Anti-Avoidance Rule in Paragraph 95(6)(b) Clarified - Lehigh Cement

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Anti-Avoidance Rule in Paragraph 95(6)(b) Clarified

Canada v Lehigh Cement Limited, 2014 FCA 103

An appeal from the TCC decision in 2013 TCC 176, granting the taxpayer's appeal of the MNR's reassessment.

At issue was the proper interpretation of paragraph 95(6)(b) of the *Income Tax Act,* specifically how wide the inquiry into the "principal purpose" of a share transaction could be.

FACTS

Lehigh and CBR acquired shares of a non-resident corporation as part of a complex and wide restructuring involving many steps (Details at paras 9-10 of the FCA decision). They received dividends from this non-resident company and claimed a deduction under paragraph 113(1)(a). The MNR disallowed the deductions and applied paragraph 95(6)(b) on the basis that the taxpayers had acquired the shares of the non-resident with the principal purpose of avoiding the payment of tax that would otherwise be payable under the ITA.

The FCA agreed with the TCC outcome (taxpayer succeeding) but for different reasons. The TCC had determined that the principal purpose of the acquisition or disposition was a question of fact to be determined in light of all relevant circumstances and that one salient consideration is whether the share purchase or sale was part of a series of dispositions or acquisitions conducted with a view to avoid tax. The TCC then considered the effect of the phrase "tax...that would otherwise be payable", and stated that this required looking at the alternate scenario where the share transaction has not occurred. In this case, the TCC determined that there was no change in tax consequences before or after the share transaction and therefore 95(6)(b) did not apply.

The MNR's position at the FCA was that in applying 95(6)(b), was that it was proper to look at a series of transactions to see if there was a tax avoidance purpose. The Taxpayer's position was that only the share transaction itself must be looked at.

ANALYSIS

The FCA began by providing a thorough overview of the legislative regime which paragraph 95(6)(b), in subdivision I of Division B of the ITA is part of. How a Canadian resident is taxed on income derived from a non-resident corporation depends on two factors:

1. the type of income; and
2. the ownership status of the non-resident corporation.

Subsection 90(1) requires that dividends received by a Canadian taxpayer from non-resident corporation be included in income when received. But, 113(1)(a) provides an offsetting deduction for dividends paid by "foreign affiliate" corporations paid out of exempt surplus. Very simply stated, 95(1) defines "foreign affiliate" to be a non-resident corporation in which a Canadian taxpayer holds at least 1% interest of any class of shares AND that taxpayer's holdings combined with the holdings of any related person total 10% or more of the class.

The court noted that the ownership status of the non-resident corporation can easily be manipulated so as to realise tax savings. The court quoted from Vern Krishna, *The Fundamentals of Canadian Income Tax* (9th ed., 2006) at page 1327, where it is said that ""taxpayers jockey to get on the right side of the distinctions to take advantage of the rules". Paragraph 95(6)(b) was enacted to address taxpayers' ability to manipulate the ownership status of non-resident corporations. The court stated (para 20):

> Broadly speaking, paragraph 95(6)(*b*) provides that where a person acquires or disposes of shares of a corporation and it can reasonably be considered that the principal purpose of the acquisition or disposition is to permit a person to avoid, reduce or defer the payment of tax, the acquisition or disposition is deemed not to have occurred.

The FCA referred to the decision in *Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54, where the rule for statuary interpretation was laid out. The FCA then set out the rules in relation to Income Tax provisions:

> [39] The provisions in taxation statutes are often detailed and particular. The *Income Tax Act* is “an instrument dominated by explicit provisions dictating specific consequences,” and this invites “a largely textual interpretation”: *Canada Trustco*, at paragraph 13.
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> [40] As a result, “[w]here Parliament has specified precisely what conditions must be satisfied to achieve a particular result, it is reasonable to assume that Parliament

intended that taxpayers would rely on such provisions to achieve the result they prescribe": *Canada Trustco*, *supra* at paragraph 11. Where the provision at issue is "clear and unambiguous," its words "must simply be applied": *Shell Canada Ltd. v. Canada*, [1999] 3 S.C.R. 622 at paragraph 40. In such circumstances, a supposed purpose "cannot be used to create an unexpressed exception to clear language" or "supplant" clear language: *Placer Dome Canada Ltd. v. Ontario (Minister of Finance)*, 2006 SCC 20, [2006] 1 S.C.R. 715 at paragraph 23, citing P. W. Hogg, J. E. Magee and J. Li, *Principles of Canadian Income Tax Law* (5th ed. 2005), at page 569.

[41] When interpreting provisions in taxation statutes, we must keep front of mind their real life context: many taxpayers study closely the text of the Act to manage and plan their affairs intelligently. Accordingly, we must interpret "clear and unambiguous" text in the Act in a way that promotes "consistency, predictability and fairness," with due weight placed upon the particular wording of the provision: *Canada Trustco*, at paragraph 12, citing *Shell Canada Ltd., supra* at paragraph 45.

[42] We must not supplant or qualify the words of paragraph 95(6)(*b*) by creating "unexpressed exceptions derived from [our] view of the object and purpose of the provision," or by resorting to tendentious reasoning. Otherwise, we would inject "intolerable uncertainty" into the Act, undermining "consistency, predictability and fairness": *65302 British Columbia Ltd. v. Canada*, [1999] 3 S.C.R. 804, at paragraph 51, citing P. W. Hogg and J. E. Magee, *Principles of Canadian Income Tax Law* (2nd ed. 1997) at pp. 475-76; see also *Canada Trustco*, at paragraph 12.

[43] In the course of applying these principles, legislative history and explanatory documents such as technical notes, budget papers and committee minutes can offer assistance.

[44] Overall, though, our task is to discern the meaning of the provision's text using all of the objective clues available to us.

In applying this test, the court accepted the taxpayer's interpretation. Paragraph 95(6)(b) focuses precisely and unequivocally on the principal purpose of the acquisition or disposition of the shares and NOT on that of the series of transactions on which the particular acquisition or disposition is part of. The FCA held that 95(6)(b) is aimed at a particular species of tax avoidance (manipulation of foreign affiliate status), and does not use the words "series of transactions or event". The FCA stated (para 50):

Rather, the words of paragraph 95(6)(*b*) require that the tax benefit must flow from the share acquisition or disposition itself and obtaining the tax benefit must be the principal purpose of the share acquisition or disposition.

The court also considered other contexts, including amendments made to other anti-avoidance provisions and the architecture of the ITA (provision in a specific area not a general area). The provision is only aimed at dealing with manipulations of foreign affiliate status (para 55).

The FCA also dealt with the MNR's argument based on the purpose of the provision. It did so by considering the potential effects of the alternative interpretations, and held that the MNR's interpretation would result in unacceptable (board and ill-defined) discretion leading to uncertainty (para 64):

> [64] Unacceptability is in the eye of the beholder. It can shift depending on one's subjective judgment and mood at the time. Using it, as the Crown suggests, to restrain the indiscriminate use of paragraph 95(6)(*b*) creates the spectre of similarly-situated taxpayers being treated differently for no objective reason. This would violate the principle that, absent clear legislative wording, the same legal principles should apply to all taxpayers: *Bronfman Trust v. The Queen*, [1987] 1 S.C.R. 32 at page 46.

The court concluded:

> [68] [...] paragraph 95(6)(*b*) is targeted at those whose principal purpose for acquiring or disposing of shares in a non-resident corporation is to meet or fail the relevant tests for foreign affiliate, controlled foreign affiliate or related-corporation status in subdivision i of Division B of Part I of the Act with a view to avoiding, reducing or deferring Canadian tax.
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> [69] The principal purpose of the acquisition or disposition of shares in the non-resident corporation is a question of fact to be determined on the basis of all relevant circumstances. An entire series of transactions may form part of the circumstances relevant to discerning the principal purpose of the acquisition or disposition of shares in the non-resident corporation. But it is not open to the Minister to look at an entire series of transactions to discern a tax avoidance purpose that is not the specific target of paragraph 95(6)(*b*).
>
> [70] Manipulating the shareholdings in the non-resident corporation to change its status in subdivision i of Division B of Part I of the Act in order to avoid, reduce or defer Canadian tax by itself does not necessarily trigger paragraph 95(6)(*b*) of the Act. The purpose must be the principal – *i.e.* dominant or main purpose – not just one of many different purposes.

In this case, the principal purpose of the share transaction was to avoid US tax and not Canadian Tax, and 95(6)(b) had no application.

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