Difference Between Astute and Abusive Tax Avoidance

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Difference Between Astute and Abusive Tax Avoidance

594710 B.C. Ltd. v The Queen, 2016 TCC 288

The Court was asked to draw a line between permissible and impressible tax avoidance strategies. The correctness of the application of the General Anti-Avoidance Rule (GAAR) was at issue when applied (i) at the partnership level and (ii) at the holding corporation level.

The TCC held that the GAAR was incorrectly applied in both instances, allowing the taxpayer's appeal. In the first instance, upon which the second relied, the failure occured at the abuse and misuse level. The MNR had failed to demonstrate a particular provisions that was abused or misused, relying on a general policy against loss tranding between unrelated parties (the court also held that the transaciton was profit trading not loss trading).

FACTS

The taxpayer was a holding company, wholly owned by a member of a family involved in the real estate business, that wholly owned a corporation that was a limited partner in a limited partnership. The other limited partners were wholly owned holding corporations of other family members' wholly owned holding corporations. The sole business of each partnership corporation was the participation in the limited partnership.

Nuinsco Resources Limited was an arm's length Canadian public corporation with large tax pools (losses and resource-related deductions) that eventually purchased al of the shares of the partner-Cos.

The plan permitted the partnership income to be paid to the corporate partner tax-free while, for tax purposes, the income was allocated almost entirely to an arm's length corporation with accumulated losses sufficient to reduce taxable income.

Rather than allocated the taxable income of the partnership to each of the partner-Cos, a series of transactions were undertaken:

- HoldCo subscribed for additional shares of PartnerCo, paid for by set-off against debt owed by PartnerCo to HoldCo, increasing ACB of the shares held in PartnerCo by the debt amount (GAAR was applied to this);

- The Limited Partnership lent cash in an amount almost equal to what would have been each limited partner's after-tax income for that fiscal period to each PartnerCo;
- Each PartnerCo declared and paid a series of sequential stock dividends to each HoldCo, consisting of preferred shares equal in value to the loan amounts (each with a PUC and ACB of $1);
  - absent GAAR, The issuance of the stock dividends would have resulted in a dividend to the HoldCo that was taxable to the HoldCo and also deductible to HoldCo (s 112), but there would have been no change in the ACB of the shares:
- PartnerCo used the proceeds from the loan to redeem the preferred shares issued in the stock dividends;
  - absent GAAR, there would be no deemed dividend received by the HoldCo, and the preferred shares would have been redeemed at ACB, resulting in no gain or loss;
- A service contract and a put-option were entered into by the partnership with non-arm's length parties;
- A second stock dividend (preferred shares) was declared by PartnerCo to HoldCo;
- Each PartnerCo sold all of its preferred shares in each HoldCo, at a price equal to the second stock dividend, and all common shares at a price equal to the ACB (stepped up by the loan-fueled share subscription) by the Loss Public-Corp (which also acquire all the shares of the GP for $1);
- The acquisition of shares by the Loss Public-Corp was funded by a loan from the partnership to it;
  - but for GAAR, the acquisition of shares, occurring at ACB, would result in no gain or loss, an acquisition of control would occur resulting in a deemed year-end for the PartnerCo, and no income was allocable to PartnerCo for its new taxation year;
- The Loss Public-Corp wound up each PartnerCo, becoming the sole limited partner; and
- the partnership allocated its net income to the Loss Public-Corp and the GP, each PartnerCo was dissolved resulting in distributions, the remaining units were sold pursuant to the option (back to the family), plus some other transactions that ended in the dissolution of the partnership.

The MNR assumed that these transactions were pre-ordained as a series and that all were avoidance transactions. The agreed statement of facts agreed that most but not all steps were part of a series fur GAAR purposes.

ANALYSIS

Initial Issues

One of the initial issues was whether the appellant had complied with the large corporation rules, specifically, whether the argument that the assessments were issued outside of the normal reassessment period should be considered given that it did not form part of the issues raised in the Notice of Objection as required by subsection 165(1.11) and therefore precluded from raising it on appeal to the TCC pursuant to subsection 169(2.1).

The TCC held that an out of time assessment is void (*Blackburn Radio Inc. v The Queen*, 2012 TCC 255 and in *The Queen v Canadian Marconi Co.,* [1992] 1 FC 655 (FCA)) and section 169.1 is aimed at precluding the TCC from doing anything but vacating or varying an assessment (para 37). If an assessment is out of time, the court held that it is void *ab initio*, and t=does not exist and cannot be given effect. Subsection 152(8) does not apply to an out of time assessment (*Lornport Investments Ltd. et al v The Queen*, [1992] 1 CTC 351 (FCA)).

The pertinent period here was the tax year ending June 1, 2006, and, in this case, the reassessment of the PartnerCo the tax year is not altered by "the fact that the Minister has reassessed Partnerco to include the tax consequences of transactions that would have otherwise fallen outside of the taxation year" (para 45). Therefore, the court would have held that the assessment was timely and valid.

The Appellant argued that the Minister cannot invoke GAAR as a result of an amount of tax owing as a result of a separate GAAR assessment of another taxpayer (para 49). The Court disagreed. The Minister assesses each taxpayer separately and, although the Minister cannot stack GAAR assessments with respect to the same taxpayer, this does not extend to third parties with derivative liability assessments (para 51). The TCC referred to the SCC decision in *Copthorne Holdings Ltd.* v Canada, 2011 SCC 63*,* where at paragraph 72 it was said:

> The analysis will then lead to a finding of abusive tax avoidance: (1) where the transaction achieves an outcome the statutory provision was intended to prevent; (2) where the transaction defeats the underlying rationale of the provision; or (3) where the transaction circumvents the provision in a manner that frustrates or defeats its object, spirit or purpose (*Trustco*, at para. 45; *Lipson*, at para. 40). 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 GAAR cannot be interpreted to allow abusive tax avoidance to go uncaught where it is subsidiary to and arising out of another act of abusive tax avoidance transaction (para 53). The consequences of the application of GAAR, pursuant to s 245(7), can include an assessment under subsection 160(2) (para 55).

Application of GAAR

The court repeated the principles in applying GAAR set ou in *Inter-Leasing Inc. v Ontario (Minister of Revenue)*, 2014 ONCA 575 (paras 49-52), and reminded itself that the GAAR is a provision of last resort (*Canada Trustco Mortgage Co. v Canada*, 2005 SCC 54, para 21). The Court must, *inter alia*:

- weigh the entirety of the evidence to identify, objectively, the purposes that were primary in the transactions, assessing the reasonableness of the evidence of the purposes (para 57);
- determine if there was a series, what transactions make up the series, what tax benefit resulted from the series, and if each transaction in the series was primarily for a *bona fide* non-tax purpose (*Copthorne Holdings Ltd.* v Canada, 2011 SCC 63, para 40);
- put the burden on the taxpayer to establish that a transaction or series of transactions was for a primary *bona fide* purpose other than to obtain a tax benefit (*1207192 Ontario Ltd. v The Queen*, 2012 FCA 259, para 6*); and*
- remember that a tax benefit need not occur in the year in question (para 64) or to the taxpayer to whom the tax consequences are re-determined by application of the GAAR (para 70).

PartnerCo Reassessment

Tax Benefit - The Appellant argued that the comparator should be if Nuinsco has acquired PartnerCo without being able to utilize the tax attributes - therefore the tax benefit was to the Public Co. The Respondent argued that the comparison should be if the Public Co had never acquired PartnerCo, as the only benefit to Public Co were the deal fees paid to it by the Appellant. The Court held that the Appellant had failed to demonstrate the reasonableness of its alternative on the facts, and a tax benefit arose (paras 72-73).

Misuse or Abuse - The Minister alleges that there is a general policy of preventing loss sharing between unrelated taxpayers. But, the Court said that it is fatal to the Minister position that the policy is broad and not attached to the provisions at issue (*Copthorne Holdings Ltd.* v Canada, 2011 SCC 63, para 118). Specific provisions must be associated with the tax benefit and be abused (para 81). The court noted that the distinction is a fine line between transactions that offend a provision in a manner that circumvent it and transactions that fall outside of the scope of the provision (para 90). However, the provisions of the ITA referred to prevent only certain types of loss trading, not profit or gain trading (para 90).

HoldCo Reassessment

The TCC did not need to deal with this reassessment but made the following observations in *Obiter:*

- A stock dividend is not a transfer of property as required by s 160 (para 132);
- A share redemption is a transfer of property (para 133);
- A transfer of property can be indirect in the context of the steps of a particular series (paras 136-147);

Misuse or abuse - The purpose of s 160 is to enable the Minister to collect a tax debt of one person from another to the extent that the value of property transferred is for less than its FMV (therefore not preserving the value of the tax debtor's property) (paras 151-52). The Court held that the reliance on the deemed year-end ruled in s249.1, in the context of the series, was abusive of s 160 of the ITA as it prevented the operation of the s 160 by divorcing the partnership income from the allocation of it for tax purposes.

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