GAAR, gaps and overlaps: the law and politics of interprovincial tax avoidance in Canada

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I. Introduction

Canada’s federal constitution allows both federal and provincial governments to impose direct taxes, including income taxes on corporations and individuals, and both levels of government do so. For the most part, a high degree of harmonization of tax bases and the rules attributing income to each province limits interprovincial avoidance and arbitrage. In the last several years a number of cases have drawn attention to gaps between provincial income tax regimes that presented opportunities for various forms of tax arbitrage and avoidance. The methods used by tax planners to exploit these opportunities bear a striking resemblance to those employed internationally, and the responses of provincial finance ministries are also similar in some respects to the anti-avoidance measures taken to combat international tax avoidance, particularly cross-border arbitrage. Although legislative amendments have now closed these gaps, litigation continues as to the effectiveness of the structures utilized, and the interpretation and application of the provincial general anti-avoidance rules (“GAARs”). The courts in the affected provinces have taken divergent views of these matters, and the Supreme Court of Canada has so far refused to hear appeals. After a review of the older cases, this paper examines the gaps (double non-taxation) and potential overlaps (double taxation) and the politics, or at least the policy choices, revealed in the most recent rulings.

II. Canada’s income tax structure

A very brief description of the Canadian corporate income tax system is given here to serve as a framework for the rest of the article.¹ Since the middle of the 20th century the federal government has been dominant in defining the income tax base, in the federal Income Tax Act (“ITA”),² for

both individuals and corporations. The provinces temporarily ceded their tax “room” to the federal government during the second world war in exchange for “tax rental” payments. In the early 1960s, all the provinces except Québec entered into bilateral tax collection agreements (“TCAs”) with the federal government in respect of their income taxes on individuals. With respect to corporate income tax, Ontario as well as Québec declined to enter into TCAs. Alberta withdrew from its corporate TCA from 1981. Ontario rejoined the coordinated system with a new TCA in 2009.

In essence, a TCA commits a province to harmonize its tax base with the federal tax base, in exchange for which the federal government collects, administers and enforces the “agreeing” province’s tax law free of charge. The great majority of income tax cases are accordingly heard by the (federal) Tax Court of Canada (“TCC”) where the taxpayer confronts the Crown (in the guise of the Canada Revenue Agency or CRA) in respect of both federal and provincial tax liability. The federal tax authorities remit the tax collected on behalf of each province as agreed/provided under the Federal Provincial Fiscal Arrangements Act. This system is very efficient from a taxpayer compliance standpoint and saves the agreeing provinces a great deal of administrative expense, but at the cost of a degree of control over tax policy, and administrative oversight that would allow for protection of the province’s interests in maximizing revenue share in relation to the claims of other provinces. This should not be over-emphasized however, given the role of the provinces in governance of the CRA, and the improved federal-provincial consultation processes in relation to tax law and administration since the late 1990s.

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3 The Alberta Chamber of Commerce has recently advocated a return to the harmonized corporate base, citing in particular a 2006 Ontario study estimating that Ontario businesses would save $90 million annually in tax, and an additional $100 million annually in compliance costs.

4 The agreeing provinces may diverge from the federal base in minor ways, and the federal government may agree to collect additional taxes imposed by the provinces in exchange for administrative fees.

5 As will be seen below, the superior courts of Québec, Alberta and Ontario had rarely if ever decided GAAR cases before the ones discussed in this paper.


7 The landscape changed quite considerably with the negotiation of new TCAs, allowing for much great provincial tax policy control, and the creation of the Canada Customs and Revenue Agency, now the CRA, which is governed by a board on which provincial revenue ministry officials are represented. See Munir A. Sheikh and Michel Carreau, "A Federal Perspective on the Role and Operation of the Tax Collection Agreements," (1999), vol. 47, no. 4 Canadian Tax Journal, 845-860, and Thomas J. Courchene, "National Versus Regional Concerns: A Provincial Perspective on the Role and Operation of the Tax Collection Agreements," (1999), vol. 47, no. 4 Canadian Tax Journal, 861-889, among other articles, for a more complete discussion of these developments.
Québec’s refusal to give up its separate tax administration and unfettered tax policy-making power was undoubtedly an expression of its political coming of age during the 1960s, dubbed the “Quiet Revolution”. Alberta’s decision to withdraw from the centralized corporate tax administration was also a rejection of federal control over tax policy-making at a time when the province was resisting the policies of the Trudeau Liberals, and the National Energy Programme in particular. I have not been able to discover why Ontario charted its own corporate tax course, but as the other province beside Quebec with a well-developed industrial base, the most important commercial and financial centre (Toronto) and a relatively large population, Ontario would not have had the same concern over inefficiency of carrying out its own revenue administration that the other provinces, all much smaller in population and weaker economically than Québec and Ontario at the time, would have had. Together, these three non-agreeing provinces represented three-quarters of all corporate income earned in Canada.

Despite having no corporate TCA, the three non-agreeing provinces have generally aligned their corporate tax bases with the federal base. In addition, they have generally applied federal rules for defining “permanent establishment” and allocating income of corporate taxpayers to PEs in the provinces where they have business activity. The various small differences in corporate tax computation and reporting rules were not so onerous as to cause widespread published calls for their elimination, though they were undoubtedly costly in some cases, and caused compliance to be more complex and time-consuming.

Until the 1990s, interprovincial tax minimization strategies seem to have focused on locating income in provinces with lower rates. In Canada each individual corporation is a separate taxpayer. The lack of consolidated reporting by corporate groups probably made such strategies

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more effective, but each successive federal proposal for consolidation was abandoned unimplemented, apparently due to provincial resistance.\textsuperscript{11}

Much of the following section of this article has been examined in more detail in existing Canadian tax literature. \textsuperscript{12} The discussion below is intended to provide a simplified background to the examination of the various ways provincial courts have applied (or refused to apply) the relevant provincial anti-avoidance rule in later cases, which is the real subject of this paper.

The Québec Shuffle

Beginning in the mid-1990s, differences in provincial tax bases and disconnects between federal and provincial rules began to come to general awareness in the tax community. All the complacency evaporated with the sale of the Winnipeg Jets (an National Hockey League team) to an Arizona franchise, the Phoenix Coyotes, in 1996. Not only was the hugely popular team departing its loyal fans for a “sunbelt” location where ice\textsuperscript{13} hockey was a foreign winter sport, it did so without the vendors being subject to any provincial tax liability on the capital gain realized. The Québec Shuffle was suddenly in the spotlight, despite apparently having been in use for quite some time.\textsuperscript{14}

In brief, the Québec Shuffle exploited the requirement for a separate election to be filed for Quebec Revenue purposes when property was transferred to a corporation in exchange for at least some shares in the transferee corporation. Both federal and Québec\textsuperscript{15} tax legislation allowed for “rollover” treatment of such transfers. An optional election determined the proceeds of


\textsuperscript{13} This is the international version of this paper, so “ice” must be specified. In Canada, this is not necessary.

\textsuperscript{14} Brad Tetz, “Current Interprovincial Issues,” 1997 Prairie Provinces Tax Conference, (Toronto:Canadian Tax Foundation, 1997), 12 1-24 dates the use of the Shuffle to the late 1980s.

\textsuperscript{15} Art. 518. Election on transfer of assets to a corporation – A taxpayer who transfers, in a taxation year, a property of which he is the owner and which is an eligible property to a taxable Canadian corporation for consideration that includes a share of the capital stock of the corporation, may election jointly with the latter, … to have the rules of this chapter apply. [my translation of s. 518 as of time of OGT] 518. The rules provided for in this division and in Divisions II and III apply where a taxpayer disposes of any of the taxpayer’s property to a taxable Canadian corporation for consideration that includes a share of the capital stock of the corporation, if the taxpayer and the corporation make a valid election for the purposes of subsection 1 of section 85 of the Income Tax Act (Revised Statutes of Canada, 1985, chapter 1, 5th Supplement) in respect of the disposition.
disposition of the transferor, and cost to the transferee corporation of the transferred property, so that whether and how much of a capital gain was realized and how much deferred was largely in the control of the parties to the transaction.

The Québec Shuffle could take the form of an inbound or outbound transaction. The simplest way to describe an inbound shuffle is as follows.¹⁶

The transferor/vendor owns all the shares of the target corporation. Targetco is resident in an agreeing province, including Ontario for this purpose, and its shares have a tax cost of $100 and a fair market value of $200. Instead of selling the shares directly to the ultimate purchaser, the takeover bidder, the vendor first transfers them to a newly incorporated Québec resident corporation (Québec Inc.) in exchange for all the shares of Québec Inc. Under the federal ITA s. 85(1), the vendor and Québec Inc. jointly elect the purchase price at cost, or $100. There is no federal or provincial tax liability, as there is no capital gain. Under the equivalent elective provision of the Quebec Tax Act (“QTA”), vendor and Quebec Inc. elect at $200. This gives the shares of Québec Inc. issued in exchange for the Targetco shares a cost to the vendor equal to $100 for federal purposes, and $200 for Québec purposes. When the shares of Québec Inc. are sold to the ultimate purchaser for $200, there is a capital gain of $100 realized for federal tax purposes, but none for Québec taxation purposes. Since there was no provincial taxation of the gain on the rollover to Québec Inc. there is no provincial tax liability at all. This is the type of transaction used in the sale of the Winnipeg Jets.

In an outbound shuffle, the Quebec resident transfers the target assets (usually shares of a corporation) to a non-Québec-resident related purchaser, electing for Québec purposes to receive proceeds equal to the tax cost of the assets, and thus deferring Quebec tax on the accrued gain.

No election is filed for federal purposes, so that federal tax is paid on the capital gain realized for federal purposes. The non-Québec-resident purchaser records a tax cost of the shares of the fair market value based on the lack of any election to treat the transaction as a rollover for federal and non-Québec purposes. When the non-Québec purchaser sells the shares received in the rollover to the ultimate arm’s length purchaser for fair market value, no further gain is recorded.

¹⁶ The transaction in the Gendis case, infra note ___ was an inbound shuffle, as was the Winnipeg Jets transaction.
No provincial tax is ever paid on the capital gain. This is the type of transaction that was undertaken in *OGT Holdings*, discussed below.

Québec had of course freely chosen not to harmonize with the federal tax base, and to provide for, and indeed require, vendor and purchaser to file a separate election under s. 518 of the QTA\(^\text{17}\) in order to defer gains on such transactions when a Québécois resident was a party to the transaction. Since Québec law did not require uniformity between the federal and Québec elections, the gap was begging to be exploited. When the profile of the Winnipeg Jets transaction demanded a response, Québec announced in December 1996 an immediately effective amendment to the QTA requiring taxpayers to elect the same amount for Québec purposes as under the federal ITA. This effectively eliminated the Quebec Shuffle, but could not undo the transactions already completed. On the same date, December 18 1996, Ontario announced in a simultaneous (but not joint) press release that it would amend its tax legislation to eliminate the Quebec Shuffle. Manitoba also took retroactive action against the Quebec shuffle in 1996. Other provinces had general anti-avoidance rules in place, but no specific anti-shuffle rules.

In order to collect tax on gains realized in respect of transactions completed before the December 1996 announcement of the amendments to s. 518, the Quebec tax authorities reassessed taxpayers using the general anti-avoidance rule enacted in 1990 as s. 1079.9 and

\(^{17}\text{518. Election upon transfer of property to a corporation} \text{ – A taxpayer who, in a taxation year, disposes of property owned by him which is eligible property to a taxable Canadian corporation for consideration which includes a share of the capital stock of the corporation may elect jointly with the latter, in prescribed form and on or before the earliest day on which one of the two must file his fiscal return in accordance with section 1000 for the taxation year in which the disposition occurs, that the rules provided in this chapter apply. [from 1972, when capital gains became subject to tax.]}

Current wording of section 518: The rules provided for in this division and in Divisions II and III apply where a taxpayer disposes of any of the taxpayer’s property to a taxable Canadian corporation for consideration that includes a share of the capital stock of the corporation, if the taxpayer and the corporation make a valid election for the purposes of subsection 1 of section 85 of the Income Tax Act (Revised Statutes of Canada, 1985, chapter 1, 5th Supplement) in respect of the disposition.
1079.10 of the QTA. The case that proceeded to trial and appeal was *OGT Holdings Ltd. v. Quebec* in respect of a transaction that occurred in early 1995.

The Quebec GAAR in force in 1995 mirrored almost exactly the original version of the federal GAAR, allowing the Quebec revenue authorities to re-determine a taxpayer’s liability under the QTA to deny a “tax benefit” that resulted directly or indirectly from an “avoidance transaction” or series of transactions. A tax benefit is a reduction, avoidance or deferral of tax or other amount payable under the QTA. An avoidance transaction was defined as any transaction or series unless it was undertaken primarily for bona fide purposes other than to obtain the tax benefit. However, if the transaction would not result directly or indirectly in a misuse of the provisions of the QTA, or an abuse having regard to the provisions of the QTA read as a whole, the tax consequences were not subject to redetermination. Obviously, the key to the applicability of the GAAR was how the court approached the issue of abusive tax avoidance.

The leading case on the federal GAAR is, and was *Canada Trustco Mortgage Co. v. The Queen*, the only Supreme Court of Canada decision at the time. Indeed, it seem likely that a ruling in *OGT* was delayed in anticipation of the SCC’s decision in *Trustco*. Trustco mandated a “unified textual, contextual and purposive” approach to interpretation of the ITA. With respect to the approach to the GAAR, it stated:

> 13 The Income Tax Act remains an instrument dominated by explicit provisions dictating specific consequences, inviting a largely textual interpretation. Onto this compendium of detailed stipulations, Parliament has engrafted quite a different sort of provision, the GAAR. This is a broadly drafted provision, intended to negate arrangements that would be permissible under a literal interpretation of other provisions of the Income Tax Act on the basis that they amount to abusive tax avoidance.

5.5.2 The 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

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18 The federal government enacted a GAAR effective from September 13, 1988 as section 245 of the Income Tax Act. It was substantially amended to apply to a wider array of abusive transactions in 2005, with the amendments being made retroactive to the original announcement date in 1988.

19 Again, the connection to the game of hockey, over which many Canadians exhibit obsessive compulsive behaviour, was present: Nike Acquisitions Inc. was purchasing all the shares of Canstar, a manufacturer of hockey equipment. Some of the Canstar shares were owned by Québec corporations controlled by the Olivieri family.

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. 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.

In summary, s. 245(4) [the requirement that the transaction result in abuse] imposes a two-part inquiry. 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.

The 2006 trial decision in OGT ruled that the Quebec Shuffle transaction was abusive. Following the SCC’s direction with respect to the application of the federal GAAR in Trustco the court adopted the following process:

“Three requirements must be established to permit application of the GAAR:

1. 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.

2. The burden is on the taxpayer to refute (1) and (2), and on the Minister to establish (3).

3. If the existence of abusive tax avoidance is unclear, the benefit of the doubt goes to the taxpayer.”

[NB italics are in original Trustco judgment.]

The Québec court found that there was a tax benefit. Specifically, the tax benefit was the complete elimination of Quebec tax on the $76 million capital gain that would have been
realized on the sale of the shares, rather than the mere deferral that would normally be
maintained until the shares received on the rollover were disposed of in a non-rollover transfer.

Second, the court found that the series of transactions was undertaken primarily to obtain the tax
benefit, and not for the claimed purpose of consolidating the investments of the Olivieri family in
Ontario in the run-up to the 1995 referendum on Quebec independence. The court ruled that
making the election under s. 518 QTA at a different price than for federal purposes was a form of
tax avoidance.

The burden of establishing the third element, abuse, is on the Minister. The taxpayer’s position
was that it had fully complied with all the conditions required for a valid election under s. 518
QTA, and that the tax consequences of the series of transactions should coincide with the terms
of the election and the clear words of the QTA. The court agreed that the transactions as they
were carried out were allowed under the law, but that the objective pursued was not legitimate
since it did not represent the legislator’s intention. The Quebec Court relied primarily on the
following statement in Trustco:

6. Abusive 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.

There was an abuse of s. 518 of the QTA, since it was used for a purpose other than that for
which it was enacted, i.e. to eliminate rather than defer recognition of the capital gain for Quebec
tax purposes. In the result, the election under s. 518 QTA was ignored with the consequence that
Quebec tax was held to be payable on the gain thus deemed to have been realized on the initial
transfer of the shares.

The Quebec Court of Appeal dismissed the appeal for essentially the same reasons as the trial
court. The QCA noted that under the plan, the corporate taxpayers knew that no capital gains tax
would be payable in Quebec, since the provincial tax would in theory be payable on the final
arm’s length transaction for fair market value in Ontario. The taxpayers also knew that no tax
would actually be payable in Ontario either; no federal election had been made to defer the gain
so the Ontario tax cost of the shares disposed of would equal their fair market value. (Ontario
recognized the federal election values). The QCA initially doubted whether s. 518 was even applicable on its terms, as it required the rollover transfer to be to a “taxable Canadian corporation”. Since neither the Quebec corporation nor the Ontario corporation would be subject to tax, the transferee corporation would, the QCA suggested, not qualify. This is clearly wrong, since a taxable Canadian corporation does not have any particular tax liability, it just has to be resident in Canada and subject to taxation, which the Ontario resident corporation undoubtedly was.

The QCA went on to align its reasoning with the trial court, confirming that electing a different purchase price under s. 518 QTA than that used for federal purposes amounted to an avoidance transaction, which distorted the purpose of s. 518. The non-tax purpose of consolidating assets in Ontario due to the political risk associated with the pending Quebec independence vote could have been achieved without abusing the provision in this way. The court stated that it could not be tolerated that a taxpayer used a legislative tool whose purpose is to defer a tax obligation to eliminate that obligation completely.

The Quebec courts treated the GAAR as a tool to reverse avoidance transactions which, while they may conform fully to the letter of the provisions of the law, are abusive because they achieve a result that does not conform to the intention of the legislator or the object and spirit of the law. While this is of course the purpose of the GAAR, the approach taken by the Québec court seems to presume that an avoidance transaction is abusive, while in fact the structure of the GAAR makes clear that abuse must be separately demonstrated, with the burden of proof on the Minister.

In OGT, it is hard to see a distinction between the tax benefit and the abuse. Most tax experts would say the tax benefit was the election at tax cost that deferred recognition of the gain. The election provision operated as intended, and there was never any suggestion that s. 518 election could only be effective if the gain was ultimately recognized in Québec.

As others have pointed out,21 it is strange that the decision not to file an election under the federal ITA can constitute an abuse of the QTA.22 Further, if a federal election had been made

\[21\] Clarke, Chan and Taylor, …
\[22\] Clarke, supra note __ at __.
corresponding to the Quebec election, it would be beyond doubt that the capital gain was Ontario’s to tax, making it difficult to argue that Quebec was prejudiced, or Quebec law was abused, by the failure to elect federally.\textsuperscript{23} If the Quebec courts are correct, presumably the Ontario tax authorities could also have successfully reassessed the taxpayers under the Ontario GAAR,\textsuperscript{24} resulting in double provincial taxation of the capital gain. The QCA’s reasoning amounts to an assertion that provincial tax must be paid on the gain, whether in Quebec or Ontario, and if the taxpayer knows that it will not be liable for tax in Ontario as a result of the mismatched federal and Quebec elections, then it is abusive to elect differently for Quebec and federal purposes.

Notably absent from the Quebec courts’ reasons is any reference to the so-called “Duke of Westminster” principle, approved by the SCC in \textit{Trustco}, that Canadian taxpayers are entitled to arrange their affairs so as to minimize their tax liability, or to the values of fairness and certainty in tax matters that the SCC has said must be protected when determining whether the GAAR applies. Also absent was any discussion of why the Quebec taxation system, specifically the corporate rollover rule, was not already aligned with the federal equivalent, i.e. what the policy choice had been to not simply have the federal election apply for Quebec purposes. Nor was there a careful textual, contextual and purposive approach applied to the interpretation of the relevant statutory provisions. OGT’s application for leave to appeal to the SCC was dismissed.\textsuperscript{25}

One way of identifying whether there has been a tax benefit is to consider the tax consequences of an alternate transaction which would have the same business or commercial result, but a higher tax liability. Here such an alternative transaction would have been to elect for federal purposes as well, which would have deferred recognition of the gain, and liability for both federal and provincial tax, until the disposition by the Ontario corporation. A second alternative would be to recognize the gain for both federal and Quebec law on the first transaction, i.e. to simply not utilize the rollover provisions in either jurisdiction. This seems to be the alternative that Quebec insists must be used to avoid application of the GAAR, despite any previous

\textsuperscript{23} Chan and Taylor
\textsuperscript{24} Ontario announced its prospective legislation blocking inbound shuffles (outbound from Ontario) the same day Quebec announced its amendments to s. 518, December 18, 1996.
\textsuperscript{25} Lebel, Deschamps, Cromwell, January 30, 2009.
suggestion that the federal and Quebec provisions could not operate independently, and that it was an abuse not to align the elections, or lack thereof.

In essence, this means that the Quebec position is that despite the apparent permissiveness of the election, if the taxpayer utilizes it so that no Québec, or other provincial tax is paid, it is an abuse of the Québec Tax Act. It was only where the capital gain would not be taxed in another province, apparently, that the use of s. 518 was abusive. This was despite the QCA’s acknowledgement that s. 518 permitted the mobility of capital gains:


Seen in the context of Quebec’s long standing assertion of tax sovereignty, the politics of the ruling are clear: Quebec courts will interpret the provincial GAAR to protect the Quebec tax base. At the same time, for transactions after the announcement of December 18 1996 requiring the election under s. 518 QTA to correspond to the election under ITA 85(1), Quebec has had to compromise its tax sovereignty to protect its base.

Retroactive reversal of the Québec Shuffle

As noted above, Ontario and Manitoba also reacted with legislation to block Quebec shuffles. In July 1996 Manitoba announced both a GAAR modelled on the federal version, and a new specific anti-shuffle provision in its income tax legislation. New section 53.2, enacted in November 1996 and made retroactive to transactions not completed by December 31, 1991, effectively reversed any shuffle transaction that denied Manitoba its share of tax on a capital gain which would otherwise have been realized and taxable in Manitoba, unless it was actually taxed in another province.

“Untaxed income” was defined in s. 53.2(1) as follows:

53.2.

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26 After the referendum it became clear that, had only a few more Quebecers voted yes, the Parti Québécois government then in power intended immediately to declare full independence from Canada. This validates the taxpayer’s concern in OGT that barriers to capital movements between Quebec and Ontario could have arisen due to a declaration of independence by Quebec, and that consolidating the family’s assets in Ontario was a significant motivation for the way the series of transactions was carried out.
(1) In this section, a person's “untaxed income” in relation to a disposition of property is the total of all amounts each of which is the portion of the person's income or taxable income earned in the year in a province, as determined under the federal regulations, that (a) is attributable to the disposition; and (b) because of the difference between the transferor's cost or adjusted cost base of the property for federal tax purposes and its cost or adjusted cost base to the transferor under the income tax law of the province, is not included in the person's income for the year under that law.

Subsection 53.2(2) ensured that untaxed income arising from a non-arm’s length transfer at less than fair market value under the ITA (i.e. due to an election under s. 85(1) ITA) was added back into the transferor’s income if the transferred asset, or property substituted for it, was later transferred at greater than its federal tax cost in a subsequent disposition:

53.2(2) Where, as part of a series of transactions or events, (a) a person or partnership (referred to in this section as the “taxpayer”) disposes of property to another person or partnership with whom the taxpayer does not deal at arm's length for proceeds of disposition under the federal Act less than the fair market value of the property at the time of the disposition; and (b) the property or other property (i) the fair market value of which is derived primarily from the property, or (ii) that is acquired by any person other than the taxpayer in substitution for the property, is subsequently disposed of for proceeds of disposition under the federal Act greater than its adjusted cost base under that Act; any untaxed income arising from the subsequent disposition shall be added to the taxpayer's proceeds of the disposition referred to in clause (a).

The Manitoba solution was unsuccessfully challenged as contrary to the principles of the TCA between Manitoba and the federal government on the basis that the CRA was not empowered to collect a retroactive Manitoba tax that was not harmonized with the federal tax base. As with OGT Holdings, leave to appeal to SCC was denied.

The Manitoba response is interesting because it ensures that the full gain is subject to both federal and provincial taxation, but is taxed once and once only, which seems to be the position

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27 Gendis – cite to trial and appeal decisions.
28 Dismissed February 8 2007 McLachlin, Deschamps, Charron.
Québec takes on interprovincial avoidance schemes. This reflects the fundamental principle underlying a coordinated system as articulated by the League of Nations in 1927:29

From the very outset, [the drafters of the model convention] realized the necessity of dealing with the questions of tax evasion and double taxation in co-ordination with each other. It is highly desirable that States should come to an agreement with a view to ensuring that a taxpayer shall not be taxed on the same income by a number of different countries, and it seems equally desirable that such international cooperation should prevent certain incomes from escaping taxation altogether. *The most elementary and undisputed principles of fiscal justice, therefore, required that the experts should devise a scheme whereby all incomes would be taxed once and only once.*

The Quebec Truffle
The lack of alignment of Quebec and federal permissive elections with respect to taxation of trusts and their beneficiaries presented tax planners with a similar opportunity to eliminate provincial tax on trust distributions using the “Québec Truffle”, a play on shuffle and trust.30 Essentially, a Québec trust could elect to have its income taxed in the hands of its beneficiaries resident in other provinces, while electing for federal purposes to have the trust, rather than the beneficiaries pay tax on the income. Since the federal election was recognized by the province where the beneficiaries were resident, no provincial tax was paid on the distributed income in either Quebec or in the province of residence of the beneficiaries. Rather than rely on the GAAR, Quebec enacted legislation in 2006, retroactive to 2001,31 requiring the trust to elect the same way for Québec purposes as for federal. Again the effect was to ensure that provincial tax was being paid somewhere, even if not in Quebec. The cost in lost tax revenue of the Truffle has been estimated at $500 million.32

Interprovincial Avoidance 2.0 – The “Ontario Shuffle”


30 Chan and Taylor, p ___.


32 Brown and Cockfield, 2013 Canadian Tax Journal 61:3 at p. 566 (footnote 8) and 588 (footnote 98).
As noted earlier, Ontario did not join the harmonized corporate tax system until 2009, and many anomalies persisted in its tax base relative to the federal definition. Possibly the most significant of these was that Ontario determined residence of a corporation by its jurisdiction of incorporation, following the U.S. approach. Therefore a foreign incorporated corporation with a PE in Ontario was not subject to Ontario tax on its income from property, even if under federal tax law it was resident in Canada because its central management and control were in Canada. Ontario imposed tax only on the foreign corporation’s income from business attributable to the Ontario PE. Although Ontario eliminated this lacuna in 2005, the litigation continues, contributing interesting GAAR and non-GAAR thinking about interprovincial gaps and overlaps.

The Ontario Shuffle is not really related to the Quebec Shuffle or Truffle, as there is no issue of mismatched federal and provincial elections. However, both transactions exploit a gap or lack of coordination with other provincial jurisdictions. The “Ontario Finco” structure is a corporate group financing structure used to direct interest paid by a borrower located in an agreeing province to the PE in Ontario of a foreign incorporated member of the corporate group, the Ontario Finco. The interest expense is deductible for federal and provincial purposes by the borrower in, say, Alberta, but the interest income of the Ontario Finco is subject only to federal tax. The interest income of Finco is not income from a business carried on in Canada through the Ontario PE, but income from property, so it escapes provincial tax altogether. The after-federal-tax income of the Ontario Finco can then be distributed as a tax free intercorporate dividend to the common parent corporation of the Alberta borrower and the Ontario Finco.

In response to a question posed at the Canadian Tax Foundation’s Round Table in 2011, the Quebec revenue authorities revealed that the federal, Alberta, Ontario and Quebec tax authorities had offered to settle with taxpayers who had participated in a Finco structure. Although a

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33 See Omri Marian “Meaningful Corporate Tax Residence”, Tax Notes International, August 19, 2013 where it is noted that a foreign corporation is not subject to US federal tax unless it has income effectively connected with a U.S. trade or business. This allows corporations incorporated outside the US, but managed within the US, to avoid US tax where the income is derived from property.

34 DeBeers Consolidated.

35 It is more appropriately called the Ontario Finco structure, which is the terminology used by Chan and Taylor.

36 No non-resident withholding tax is applicable to the interest, as the provinces do not impose them, and the federal government views the Ontario Finco as a resident of Canada.
majority had accepted the offer of settlement, some declined in favour of a judicial resolution. It was indicated that the Quebec revenue authorities were processing some cases for reassessment and preparation for litigation.

Two of the Ontario Finco cases that went to litigation have been finally resolved: and Husky Energy Inc. v. Alberta,37 and Canada Safeway Limited v. Alberta.38 A third case, Inter-Leasing, is under appeal in Ontario.39 In all three cases, the corporate group carried out a reorganization to finance the group’s business activities in Alberta using an Ontario Finco incorporated in the British Virgin Islands as described above, though of course the actual details were quite a lot more complex. The Alberta tax authorities challenged the effectiveness of the reorganization both on technical grounds of compliance with the relevant provisions, and as abusive tax avoidance under the Alberta GAAR. The alleged abusive avoidance transactions were the deduction of the interest paid by the Alberta borrower to the Ontario Finco under ITA paragraph 20(1)(c), and the deduction by Finco’s parent corporation of the dividends received from the Finco under ITA subsection 112(1). It was also alleged that paragraph 12(1)(c), which requires the inclusion of interest income in computing income subject to tax had been abused by the transfer of the debt from an Alberta lender to the Ontario Finco.

Although it does not have a corporate TCA with the federal government, Alberta aligns its tax base very closely with the federal base. Indeed, since the new TCAs of the late 1990s and early 2000s were agreed, it is quite difficult to find any daylight between Alberta corporate tax provisions and federal ones. At the time relevant to the transactions in Husky and Safeway, (roughly 2001 to 2005) the relevant provisions of the ITA and the Alberta Corporation Tax Act (ACTA), were identical,40 and the federal provisions were referenced in the judgments. Safeway saved between $6 and $7 million in Alberta tax each year the structure was in place; the amount in issue in Husky was not stated, but the borrowed funds totaled $722 million and the plan was in place for over two years.

38 2011 ABQB 329; aff’d 2012 ABCA 232 (Madam Justice Romaine)
39 Inter-Leasing, Inc. v. Ontario (Revenue) 2013 ONSC 2927, June 26 2013.
40 Even the Alberta GAAR was identical to the federal provision, except that it referenced abuse of the ACTA.
There was a pre-GAAR body of SCC case law discussing the policy behind the interest expense deduction provided by ITA 20(1)(c), which is “to encourage the accumulation of capital which would produce taxable income”.\textsuperscript{41} The borrowed funds must be used directly to earn income from a business or property for the interest to be deductible. However, this does not mean that a taxpayer must continue to finance its business activities with equity, and a borrowing that contributes debt capital for the business and allows retained earnings to be distributed, or shares to be redeemed is eligible for the interest deduction.\textsuperscript{42} Husky had reorganized the debt financing of its subsidiaries so that the lender was a BVI incorporated Ontario Finco, while in Safeway the operating company had distributed retained earnings and repaid debts in the form of commercial paper and then borrowed from its parent corporation to replace that capital. The parent corporation then assigned the debt to the Ontario Finco.

The Husky and Safeway cases were heard separately at trial, though less than a month separates the dates of the judgments in 2011. The taxpayers were successful, on the basis that there was no abuse of the ACTA. The appeals were heard by the same panel of three justices, and the reasons dismissing the appeals in both cases were written by Hunt J.A. and released on July 30 2012.

The Alberta courts had no difficulty finding that there had been a tax benefit in respect of both the interest deduction and the dividend deduction, although the latter was contested. That the principal motivation for the series of transactions was tax avoidance was also not in doubt. As in \textit{OGT Holdings}, the main issue was whether there had been abusive avoidance.

The SCC had decided two more GAAR cases by the time Husky and Safeway reached the Alberta courts, so that there was more complete guidance for determining what constituted abuse. In \textit{Lipson v. Canada},\textsuperscript{43} abuse as defined in Trustco was confirmed as a transaction or series where the result (a) is “an outcome that the provisions relied on seek to prevent; (b) defeats the underlying rationale of the provisions relied on; or (c) circumvents certain provisions in a manner that frustrates the object, spirit or purpose of those provisions.” This definition was

\textsuperscript{41} \textit{Bronfman Trust v. The Queen} 87 DTC 5059, [1987] 1 S.C.R. 32.
\textsuperscript{42} TransPrairie, Singleton.
\textsuperscript{43} 2009 DTC 5015, 2009 SCC 1, [2009] 1 SCR 3 (“Lipson”) at para __.
affirmed in *Copthorne Holdings Ltd. v. Canada*,44 where the court added at [72]: “These considerations are not independent of one another and may overlap. At this stage, the Minister must clearly demonstrate that the transaction is an abuse of the Act, and the benefit of the doubt is given to the taxpayer.”

The approach of the Alberta courts to the application of the provincial GAAR to interprovincial tax avoidance is, not surprisingly given the opposite outcome, strikingly different from the Quebec courts in *OGT Holdings*. In *Husky*, the trial judge comments at the outset on the emphasis put on certainty by the judges who decided the tax cases she is asked to apply, and on the values of consistency, predictability and fairness in tax matters that the courts are particularly concerned to protect.45 When the judge turns to the *Trustco* case to apply the GAAR, she begins [27] with the statement of the SCC at [1] of *Trustco*:

> 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. The task in this appeal is to unite these two approaches in a framework that reflects the intention of Parliament in enacting the GAAR and achieves consistent, predictable and fair results.

She then cites from *Trustco* [11-12] where the SCC affirms the Duke of Westminster principle permitting taxpayers to arrange their affairs to minimize tax, and indicates that where the statutory provisions are precise, taxpayers should be able to rely on them. The citation from Shell referred to by the SCC in *Trustco* is also reproduced:

> [A]bsent 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.46

These references are absent from OGT, and are obviously far more sympathetic to the taxpayer than those portions of Trustco that are emphasized in OGT.

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44 2012 DTC 5007, 2011 SCC 63 (hereafter “Cophorne”).
45 It is obvious from both judgments at trial that neither judge had ever heard an income tax case before, let alone a GAAR case.
The central issue, whether an avoidance transaction, i.e. one that has as its primary (or even sole) motivation the avoidance of tax, can ever be within the object, spirit and purpose of the provisions of the legislation that textually support it, was the core of the dispute in *Husky*, as in OGT. The Crown argued directly that tax avoidance is not within the spirit of the relevant provision allowing the interest deduction.[52] Husky responded that a tax avoidance motivation is irrelevant as long as the interest deduction was incurred in respect of borrowed funds that were used to earn income from the borrower’s business.

The court ruled: [59] “It cannot be abusive for corporations to reorganize and refinance. To find that [the relevant members of the corporate group] cannot change the way they finance their operations when the motivation is tax avoidance would mean that they are chained to Alberta. Attaching a chain to any corporation who engages in tax avoidance is nowhere within the object, spirit and purpose of s. 20(3)(c).[47] It cannot be the case when a fundamental principle of tax law is that taxpayers may arrange their affairs to minimize tax.” In short, the judge said, the validly created legal relations between the borrower and lender within the corporate group must be given effect; there was nothing abusive in deducting the interest.

With respect to the untaxed intercorporate dividends, s. 112(1) provided that where a corporation has received a taxable dividend from … a corporation resident in Canada and controlled by it, an amount equal to the dividend may be deducted from the income of the receiving corporation for the purpose of computing its taxable income. The Crown and Husky agreed that the purpose of the deduction was “to avoid multiple taxation of income as it passes through a chain of corporations”. The alleged abuse was that the Ontario government did not impose tax on the (interest) income of Ontario Finco out of which the dividends were paid, and s. 112(1) is only for income that has already been taxed. Ontario Finco was a hybrid, taxed provincially as a non-resident and federally as a resident, so that s. 112(1) should not apply to the extent that the dividend was paid out of untaxed income. Allowing the deduction, argued the Minister, would

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[47] S. 20(3)(c) states that funds borrowed to repay a debt are deemed to be used for the same purpose as the repaid debt.
distort the way s. 112(1) is supposed to work, in the same way that the Quebec provision was twisted and distorted in *OGT Holdings*. [61-63]

Husky countered that the wording of the legislation was clear, and a different policy choice could have been made to require the recipient of the dividend to demonstrate that the income had already been subject to tax, rather than only requiring that the income be “within the Canadian tax net”. The choice that was made by the legislature is appropriate to “a federation where different provinces make different policy choices about taxation.”

The court ruled that the purpose of s. 112(1) was to avoid multiple taxation of income, but not to ensure that income is taxed at least once. The payment of interest to Ontario Finco, and the payment of dividends to the parent corporation that controlled Ontario Finco were separate transactions. It was not abusive for the Husky group to refinance using an Ontario entity.

The third allegation of abuse was essentially that the provision requiring interest income to be included for tax purposes, s. 12(1)(c) was circumvented by the reorganization and refinancing. The result was that interest that had been paid to Alberta lenders and taxed in Alberta was now paid to Ontario Finco and was exempt of tax under Ontario law. In response, Husky said it was “not abusive for a taxpayer to move from one province to another to benefit from a lower tax rate.” It was not open to the court to recharacterize the transaction to treat the dividend as if it were the interest income, and tax it as revenue earned in Alberta.

In conclusion the trial judge stated at [72] “I agree with Husky that the Crown’s fundamental objection is that Husky refinanced its business to take advantage of Ontario tax policy which resulted in a tax reduction for Husky and a loss of tax revenues for Alberta. Each province is sovereign and has the right to set its own tax policy. … There is no principle, constitutional or otherwise, that says a province may prevent corporations doing business within the province from taking advantage of another province’s tax policy.”
The trial decision in Safeway was very similar, though perhaps more conventionally and clearly reasoned. Again, in setting out the process required by Trustco, the court specifically referred to the SCC’s affirmation of the Duke of Westminster principle:

According to the Explanatory Notes, Parliament recognized the Duke of Westminster principle “that tax planning — arranging one’s affairs so as to attract the least amount of tax — is a legitimate and accepted part of Canadian tax law” (p. 464). 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.

Most significant perhaps is the court’s acceptance of Safeway’s argument that there could be no finding of abuse given that the Minister did not challenge the interest deduction while the debt was held by the parent company (i.e. before the assignment to Ontario Finco) or after the amendments to the Ontario tax regime that made Ontario Finco subject to tax on the interest income. The Alberta GAAR was thus being applied to negate the result under Ontario law of an otherwise fully legitimate financing structure. The court also clearly rejected any argument that a creation of an interest expense in furtherance of an avoidance transaction can never be within the object, spirit or purpose of para 20(1)(c). This, the court held, was to conflate avoidance with abuse, when the GAAR clearly separates the two concepts. The lack of a non-tax motivation was not relevant to the abuse analysis.

At para 77, the court accepted Safeway’s submission that “the free flow of capital across Canada is constitutionally protected and choosing where to employ capital in order to obtain the most favourable provincial tax result is legitimate tax minimization.” This is a very odd statement; there is nothing in the Canadian constitution that overtly protects free movement of capital, and nothing in the minuscule jurisprudence on the Canadian economic union that would support such an assertion.

With respect to s. 12(1)(c), the requirement to include interest in computing income subject to tax, the Minister alleged that the transfer of the debt from an Alberta taxpayer to the Ontario Finco was an avoidance transaction that resulted in a tax benefit. However, since this transaction
had taken place a fair market value, and had validly transferred the legal entitlement to the
interest to Ontario Finco, it was hard to avoid the conclusion that what the Minister sought to do
was recharacterize the assignment of the debt as an avoidance transaction because an alternative
transaction with the equivalent commercial result would have resulted in higher taxes. The court
found that there was no tax benefit arising from an avoidance transaction. The issue of abuse of
12(1)(c) did not arise. [102]

The trial court found that there was a tax benefit and an avoidance transaction when the structure
was put in place to utilize the s. 112(1) dividend deduction. As to whether it was abusive, the
court found that the purpose of s. 112(1) was set out in Lamont Management Ltd. v. Canada: it is
“to preclude double taxation at the corporate level”. The fact that the income out of which the
dividends were paid was not taxed at the provincial level was not an indication that the purpose
of s. 112(1) was undermined. The court cited the danger of “[f]inding unexpressed legislative
intentions under the guise of a purposive interpretation” in rejecting the claim that to be eligible
for the deduction, the income must have been subject to both provincial and federal tax. Thus
the “once and only once” principle cannot be read in to s. 112(1) to find abuse.

The Alberta Court of Appeal dismissed the appeals in Husky and Safeway without finding any
errors of law that could be said to have undermined the correctness of the trial judges’
conclusions. While the trial judge in Husky had not followed the three steps mandated in
Trustco, the Alberta Court of Appeal had no difficulty finding both a tax benefit and an
avoidance transaction, so that the abuse issue was properly conclusive of the case. It cited an
SCC GAAR case decided after the Husky trial decision, Copthorne, that there is no general
principle against corporate reorganization. It rejected the suggestion that since the Husky group
did not need to borrow the money, and it did not result in an accumulation of capital, the
deduction of the interest was contrary to the purpose of 20(1)(c). It was sufficient that the
borrowed money was used to earn income from the Husky Group’s business for it to be within
the purpose of the provision and absence of a commercial purpose is not the equivalent of abuse.
The lack of consolidated reporting by corporate groups means that the deduction of interest by
one member of the group in Alberta must be considered separately from the tax consequences of

48 [200] 3 F.C. 508 at 3
the receipt of interest income by another member of the group – the deductibility of the interest by one does not depend on the inclusion by the other. The Alberta Court of Appeal cited the statement of the Federal Court of Appeal in *Lehigh Cement Limited v. Canada*\(^49\) to the effect “that there was no abuse when the transaction exploited ‘a previously unnoticed legislative gap’”, or “took advantage of a loophole in the statutory scheme” as in *Canada v. Imperial Oil Ltd.*, \(^50\) concluding “…it would be a stretch to find abusive avoidance simply because a taxpayer took the benefit of another province’s advantageous tax treatment.”

Most significantly, in both Husky and Safeway the Alberta Court of Appeal rejected Alberta’s argument, relying on *OGT Holdings*, “that it ‘can be abusive avoidance’ to exploit the lack of alignment between provincial and federal tax acts”. It noted that OGT involved other provisions, and had been criticized. It then stated:

> “Finally, Canada's constitutional reality is that each level of government has taxation authority. Provinces are free to fully adopt the federal regime, and some have done so. Alberta and Ontario have not.”\(^51\)

Media coverage of the results in Husky and Safeway reveals a significant difference between the reaction of the Alberta tax authorities, and the Alberta Minister of Finance. While the ministry official expressed deep disappointment with the outcome, Minister Horner said “Many businesses that I was involved with paid significant amounts to get good advice as to how to position themselves well for tax purposes. You can’t begrudge companies for doing that”. The leader of the Alberta New Democratic Party condemned the tax avoidance as “not morally right”.\(^52\)

**Ontario Shuffle 2.0 – *Inter-Leasing v. Ontario*\(^53\)**

\(^49\) 2010 FCA 124 at [37]
\(^50\) [2004] DTC 6044, 2004 FCA 36 @ [79].
\(^51\) Safeway at [54], Husky at [59].
\(^53\) Supra, note ___.

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Inter-Leasing is a factually analogous case to Husky and Safeway. The Precision Group used essentially the same structure and a BVI Ontario Finco to eliminate provincial tax on interest, but viewed from the Ontario perspective. Strictly speaking, Inter-Leasing is not a GAAR case as it was decided on other grounds, with GAAR applied only in obiter dicta. However, it starkly demonstrates the potential of an uncoordinated system to result in provincial double taxation, not just double non-taxation. In the Safeway case, both the trial and appellate judgments noted that Ontario had reassessed Ontario Finco in respect of the interest income. In Inter-Leasing, the Ontario Superior Court of Justice held that Ontario Finco was, after all, subject to Ontario tax totaling some $36 million on the interest income (over $271 million) received from the Alberta borrower. The court held that as a member of the Precision Group, the interest income was earned as an integral part of a business carried on in Canada, and was not income from property, and thus not exempt from Ontario tax in the hands of a non-resident corporation. Inter-Leasing the court held, was a part of the Precision Group Canadian enterprise, and ‘its role was fundamental and critical to the accomplishment of an ongoing joint venture with the other companies in the Precision Group”. The business carried on by the Precision Group was a business carried on in Canada by Inter-Leasing.

Although not strictly necessary, the OSCJ did give its views on the application of the Ontario GAAR, which was not distinguishable from the federal version. The tax benefit identified was the entitlement to the “provincial abatement” in s. 124 of the ITA for income earned by a corporation in a province. The provincial abatement is a federal recognition of the right of the provinces to tax income of corporations attributable to PEs located in the province. It reduces federal tax payable by 10 points to leave room for provincial taxation of the same corporate income. Since the federal system recognized Inter-Leasing as a Canadian resident earning income in Ontario, it was entitled to the abatement, even though for provincial purposes it did not pay tax on the income. The transactions undertaken to put the financing structure in place were obviously avoidance transactions as they had no purpose other than to obtain the tax benefit.

The identified provision of the OCTA that Inter-Leasing had abused was 2(2), the provision which imposed Ontario tax on a corporation incorporated in a jurisdiction outside Canada, but
that had a PE in Ontario. As a charging provision, the purpose of 2(2) was simply to raise revenue, and “to define the tax base as broadly as possible in order to generated tax revenue”. Therefore, the court said,

“… it will be very difficult to find that any “tax benefit” resulting from an “avoidance transaction” is consistent with the “object, spirit or purpose of this category of legislative provision. It seems unlikely there will be any underlying policy choice by the legislator that will afford refuge for the taxpayer under the third part of the analytical framework. Expressed another way, the Minister would likely have no difficulty meeting the onus of establishing that such tax avoidance is inconsistent with the object and purpose of the particular legislative provision in issue. When it comes to charging provisions the object and purpose is to raise revenue, rather than promoting certain taxpayer choices the government wants to encourage. [43]

With respect, the abuse in this case is really the claiming of the provincial abatement, rather than the reliance on section 2(2) of the OCTA by a foreign corporation. The abuse, if any, would be of a provision of the ITA, rather than of Ontario tax law. That would only increase the interest of this case however, since it would imply that exploiting a federal concession of tax jurisdiction amounts to abuse of Ontario law. This is similar to the reasoning in OGT, that not aligning the federal and Québec elections was an abuse of Québec law.

In Inter-Leasing the court did not purport to make a ruling on the application of the GAAR, but it seems likely that an appellate court will do so. The result in Inter-Leasing on the issue of whether the interest was income from property or income from a Canadian business is very surprising, and may well be reversed, so that the GAAR issue becomes central.

Law or Politics?

The striking aspect of the cases reviewed above is the divergence in approach to virtually identical GAAR provisions by the courts in different provinces. Where Québec takes a very hard line, treating the exploitation of the gap between federal and Québec tax rules as “twisting and distorting”, and thus an abuse of the QTA election provision in OGT, the Alberta courts see the exploitation of a difference in provincial tax policies as legitimate. Québec focuses on the
object, spirit and purpose of the relevant provision, and any result that falls outside this as abuse, while Alberta judges focus on the freedom of taxpayers to arrange their affairs to minimize tax.

Notably absent from all the judgments on the provincial GAARs is an explicit and careful unified textual, contextual and purposive approach to interpretation of the relevant provisions, before turning to whether the object, spirit and purpose has been frustrated, and thus abused. This may be due to the nature of the provisions at issue. They are relatively simple, permissive rules that have existed in Canadian tax legislation for a long time. As the SCC pointed out in Trustco, where the text is clear, a contextual and purposive interpretation may not add anything to the meaning of the words used in the text.

A contextual interpretation requires the court to consider whether related provisions to those that are allegedly abused contribute any understanding to the correct interpretation of the latter. Finally, a purposive interpretation involves a search for the underlying rationale of the provisions at issue. Once this is determined, the court must assess whether that underlying rationale has been frustrated by the transactions that have been found to be avoidance transactions.

In OGT, the courts came perilously close to finding that the tax benefit, the avoidance transaction and the abuse are all one and the same – the elimination of all provincial tax rather than the mere deferral said to be the purpose of the s. 518 election. There is no delineation of any underlying rationale of ensuring that all corporate income is taxed by a province. As had been said, the reasoning is unpersuasive and amounts to simply a position that the series of transactions does not pass the “smell test” of abusive avoidance. 54

The Husky and Safeway cases make clearer statements in relation to the interpretation and underlying purpose of the relevant provisions, but are still somewhat weak on conclusions regarding a contextual and purposive interpretation. It can be discerned from the judgments of the Alberta Court of Appeal that the underlying rationale of the relevant provisions was the same as for federal purposes, to allow interest to be deducted if the borrowed funds were used to earn income, and to ensure there was no double taxation when profits were distributed up a corporate

54 Andrew Etcovitch case comment. Canadian Tax Journal 2009 Vol 57 no. 2
chain. Alberta is of course a much more pro-business, low tax political environment than Québec, as can be seen from the reaction of the Alberta finance minister cited above. This laissez-faire approach could be said to carry through to its judiciary.

From the summary remarks in *Inter-Leasing*, it seems the court ruled out any exemption from tax as meeting the underlying rationale of a charging provision, which is bizarre in the case of a charging provision that clearly exempts certain income of non-resident corporations from tax. Until an appellate decision is rendered on the GAAR issue, *Inter-Leasing* contributes nothing to the jurisprudence on textual, contextual and purposive interpretation of provincial tax laws. However, it will remain of interest for its potential impact on liability to taxation of Ontario Fincos.

It is logically difficult if not impossible to discern an underlying rationale of ensuring that all corporate income is subject to provincial tax “somewhere” in the course of interpreting provincial tax laws that are deliberately and explicitly not coordinated with the federal system. If that rationale were present, there would arguably have to also be found another principle, that income be subject to provincial tax in only one province, i.e. that there is a “once and only once” purpose to the uncoordinated portion of the Canadian corporate tax system. This is quite likely possible with respect to the system of TCAs between the agreeing provinces and the federal government, but contradicts the assertion of substantive and administrative tax sovereignty of the non-agreeing provinces. If no such rationale can be identified, then it cannot be frustrated, and accordingly cannot be abused.

The raison d’être of a GAAR is to fill a gap or eliminate a duplication where the text of the statute, read literally, would result in the tax benefit claimed by the taxpayer. The gap that is exploited is not a provision of any law, but the misalignment itself. No particular provision of a provincial tax law is frustrated or circumvented; it is absence of coordination in the system itself that provides the opportunity. Applying the federal GAAR to a harmonized system does not require the court to search for the rationale underlying separate policy choices by different tax legislators; applying a provincial GAAR to an interprovincial gap would require the court to find
a rationale for reversing the double non-taxation that does not in fact exist, as each province has
gone its own way in designing its tax system.

That these gaps have been so expensively exploited has forced the non-agreeing provinces to
align their tax laws to eliminate the gaps. Several provincial GAARs now define an avoidance
transaction as one that has as its primary purpose the avoidance of tax under the tax law of
another province, or the ITA or its regulations. The Alberta GAAR now provides:

(3) An avoidance transaction is any transaction

(a) that, but for this section, would result, directly or indirectly, in a tax benefit, or

(b) that is part of a series of transactions, which series, but for this section, would result,
directly or indirectly, in a tax benefit,

but does not include a transaction that may reasonably be considered to have been undertaken or
arranged primarily for bona fide purposes other than for one or more of the following:

(c) to obtain the tax benefit;

(d) to reduce, avoid or defer tax, or another amount payable as or in respect of tax under any
other federal or provincial Act or regulation;

(e) to increase a refund of tax, or of another amount in respect of tax, under any other federal
or provincial Act or regulation. (Emphasis added.)

The expansion of the definition of “avoidance transaction” to include transactions designed to
avoid federal and other provinces’ taxes is present in other provinces’ GAARs now as well. [BC]

55 “Abuse” is also defined more expansively: (3.1) 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 or the regulations,

(ii) the Income Tax Regulations (Canada) as they apply for the purposes of this Act,

(iii) the Income Tax Application Rules (Canada) as they apply for the purposes of this
Act,

(iv) a tax treaty, or

(v) any other Act or regulation of any other jurisdiction 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,
The diminished viability of an uncoordinated system for Canada’s largest province, and the advantages of joining the coordinated seem to have been accepted with Ontario’s agreement to a new corporate TCA in 2009, with the federal CRA taking over tax administration for that province.

Québec remains resolutely outside the federal system from the point of view of administration and enforcement of its tax law.\textsuperscript{56} However, the Shuffle and Truffle have clearly forced some concessions towards legislative alignment with the coordinated system. The Québec GAAR, like Alberta’s, now contemplates avoidance of federal, and other provinces’ tax as giving rise to abuse subject to re-determination. There is a separatist Parti Québécois minority government now in power in Quebec, and although it is quite weak, there is no suggestion that even a change of government would result in greater coordination, or any willingness to allow the CRA to take over administration and enforcement in the interests of efficiency and cost reduction.

Leave to appeal to the SCC requires the applicant to convince a panel of three judges that the issue in the case is of national importance. From a constitutional perspective, free movement of capital and coordination of provincial tax bases would normally be viewed as at least potentially meeting this test, especially when courts of appeal in two or more provinces have come to opposite conclusions. Denial of leave to appeal by the SCC in \textit{OGT} implies that either the QCA decision is seen as correct, or there is a reluctance to interfere in a situation that has political overtones, but no future impact, now that both Quebec Shuffle and Truffle have been eliminated.

The same can be said of denial of leave to appeal in \textit{Husky, Safeway} and even \textit{Gendis}. The SCC may agree with the outcome, or be unwilling to interfere in provincial appellate judicial decisions about provincial tax policy unless there is a clear error of law that has future ramifications. The refusal of leave would then seem to be at least partially a “political” decision. Husky and Safeway may be seen as distinguishable, legally and/or factually from OGT, so that

\begin{footnote}
\textsuperscript{56} There is a bilateral agreement between Québec and the federal government with respect to the Goods and Services Tax, but Québec did not cede anything to the federal government when it formally aligned its sales tax with the federal GST. The Quebec revenue ministry collects federal GST on behalf of the federal government as well as the almost fully harmonized Quebec Sales tax, rather than the other way round!
\end{footnote}
there is no conflict between them that needs to be resolved. If, however, *Inter-Leasing* is upheld on appeal, especially on the GAAR argument, the SCC may be forced to intervene to prevent double taxation by provinces, or at least to clarify if there is any such principle of “once and only once” provincial taxation in the Canadian federal system.