Tax Planning Gone Wrong (and how to avoid it) - Sas Ansari

Author : admin

Tax Planning Gone Wrong (and how to avoid it)

Golini *v The Queen*, 2016 TCC 174

What is the difference between "smoke and mirrors" and "structured transactions" in the tax world? How does a taxpayer ensure that s/he is on the correct end of the spectrum that divides that chasm?

Tax planning transactions must ensure that the wording in individual steps of the overall plan do not present the circumstances of the transaction to be other than the whole taken together. Otherwise, the transactions are a sham and the words mere "smoke and mirrors". Even if most transactions are legally enforceable and presented in their legal reality, those that stretch legal reality to breaking doom a tax plan.

A sham allows the court to determine tax consequences on the basis of the real transactions, not the 'legal' ones hiding such a sham.

Sometimes tax planners tie themselves into a knot trying to get a no-tax outcome and, in doing so, go beyond legal reality. Ensure that all transactions part of the tax plan have a primary business purpose, reflect proper value, do what they purport to do, and are legally effective.

The case is lengthy but worth a deep read by tax planners.

FACTS

[please read the case to understand the lengthy facts, - they are not fully represented here]

The taxpayers, as part of estate and shareholder planning, engaged in a number of transactions on the advice of professional advisors. Specifically , they engaged in a Retirement Compensation Arrangement though an estate freeze and an Optimizer Plan. The Tax Court held that the taxpayers were guided by the professionals entirely (including the use of lenders, etc), and were not aware of what the professionals did in the background (including incorporating companies for the purpose of this transaction).

The plan involved:

- S 85 roll-over into a new holdco;
- a bridge loan from an offshore financial institution;
- Redemption of shares using the bridge loan amounts;
- purchase of an annuity linked to a life insurance policy (with a death benefit);
- Provision of a limited recourse loan connected to the preceding transactions;
- Use of limited recourse loan to subscribe for shares, with investment used to repay bridge loan;

The ultimate result was the creation of an interest deduction for Sr and a stepped up PUC for Jr.

The CRA took the position that either:

- The transactions were a sham such that there was a failure to report a deemed dividend or benefit; or
- There was a shareholder benefit to Sr; or
- The transactions created a "tax shelter"; or
- The carrying charges are unreasonable; or
- GAAR applies to deny the tax benefit.

ANALYSIS

The Court did not hold the transactions to be a sham, but did find that they are subject to GAAR. However, there was no need to rely on GAAR as the ITA adequately covered these transactions.

There was a shareholder benefit to Sr. under 15(1). The shareholder received immediate access to $6M tax-free with an obligation to only pay $40K guarantee fee and $80K in interest per year for 15 years. The corporation took on the obligation to repay the loan to the shareholder by assigning the annuity and insurance proceeds it purchased. The facts in this case did not make the corporation's actions a contingent assignment or a collateral guarantee (*Alberta (Treasury Branches) v MNR*; *Toronto Dominion Bank v MNR*, [1996] 1 SCR 963).

The Court, in reaching this conclusion took a bird's eye view (para 94), and was not distracted by the specific wording in particular provisions of the various agreements. The court recognised that it could not ignore legal realities (*Shell Canada Ltd v The Queen*, [1999] 3 SCR 622), but stated that the documents make it clear that the loan would not have to be repaid - in determining whether there was a benefit to the shareholder, the court felt it was not to get hung up on distinctions between conditional or absolute assignment where the wording of the contracts does not contradict the bird's eye view conclusion (para 96). The court stated (para 98):

> I grant the documents may be interpreted as not constituting an absolute assignment,

> but they can as readily be interpreted to do exactly what the parties intended, and that is to relieve Paul Sr. of his burden of repayment and have Holdco repay the loan with insurance proceeds – pure and simple. So while the documents may be written to avoid the interpretation of an absolute assignment, they're equally written to ensure Paul Sr. does not have to repay the loan and therefore has an immediate benefit from the receipt of $6,000,000 used to acquire the Ontario Inc. shares. [emphasis added]

The court looked at the economic reality of a rational person entering into the overall series of transactions and was not distracted by the possibility of the taxpayer acting irrationally and against his self-interest in determining whether or not there was a benefit and what the value of the benefit to the shareholder was.

If this conclusion was wrong, the Court stated that the transactions would be a Sham - representing the transactions as something they are not. (for the law on sham see HERE at pp 26-28). The documents misrepresented what was in effect an absolute assignment as one that was a contingent one. The court said that these transactions abound with "Smoke and Mirrors" (para 107). There were transactions that stretched legal reality to breaking (para 107). Where there is a sham, the court can disregard the presented transaction and determine tax consequences by the real transaction hidden by the sham (para 109). The taxpayer here, because of the knowledge of the overall transaction, knew the documents were not what they pretended to be (*Mariano v The Queen*, 2015 TCC 244).

Real transactions are legal ones, and not ones where what appears to be legal binding is undone by "nudging and winking". The sham here, making the legally contingent a real absolute, is the limitation of the recourse of the lender in case of default to the annuity and insurance proceeds due to the corporation.

The Court also comments on the applicability of GAAR, and finds that the underlying policy of s 84(1) was abused to obtain a tax benefit.

In conclusion, the court dismissed the appeal because the findings would result in an increase in tax liability beyond the CRA's reassessment (something the court cannot do), and stated:

> The *Act* is comprehensive: it has grown to be a mammoth tome attempting to cover every possible situation that taxpayers and their planners can concoct to minimize taxes – and concoct they do. Fearing plans were outwitting the legislation, the GAAR was introduced as an overriding general anti?avoidance provision. This was not to deny a taxpayer's right to arrange affairs to minimize taxes, but to ensure such was done within the spirit of the law, hopefully saving the need for several hundred more pages of legislation to cover off more and more complex plans. And the plans continued, in the Fisc's eyes skirting with legitimacy, and thus the non?legislative concept of sham got

life. In these reasons I am simply attempting to make a common sense interpretation of the legislation without resort to the more nebulous concepts of sham or spirit of the law that admittedly can tie us all in knots. Subsection 15(1) of the *Act* taxes a shareholder benefit. I find Paul Sr. clearly benefitted as a shareholder both with respect to the $6,000,000 loan and the capitalized interest. But I also find he is entitled to deduct the cash portion of the interest.

Sas Ansari, BSc BEd PC JD LLM PhD (exp) CPA In-Depth Tax 1, 2 &3

Back To Top OR Home

medianet_width = "160"; medianet_height = "90"; medianet_crid = "749795932"; medianet_versionId = "111299"; (function() { var isSSL = 'https:' == document.location.protocol; var mnSrc = (isSSL ? 'https:' : 'http:') + '//contextual.media.net/nmedianet.js?cid=8CUW8XQ2I' + (isSSL ? '&https=1' : ''); document.write(''); })();