General Anti Avoidance Rule GAAR - Sas Ansari

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General Anti-Avoidance Rule - GAAR

Univar Holdco Canada ULC v The Queen, 2016 TCC 159

At issue was whether the transactions used to strip almost $1B in surplus from a Canadian subsidiary by a UK private equity firm was caught by GAAR - specifically whether the transaction was a misuse or abuse of the relieving exemption in 212.1.(4) of the ITA.

The Court held that the transactions "circumvented the application of the anti-avoidance rule in section 212.1 in a manner that “frustrated or defeated the object, spirit or purpose” of section 212.1 in general and subsection 212.1(4) in particular: *Canada Trustco Mortgage Company v Canada*, 2005 SCC 54 at paragraph 45."

FACTS

A UK private equity firm acquired a Netherlands public corporation with a Canadian operating sub that had $899M in surplus. A series of transactions were entered into to avoid the anti-avoidance rule in 212.1 by taking advantage of the relieving provision in 212.1(4). The transactions involved are not reviewed here.

The CRA applied GAAR and the taxpayer admitted a tax benefit and an avoidance transaction. This left the issue of misuse and abuse.

ANALYSIS

The TCC began by reviewing the legislation. Subsection 212.1(1) deals with dispositions by non-residents of Canadian resident corporations to other Canadian resident corporations that is not at arm's length with the non-resident, where immediately after the disposition the subject corporation is connected (s 186(4)) with the purchaser corporation. The effect of the provision includes a deemed dividend to the extent that the FMV of non-share consideration exceeds the PUC of the shares disposed, and includes a PUC grind to prevent a step-up of PUC beyond the historic value.

Subsection 212.1(4) exempts a disposition from the application of 212.1(1) where the disposition is to a purchaser corporation that immediately before the disposition controls the non-resident seller.

The corporations were in a sandwich structure that, after a few 'contortions' resulted in the surplus to be stripped out of the Canadian corporation. There were no shares of the Canadian sub sold and no money came into Canada to increase the PUC of the shares (para 41).

In order for GAAR to apply, one of the requirements is that there was "a*busive 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." (para 45 - *Canada Trustco Mortgage Company v Canada*, 2005 SCC 54). The burden is on the Crown to prove this. Abuse 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".

The "abuse or misuse" requirement can be met in three ways - *Lipson v Canada*, 2009 SCC 1:

- the outcome is one the provision relied on seeks to prevent
- the outcome defeats the underlying rationale of the provisions relied on, or
- the outcome circumvents certain provisions in a manner that frustrates the object, spirit and purpose of those provisions.

Courts engage in two steps (para 62):

1. the need to identify the object, sporit or purpose of the provisions of the ITA relied on to obtain the tax benefit as part of the overall scheme of the ITA, relevant provisions, and with premissible extrinsic aids; and
2. consider whether the facts of the case at bar are such that the object, spirit or purpose of the provision is defeated or frustrated.

The Appellant argued that the reorganization was part of an arm's length purchase, and therefore was not what section 212.1 aimed at - accessing undistributed cash of a corporation though non-arm's length transactions where control of the corporation being stripped is not changed. The Appellant argued that had the purchaser used a fully capitalized Canadian acquisition corporation to make the purchase of the Canadian sub, the amount could have been paid back as tax-free intercorporate dividends. However, the circumstances of this case required the purchaser to use a different route to get to the same result. The use of 212.1(4) was contemplated at the acquisition stage to avoid the application of 212.1(1).

The Respondent argued that 212.1 is an anti-avoidance provision that aims to prevent dividend stripping that is integral to the PUC scheme of the ITA - *Copthorne Holdings Ltd v Canada*, 2011 SCC 63. The purpose of the provision is to prevent tax-free distributions of a corporation's retained earnings to a non-resident corporation through transactions designed to distribute funds in excess of the initial investment (para 59).

Section 212.1, the international counter part of 84.1, is meant to prevent dividend stripping - *Collins & Aikman Products Co v R*, 2009 TCC 299 at paras.55 and 105, aff'd 2010 FCA 251. A dividend strip is:

> any transaction by a taxpayer that involves the shares of a Canadian corporation and that, directly or indirectly, effects a distribution to the taxpayer of all or part of that corporation's surplus at a tax cost that is less than the tax otherwise payable on a dividend of that surplus to the taxpayer

- Blake Murray, "The 1977 Amendments to the Corporate Distribution Rules"(1978) 16:1 Osgoode Hall LJ 155 at 181.

The Court noted that the ITA doesn't contain a general policy against dividend stripping and that surplus stripping is by itself not abusive tax avoidance - *Gwartz v R*, 2013 TCC 86; *Copthorne v The Queen*, 2007 TCC 481. But here, there is a specific provisions that aims to stop dividend or surplus stripping.

PUC, or Paid Up Capital, is defined in subsection 89(1) and is computed without reference to the TIA provisions other that those meant to modify it - in short, PUC is the modified stated capital of the corporation that records the capital input of shareholders per share across the classes of shares (paras 68-69). One of the adjusting provisions is 212.1 which prevents a non-resident person from avoiding Part XIII tax on dividends through non arm's length sale of shares in certain circumstances.

There are two parts to 212.1. The first is a deemed dividend of any non-share consideration in excess of the PUC taxable under 212(2). The second is a PUC grind to prevent the increase of PUC without additional capital infusions, again preventing capital removal in excess of historic PUC. The exception in 212.1(4) applies where the non-resident is controlled by the purchaser immediately before the sale. This would keep the surplus in Canada as the purchaser is a Canadian resident corp.

The transaction complied with the text of the provisions. It is a defeat or frustration of the object, spirit, and purpose that is at question.

The context of 212.1 includes the provisions that affect how the ITA treats distributions from corporations resident in Canada generally. The ITA attempts to integrate corporate and personal income tax so that the amount of tax isn't unduly affected by the structure used to earn the income that flows to an individual resident in Canada. Payment to non-resident of after-tax retained earnings of a corporation are subject to withholding tax under Part XIII. Section 212.1 is part of the withholding tax scheme imposed by 212(2). The PUC scheme is also part of 212.1

The PUC scheme is also part of 212.1 and is meant to limit tax-free distributions to PUC - their skin in the game in Canada - so that any distribution in excess of their investment is taxable. The excess distribution to a non-resident is subject to withholding tax (25% reduced by tax treaties) and must be withheld and remitted by the payor corporation pursuant to subsection

215(1).

The exception in 212.1(4) is in the context of this whole scheme, and cannot be used to defeat the very application of 212.1. The Court held that (para 83):

> It is my view that subsection 212.1(4) is aimed at a narrow circumstance where the purchaser corporation, which is resident in Canada, actually controls the non-resident corporation without manipulating the corporate structure to achieve that control.

By reference to the budget documents and technical notes, the Court held that the purpose of 212.1 was to prevent the conversion of what would otherwise be taxable distribution of surplus into capital gains that may not be taxable in Canada - thus to "prevent non-resident shareholders from reorganizing their Canadian resident corporations so that they can convert dividend distributions that would ordinarily be subject to non-resident withholding tax under Part XIII into tax-free capital gains" (para 92).

The court went on to outline the purpose of the exception in 212.1(4) (para 97):

> That purpose is to allow for a *bona fide* sale of shares from a non-resident corporation to a Canadian resident corporation where it is the Canadian resident corporation that controls the non-resident corporation. The exception should not apply in the situation where a non-resident owns shares of the Canadian resident purchaser corporation. The exception does not apply where a non-resident uses non-arm's length reorganizations of their Canadian resident corporations to convert dividend distributions that would otherwise be subject to non-resident withholding tax under Part XIII into tax-free capital gains.

In response to the argument that the taxpayer could have achieved the outcome had it fully capitalized a Canadian corp to make the purchase of the Canadian subsidiary, the Court stated that this was not done and in tax law, form matters - *Friedberg v The Queen*, [1992] 1 CTC 1.

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