit. The issue, requiring a strictly factual determination, is whether it is reasonable to conclude that the taxpayer’s primary purpose in undertaking the particular transaction (or any transaction in a series of transactions) was a bona fide purpose other than to obtain

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11 Ibid., at paragraph 37 (emphasis in original).
the tax benefit. The Tax Court’s conclusion in this respect cannot be upset by an appellate court absent a palpable and overriding error.

Consider the deduction in issue in *Canada Trustco*—capital cost allowance (CCA) on an asset acquired for business purposes—in the following four scenarios:

1. The taxpayer buys the asset from savings.
2. The taxpayer fully finances the purchase of the asset on a full-recourse basis.
3. The taxpayer fully finances the purchase of the asset on a non-recourse basis (that is, the only security provided by the taxpayer for the loan is the asset itself).
4. The taxpayer acquires the asset in a sale and leaseback transaction similar to *Canada Trustco*.

A tax benefit arises in all four situations simply because the taxpayer is able to claim a deduction (CCA in scenario 1, and CCA plus interest in scenarios 2, 3, and 4) in computing income. That is not to say that any of the scenarios necessarily involves an avoidance transaction. The first scenario is straightforward: assuming that the taxpayer’s primary purpose in acquiring the asset was to use it for business purposes, there is no avoidance transaction. The second scenario is a little more difficult because the taxpayer is effectively getting a double deduction—both CCA and an interest expense. Even here, it is difficult to conclude that there is an avoidance transaction where the taxpayer’s primary purpose in acquiring the asset is to use it for business purposes. Although the taxpayer has not used its own resources to acquire the asset, the taxpayer remains fully exposed under the loan. The third and fourth scenarios are more difficult still because the taxpayer’s financial exposure in both cases disappears. The only difference between the third and fourth scenarios is the risk exposure to the lender; the risk exposure to the taxpayer in both cases is the same. Again, if it is reasonable to conclude that the taxpayer’s primary purpose in acquiring the asset was for business purposes rather than to benefit from the CCA deduction and interest deduction, the fact that it was able to negotiate a non-recourse loan in order to avoid any financial risk should be immaterial. However, the absence of any financial risk to the taxpayer suggests that the transactions primarily had a tax purpose. In *Canada Trustco*, the Tax Court concluded that there was an avoidance transaction—in other words, it concluded on balance that the

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12 In *Univar*, if Bell J had correctly decided that there was a tax benefit—because the taxpayer deducted interest—that would not have been sufficient to conclude that any of the transactions in the series undertaken by the taxpayer was an avoidance transaction. The issue, which was open for the court to determine, was whether Univar Canada’s primary purpose in undertaking any of the transactions constituting the series—being all of the steps in the double dip, from borrowing the money to receiving the exempt surplus dividends—was a bona fide purpose other than to obtain the interest deduction.

13 For the purposes of this example, I assume that the taxpayer is not subject to the leasing property rules in regulation 1100(15) or the specified leasing property rules in regulation 1100(1.1).
taxpayer’s primary purpose was to benefit from the deductions. This conclusion could not be upset on appeal absent a palpable and overriding error. Whether the transaction in that case met the third requirement—abusive tax avoidance—is another matter.14

In my view, the minister’s submissions on tax benefit and tax avoidance would be more effective if the minister recognized a taxonomy of tax-avoidance transactions and shaped its arguments before the court accordingly.15 Basically, all tax-avoidance transactions fit one of three fact patterns: substitutable transactions, tax attribute trading, and tax attribute fabrication. All three should clearly satisfy the first two GAAR requirements.

The first type of tax-avoidance transaction is exemplified by cases such as Shell Canada Limited v. The Queen et al.16 and the legendary Duke of Westminster.17 In these cases, the transactions are characterized by “substitutability”: more than one method exists to achieve the same non-tax result, and the taxpayer uses the method that gives rise to less tax (whether by reduction, deferral, or avoidance of tax). The better tax result is obviously a tax benefit, and provided that the taxpayer chose the particular arrangement (over its alternatives) for tax reasons, there is an avoidance transaction. The more difficult issue in these cases is whether there has been “abusive” tax avoidance.

However, two recent post–Canada Trustco GAAR decisions of the Tax Court illustrate continuing problems with the interpretation of subsection 245(3), particularly in the context of substitutable transactions. The first, Evans v. The Queen,18 concerned a series of transactions whereby a taxpayer effectively used the capital gains exemption in respect of qualified small business corporation shares under subsection 110.6(2.1) in combination with the exemption from the personal attribution rules in paragraph 74.5(1)(b) to remove corporate surplus from a corporation virtually tax-free. The transactions undertaken were simple. A small business corporation wholly owned by the taxpayer declared a high-low stock dividend with a declared amount of $100 and issued to the taxpayer redeemable, retractable shares in the amount of $487,000. The taxpayer then sold these shares.

14 The minister in Canada Trustco focused on the right issue under subsection 245(4): whether the Act permits the deduction of CCA where the taxpayer put no capital at risk in acquiring the asset in question. The minister might have had more success if it had been argued that there was a clear legislative scheme, highlighted by section 143.2, that the cost of property for CCA and other deduction purposes is limited to the taxpayer’s at-risk amount. The minister’s factum in Canada Trustco did not refer to section 143.2. The taxpayer’s factum did, but in support of its argument that the “at-risk” rules in the Act were specific and limited and that GAAR could not be used to expand their ambit. This argument is similar to that made, unsuccessfully, by the taxpayer in Mathew, that the stop-loss rules are limited to specific situations covered by specific anti-avoidance rules and that GAAR could not be used to expand their ambit.

15 I am indebted to my colleague Tim Edgar for these observations.

16 99 DTC 5669; [1999] 4 CTC 313 (SCC).


18 2005 TCC 684.
to a partnership in which his wife and three children were partners for a promissory
note bearing the prescribed rate of interest (then 5 percent). The taxpayer’s gain
($486,900) was sheltered under subsection 110.6(2.1). Over time, the corporation,
through a combination of dividends and share redemptions, paid significant amounts
to the partnership, which the partnership used to pay down the promissory note.
The dividends and deemed dividends received by the partnership, and the partner-
ship’s interest expense on the promissory note, were allocated to the partners. As
low income earners, the partners had little, if any, tax liability resulting from the
partnership income. The taxpayer reported the small amount of interest income
received from the partnership, but (obviously) the repayment of principal was not
reported. This transaction is a clear example of a substitutable transaction, and
there should have been no issue about the existence of an avoidance transaction.
Surprisingly, Bowman CJ concluded that there was no avoidance transaction be-
cause, in his view, the primary purpose of the series of transactions was to put
corporate funds in the taxpayer’s hands and this was a legitimate non-tax purpose.19

With respect, Bowman CJ seems to have misconstrued subsection 245(3) and the
clear instructions of the Supreme Court in Canada Trustco in interpreting this provision:

If at least one transaction in a series of transactions is an “avoidance transaction,”
then the tax benefit that results from the series may be denied under the GAAR. This is
apparent from the wording of s. 245(3). Conversely, if each transaction in a series was
carried out primarily for bona fide non-tax purposes, the GAAR cannot be applied to
deny a tax benefit.20

Thus, it is not the taxpayer’s purpose in undertaking the entire series that is relevant;
it is the taxpayer’s purpose in undertaking each transaction in the series. Clearly, Evans
undertook each transaction in the series so that the corporation’s money would end
up in his hands without anyone paying any (or any significant) tax. Arguably,
Bowman CJ misconstrued subsection 245(3), and his conclusion in this respect can
be considered the result of an error in law as opposed to a palpable error of fact.

The second recent problematic decision concerning subsection 245(3) is Overs
v. The Queen.21 In this case, the taxpayer owed his wholly owned corporation (“Opco”)
approximately $2.3 million, which he had not borrowed for income-earning
purposes. The taxpayer undertook a series of transactions in order to repay the
loan, thus avoiding an income inclusion under subsection 15(2), and to generate an
interest deduction on the amount borrowed. The taxpayer sold to his spouse common
shares of Opco having a value equal to the amount of his shareholder loan. The
spouse financed the purchase with a bank loan guaranteed by Opco. The taxpayer
used the proceeds of sale to repay his shareholder loan. Opco used the funds to
purchase term deposits that were posted as security to the bank under its loan

19 Ibid., at paragraph 22.
20 Supra note 1, at paragraph 34.
guarantee. The taxpayer did not elect out of the spousal rollover in subsection 73(1). Consequently, the taxpayer reported no gain on the share sale, and in addition, he applied the attribution rules in subsection 74.1(1) to deduct the interest paid by his spouse under the bank loan. (The interest was deducted under paragraph 20(1)(c) on the basis that the loan was used to acquire common shares.) The minister denied the taxpayer’s interest deduction under GAAR. Little J concluded that there was no avoidance transaction, apparently because the taxpayer “followed the rules” in each of subsections 15(2), 73(1), and 74.1(1).22

With respect, this reasoning misconstrues the test laid down in subsection 245(3). The question that should have been addressed was whether the taxpayer’s primary purpose in undertaking any of the various transactions was to obtain a tax benefit (that is, the interest deduction). The fact that the taxpayer achieved this result through a combination of statutory provisions is irrelevant at this stage of the GAAR analysis. The manner in which the statutory provisions apply is relevant at the third stage of the GAAR analysis—abusive tax avoidance. As in Evans, the manner in which the Tax Court interpreted and applied subsection 245(3) should be considered an error in law and open to review on appeal.

The second type of tax-avoidance transaction is exemplified by cases such as Duha Printers (Western) Ltd. v. The Queen,23 Canada Trustco, and Mathew. In these cases, a taxpayer “trades” tax attributes that it cannot use with an arm’s-length taxpayer, usually for a price equal to a small fraction of the tax thereby saved. These tax attributes might be losses or deductions, such as CCA, which the taxpayer cannot use but which have value (in terms of tax savings) to someone else. Here again, there is no question that there is a tax benefit, and there should be no question that there is an avoidance transaction. Furthermore, in many of these cases, there should be no question that the transactions constitute “abusive” tax avoidance.

The third type of tax-avoidance transaction—clearly the most abusive—is where the taxpayer “fabricates” tax attributes out of thin air. “Buy-low, donate-high” charitable tax credit schemes, such as those illustrated by Klotz v. The Queen24 and Canada (Attorney General) v. Nash,25 are good examples. In such cases, there is clearly both a tax benefit and an avoidance transaction. It should also be clear that the transactions constitute abusive tax avoidance.

The point is that in virtually all GAAR cases, the court should concentrate on subsection 245(4) because the first two requirements should be “no-brainers.” If it is difficult to conclude that there has been both a tax benefit and an avoidance transaction, the minister probably should not be litigating the case under GAAR. That, in my view, is the minister’s “burden” regarding the first two requirements: choosing the appropriate cases to litigate under GAAR.

22 Ibid., at paragraph 18.
25 2005 FCA 386.
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Even if it is determined that there is an avoidance transaction, subsection 245(4) provides that GAAR applies “only if it may reasonably be considered” that the transaction results in a misuse of the provisions of the Act (or the Regulations, the Income Tax Application Rules, a tax treaty, or any other relevant enactment) or an abuse having regard to those provisions read as a whole. This is the wording (paraphrased) contained in subsection 245(4) as amended by the 2004 budget.26 Although not specifically discussed in *Canada Trustco*, this amendment removes the double negative previously found in subsection 245(4):

For greater certainty, [GAAR] *does not apply* to a transaction where it may reasonably be considered that the transaction *would not result* directly or indirectly in a misuse of the provisions of this Act or an abuse having regard to the provisions of this Act, other than this section, read as a whole [emphasis added].

While the Supreme Court indicated that the amendments to subsection 245(4) “would not warrant a different approach to the issues on appeal,”27 it later stated:

The negative language in which s. 245(4) is cast indicates that the starting point for the analysis is the assumption that a tax benefit that would be conferred by the plain words of the Act is not abusive. This means that a finding of abuse is only warranted where the opposite conclusion—that the avoidance transaction was consistent with the object, spirit or purpose of the provisions of the Act that are relied on by the taxpayer—cannot be reasonably entertained. In other words, the abusive nature of the transaction must be clear.28

Whether or not the Supreme Court realized that the amendments removed the double negative from subsection 245(4), I do not think that the amended wording affects the assignment of the burden of proof (to the extent that there is an evidentiary burden of proof) under the subsection. Before the amendment was introduced, David Duff had suggested that subsection 245(4) should be amended so as to shift the burden explicitly to the minister by stating that “GAAR does not apply unless it may reasonably be considered that the transaction results in a misuse or abuse.”29 Although the amendment does not replicate Duff’s wording, there should be no doubt that the burden is (and should be) on the minister in this

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26 SC 2005, c. 19, section 52(2), applicable retroactively from September 12, 1988 (the original application date for GAAR).
27 Supra note 1, at paragraph 7.
28 Ibid., at paragraph 62.
respect. The replacement of the double negative with “only if” in subsection 245(4) accomplishes the result recommended by Duff. The question remains: Precisely what does the minister’s burden entail?

Most commentators agreed that the Federal Court of Appeal decision in *OSFC Holdings Ltd. v. The Queen*\(^{30}\) imposed a high threshold before GAAR would apply. According to the oft-quoted passage, “to deny a tax benefit where there has been strict compliance with the Act, on the grounds that the avoidance transaction constitutes a misuse or abuse, requires that the relevant policy be clear and unambiguous.”\(^{31}\) To what extent, if any, has this approach been modified by the Supreme Court’s decision in *Canada Trustco*, and to what extent, if any, does it affect the minister’s burden?

A fundamental problem with the judgment in *Canada Trustco* is that it seems to confuse “burden of proof,” which is an evidentiary burden in a question of fact,\(^{32}\) with the persuasiveness of a party’s arguments about statutory interpretation, which is clearly a legal question. Subsection 245(4) involves separate questions of law and fact. As indicated by the Supreme Court,

> [t]he heart of the analysis under s. 245(4) lies in a contextual and purposive interpretation of the provisions of the Act that are relied on by the taxpayer, and the application of the properly interpreted provisions to the facts of a given case. The first task is to interpret the provisions giving rise to the tax benefit to determine their object, spirit and purpose. The next task is to determine whether the transaction falls within or frustrates that purpose. The overall inquiry thus involves a mixed question of fact and law. The textual, contextual and purposive interpretation of specific provisions of the *Income Tax Act* is essentially a question of law but the application of these provisions to the facts of a case is necessarily fact-intensive.\(^{33}\)

Here is the main source of confusion created by the judgment. The court begins by stating that the analysis under subsection 245(4) involves two *distinct* steps: the first, purely a question of law, is “to interpret the provisions giving rise to the tax benefit to determine their object, spirit and purpose”; the second, predominantly a question of fact (according to the court), is “to determine whether the transaction falls within or frustrates that purpose.” It only confuses the reader to immediately

\(^{30}\) 2001 DTC 5471; [2001] 4 CTC 82 (FCA).

\(^{31}\) Ibid., at paragraph 69.

\(^{32}\) *Black’s Law Dictionary*, 8th ed., defines “burden of proof” as “[a] party’s duty to prove a disputed assertion or charge. The burden of proof includes both the burden of persuasion and the burden of production.” The former is defined as the party’s duty “to convince the fact-finder to view the facts in a way that favors the party”; the latter refers to the party’s duty “to introduce enough evidence on an issue to have the issue decided by the fact-finder, rather than decided against the party in a peremptory ruling such as a summary judgment or a directed verdict.” Thus, the burden of proof is normally understood to be a factual burden, not a burden of establishing the correct interpretation of the law.

\(^{33}\) Supra note 1, at paragraph 44.
thereafter describe these two distinct steps as an “overall inquiry” (that is, a singular inquiry) involving “a mixed question of fact and law.”

The main tenor of the judgment, and indeed the manner in which the court actually applied subsection 245(4), indicates that there are two separate inquiries. The first is a legal inquiry: to interpret the statutory provisions or statutory scheme upon which the taxpayer relied for the tax benefit in order to determine the object, spirit, or purpose (or “legislative intent”). The second inquiry is to determine whether there was abusive tax avoidance. In this respect, the Supreme Court clarified that the reference to “misuse” or “abuse” in subsection 245(4) does not dictate two separate legal inquiries, thus overruling the approach of the Federal Court of Appeal in OSFC.34 Rather, according to the Supreme Court in Canada Trustco, subsection 245(4) requires a single, unified approach to the textual, contextual and purposive interpretation of the specific provisions of the Income Tax Act that are relied upon by the taxpayer in order to determine whether there was abusive tax avoidance.35

Later, the court repeats the “two-part inquiry” involved under subsection 245(4):

The first step is to determine the object, spirit or purpose of the provisions of the Income Tax Act that are relied on for the tax benefit, having regard to the scheme of the Act, the relevant provisions and permissible extrinsic aids. The second step is to examine the factual context of a case in order to determine whether the avoidance transaction defeated or frustrated the object, spirit or purpose of the provisions in issue.36

This inquiry appears to be virtually identical to Rothstein JA’s guidelines in OSFC:

The approach to determine misuse or abuse has been variously described as purposive, object and spirit, scheme or policy. I will refer to these terms collectively as policy of the provisions in question or of the Act read as a whole.

Determining whether there has been misuse or abuse is a two-stage analytical process. 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.37

Indeed, going back 21 years, it is difficult to see any distinction between the Supreme Court’s approach to subsection 245(4) and the judicial anti-avoidance doctrine espoused by Estey J in Stubart Investments Limited v. The Queen:

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34 Supra note 30, at paragraph 59.
35 Supra note 1, at paragraph 43.
36 Ibid., at paragraph 55.
37 Supra note 30, at paragraphs 66-67. It is unfortunate that Rothstein JA chose “policy” as the collective term for “purposive, object and spirit, scheme or policy.” Most subsequent GAAR decisions ignored his reference to all of the terms, leading to much confusion about the court’s role in determining the legislative intent of the statutory provisions in issue.
[T]he formal validity of the transaction may also be insufficient where . . . “the object and spirit” of the allowance or benefit provision is defeated by the procedures blatantly adopted by the taxpayer to synthesize a loss, delay or other tax saving device. . . . This may be illustrated where the taxpayer, in order to qualify for an “allowance” or a “benefit,” takes steps which the terms of the allowance provisions of the Act may, when taken in isolation and read narrowly, be stretched to support. However, when the allowance provision is read in the context of the whole statute, and with the “object and spirit” and purpose of the allowance provision in mind, the accounting result produced by the taxpayer’s actions would not, by itself, avail him of the benefit of the allowance.\(^\text{38}\)

So here we are, 21 years later, with the Supreme Court now (finally) adopting Estey J’s approach to statutory interpretation, although perhaps limiting it to tax-avoidance transactions challenged under GAAR. This is ironic, given that GAAR was enacted because of the perceived shortcomings of the \textit{Stubart} decision.\(^\text{39}\) Plus ça change, plus c’est la même chose.

Where are we, then, in terms of the minister’s burden of proof under subsection 245(4)? Specifically, does the minister bear the burden of establishing clear abuse under a single “overall inquiry” that is a mixed question of law and fact? Or is the minister’s obligation limited to a factual burden of proof in the second step of a two-step analysis, after the court has addressed the purely legal question of determining the legislative intent of the provisions in issue? Put another way: For the “abuse” to be “clear,” is it only any factual aspect of the question of abuse that the minister

\(^\text{38}\) 84 DTC 6305, at 6324; [1984] CTC 294, at 317 (SCC).

\(^\text{39}\) In enacting GAAR, Parliament rejected Estey J’s view in \textit{Stubart} that the “object and spirit” test would serve as an effective anti-avoidance doctrine. The approach of the Supreme Court of Canada to tax-avoidance cases (in pre-GAAR fact situations) after \textit{Stubart} justified Parliament’s misgivings. Despite the consistent reference to Driedger’s principles of statutory interpretation in virtually every Supreme Court of Canada tax decision since \textit{Stubart}, the court, particularly in the 1990s, indicated that the object and purpose of a provision was irrelevant where the meaning of the provision was “plain” or “clear and unambiguous”: see, for example, \textit{Antosko et al. v. The Queen}, 94 DTC 6314; [1994] 2 CTC 25 (SCC); and \textit{Friesen v. The Queen}, 95 DTC 5551; [1995] 2 CTC 369 (SCC). In \textit{Canada Trustco} (supra note 1, at paragraph 10), this determinative role of the text of provisions of the \textit{Income Tax Act} is described as a “dominant role” in the interpretive process. Even so, the court later suggests (at paragraph 47), “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. . . . In order to reveal and resolve any latent ambiguities in the meaning of provisions of the \textit{Income Tax Act}, the courts must undertake a unified textual, contextual and purposive approach to statutory interpretation.” This discussion of “latent ambiguities” is reminiscent of Cory J’s comments on statutory interpretation in tax cases in \textit{The Queen v. Province of Alberta Treasuries Branches et al.}, 96 DTC 6245, at 6248; [1996] 1 CTC 395, at 403-4 (SCC). One is left wondering whether the “textual, contextual, purposive” approach is now relevant only in GAAR cases or whether it applies in all income tax cases involving questions of statutory interpretation.
must establish, or must the minister also establish (or the court conclude)\(^{40}\) that the legislative intent of the provisions in issue is clear? If the latter, then the court has simply restated the test from \(OSFC\), unless “clear” means something different from “clear and unambiguous”:

\[\text{The practical burden of showing that there was abusive tax avoidance lies on the Minister. The abuse of the Act must be clear, with the result that doubts must be resolved in favour of the taxpayer. The analysis focuses on the purpose of the particular provisions that on their face give rise to the benefit, and on whether the transaction frustrates or defeats the object, spirit or purpose of those provisions.}\(^{41}\]

If, on the other hand, the former approach is correct—that the court must first determine the legislative intent of the provisions in issue and then consider abuse—it should be relatively easy for the court to decide whether or not the taxpayer’s transactions frustrate (even \textit{clearly} frustrate) that legislative intent. The minister’s burden of establishing the factual aspect of the question of abuse should be easily satisfied because the transactions actually undertaken by the taxpayer are rarely in dispute in a \(GAAR\) case. With this approach, there should be few cases in which there is a doubt that must be resolved in favour of the taxpayer.

The contrast between these two approaches is best illustrated by considering the differing results that a court might reach under each. Using a single, unified approach, a court might conclude that it cannot determine the clear legislative intent of particular provisions—or that the minister has not satisfied the court as to what the clear legislative intent is—and therefore \(GAAR\) cannot apply because a taxpayer cannot frustrate something that is not known. \textit{Hill v. The Queen}\(^{42}\) provides a good example. \textit{Hill} concerned a series of transactions designed to convert unpaid (and therefore non-deductible) compound interest into unpaid (but accrued and therefore deductible) simple interest (an example of the substitutable type of avoidance transaction). The minister challenged the transactions on a number of grounds, including \(GAAR\). Miller J concluded that \(GAAR\) did not apply, on the following basis:

\[\text{I was not referred by the Respondent to any materials that would assist me in understanding why the government permitted the deduction of simple interest on a payable basis and only permits the deduction of compound interest on a paid basis. What is the policy? It is not my role to speculate; it is the Respondent’s role to explain to me the clear and unambiguous policy. He has not done so. I am therefore unable to find that there has been a misuse or abuse as contemplated by subsection 245(4) of}\]

\(^{40}\) As discussed further below, as a question of law, legislative intent is a matter for the court to decide; it is incorrect to place a burden on the minister to “prove” legislative intent.

\(^{41}\) Supra note 1, at paragraph 69.

\(^{42}\) 2002 DTC 1749; [2003] 4 CTC 2548 (TCC).
the Act. Consequently, subsection 245(2) does not apply to the Appellant's avoidance transactions.\footnote{Ibid., at paragraph 62.}

Under a two-step approach, it would be incumbent upon the court to first determine the legislative intent of paragraphs 20(1)(c) (regarding simple interest) and 20(1)(d) (regarding compound interest) before turning to the question of abuse. As Brian Arnold notes in his criticism of the \textit{Hill} decision,

[i]t is no concern of the courts why Parliament chose to distinguish between the timing of the deduction of simple interest and that of compound interest. The role of the courts is to interpret legislation in accordance with the intention of Parliament. Where the intention of Parliament is clear, as it is in the case of the timing of the deduction of compound interest, it is not the courts’ role to inquire into the justification for Parliament's actions.\footnote{Brian J. Arnold, “The Long, Slow, Steady Demise of the General Anti-Avoidance Rule” (2004) vol. 52, no. 2 \textit{Canadian Tax Journal} 488-511, at 501. Arnold argues that Miller J misapplied the test in \textit{OSFC} by confusing “policy,” as the Federal Court of Appeal used the term in that decision—to encompass “purposive, object and spirit, scheme or policy”—with the notion of parliamentary policy. See supra note 37 and the accompanying text.}

In \textit{Canada Trustco}, the Supreme Court clearly states that the question of abuse is a separate inquiry from the determination of legislative intent:

Once the provisions of the \textit{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).\footnote{Supra note 1, at paragraph 46. As discussed further below, it is surprising that the court refers to the second inquiry as purely a question of fact. Two paragraphs earlier, it is described as “fact-intensive.” Even this description is problematic.}

In both \textit{Canada Trustco} and \textit{Mathew}, the Supreme Court divided its analysis of subsection 245(4) into two distinct steps. First, the court determined the legislative intent of the statutory provisions in issue in the particular cases (the CCA provisions in \textit{Canada Trustco} and subsection 18(13) and section 96 in \textit{Mathew}).\footnote{In \textit{Mathew}, the court came to some surprising conclusions in this respect—in particular, the suggestion (supra note 2, at paragraph 51 and repeated elsewhere) that the partnership rules in section 96 “are predicated on the requirement that partners in a partnership pursue a common interest in the business activities of the partnership, \textit{in a non-arm’s length relationship} [emphasis added].”} Then, in light of that determination, the court considered whether the taxpayer’s transactions in each case constituted abusive tax avoidance. Given the court’s analytical approach in the two cases and the way it describes the subsection 245(4) analysis (at least most of the time), it is preferable to describe the analysis as involving two \textit{distinct}
inquiries—one legal, the other “predominantly factual”—that must be addressed under subsection 245(4). It is simply inappropriate to refer to these distinct steps as one “overall inquiry” involving “a mixed question of fact and law.”

In the second inquiry, the one that is described by the court as “predominantly factual,” the court imposes a burden on the minister to establish “clear” tax avoidance. In making this determination, the court provides judges with three guidelines:

![Image](https://example.com/image)

This analysis will lead to a finding of abusive tax avoidance when a taxpayer relies on specific provisions of the *Income Tax Act* in order to achieve an outcome that those provisions seek to prevent. As well, abusive tax avoidance will occur when a transaction defeats the underlying rationale of the provisions that are relied upon. An abuse may also result from an arrangement that circumvents the application of certain provisions, such as specific anti-avoidance rules, in a manner that frustrates or defeats the object, spirit or purpose of those provisions.

While the minister would be well advised to muster the facts and present the argument accordingly, each of these guidelines appears to me to be more legal than factual. Indeed, in my view, whether a transaction frustrates or defeats legislative intent—whether the transaction constitutes *abusive* tax avoidance—is more a question of law than of fact. In any event, in each case, it is first necessary to determine the legislative intent of the provisions in issue before considering whether there has been abuse.

Even at this first step in the inquiry, which is purely a legal question of statutory interpretation, the court appears to impose a burden on the minister:

![Image](https://example.com/image)

The court indicates that the minister must “identify” the object, spirit, or purpose of the legislation, rather than “prove” it. Even so, I fail to see how the minister is in a “better position” than the taxpayer to make submissions on legislative intent, unless the court is inferring that the minister has access to information about legislative intent to which taxpayers do not have access. Even if this were the case, I doubt

47 Supra note 33 and the accompanying text.
48 Supra note 1, at paragraph 45.
49 Ibid., at paragraph 65.
that the court would consider such information to be a “permissible extrinsic aid.” Perhaps the court is concerned about economically disadvantaged taxpayers who cannot afford access to the same information as the minister. But I doubt that many economically disadvantaged taxpayers will face a GAAR reassessment.

The preferable view is that the court simply requires the minister to make some argument (relying on text, context, and permissible extrinsic aids) about legislative intent, although the minister does not bear any burden of proof in this respect. In Evans, Bowman CJ described the minister’s obligation in the first inquiry as follows:

- The words “burden of proof” of which the Supreme Court of Canada speaks may imply an evidentiary burden but primarily they impose a requirement that the Crown identify the object, spirit or purpose of the relevant legislation that is said to be frustrated or defeated. This may be described as a “burden of persuasion” although this is not the usual sense of the expression “burden of proof.”

Bowman CJ refused to elaborate further on how this burden of persuasion would be met or what evidence could be adduced. He implies, though, that it is for the minister to persuade the court as to the correct interpretation of the legislation. This may be a practical description of the psychology at play when questions of law are argued and decided in court; but, in my view, ultimately it is for the court to answer questions of law. Indeed, as a question of law, it is open to the court to interpret the statutory provisions differently from the interpretation suggested by either the minister or the taxpayer. Both the minister and the taxpayer can make arguments about legislative intent—that is, they may both argue about the correct textual, contextual, and purposive interpretation of provisions, and both may refer to permissible extrinsic aids—but ultimately it is for the court to interpret the provisions. In doing so, the court should determine the most reasonable legislative intent; abuse should not be limited to frustration of a “clear and unambiguous” legislative intent. In this respect, I believe that the Supreme Court has lowered the “standard” for determining legislative intent from that espoused in OSFC.52

50 Supra note 18, at paragraph 35.
51 In this respect, Rothstein JA’s comments in OSFC (supra note 30, at paragraph 68) about the judge’s role and the obligation of the minister are more accurate: “Ascertaining the relevant policy is a question of interpretation. As such it is ultimately the duty of the Court to make this determination. There is no onus to be satisfied by either party at this stage of the analysis. However, from a practical perspective, the Minister should do more than simply recite the words of subsection 245(4), and allege that there has been misuse or abuse. The Minister should set out the policy with reference to the provisions of the Act or extrinsic aids upon which he relies. Otherwise he places the taxpayer and the Court in the difficult position of trying to guess the relevant policy at issue.” The “policy” Rothstein JA refers to is, of course, “purposive, object and spirit, scheme or policy” (see supra note 37 and the accompanying text).
52 The consequence of the higher OSFC standard is illustrated by the Federal Court of Appeal’s conclusion in The Queen v. Imperial Oil Limited, 2004 DTC 6044; [2004] 2 CTC 190, at paragraph 40 (FCA): “Thus, if the scheme may reasonably be considered not to result directly
Again, take *Evans* as an example. In concluding that GAAR did not apply, Bowman CJ stated:

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 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.53

With respect, it would have been preferable if Bowman CJ had considered the case as one involving competing legislative schemes. On the one hand, it is open for the court to conclude that there is a clear statutory scheme against “dividend stripping,” as illustrated by sections 84, 84.1, and 212.1. Thus, for example, if the taxpayer had sold his shares to a corporation, the shareholders of which were his wife and three children, in exchange for a promissory note, paragraph 84.1(1)(b) would have deemed the taxpayer to have received a dividend, instead of realizing a capital gain on the disposition. By selling the shares to a partnership, the taxpayer sidestepped section 84.1. This is an example of the third type of abusive tax avoidance listed by the Supreme Court in *Canada Trustco*—where the taxpayer has circumvented the application of a specific anti-avoidance rule.54 On the other hand, the Act clearly provides for the different tax treatment of partnerships and corporations. Furthermore, the Act permits the sale of property directly or indirectly to a spouse or minor child (one of the three children in the *Evans* partnership was a minor), avoiding the attribution rules in section 74.1, even where the only consideration given is a promissory note, provided that the note bears interest at the prescribed rate and such interest is paid within 30 days of the end of each year in which the note is outstanding.55 This case could be viewed as one where the anti-dividend-stripping scheme in the Act is competing with a scheme that permits income splitting in certain circumstances. It is then for the judge to choose which scheme is predominant. If this choice is impossible to make, this could be one of those few cases where the matter of abuse is not clear—that it is in doubt and that such doubt must be resolved in favour of the taxpayer.

It is still too early to determine how trial courts and appellate courts will apply the Supreme Court’s new GAAR guidelines, and particularly whether the standard for determining legislative intent has been altered in any way. But it is always open

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53 Supra note 18, at paragraph 30.
54 Supra note 48 and the accompanying text.
55 Paragraph 74.5(1)(b).
to an appellate court to overturn a lower-court decision on the basis that the trial judge made an error in law. Because subsection 245(4) requires two distinct inquiries, the first of which requires the trial judge to determine legislative intent, surely a trial judge who fails to make this determination has made an error in law in much the same way as a trial judge who makes an erroneous determination of legislative intent. Neither case requires a “palpable and overriding error” of law. In either case, the trial judge has clearly not “proceeded on a proper construction of the provisions of the Income Tax Act,” and an appellate tribunal should interfere.