Tax Planning for Property Sale - Sas Ansari

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Oxford Properties Group Inc v The Queen, 2016 TCC 204

At issue was whether the series of transactions were abusive tax avoidance caught by the General Anti-Avoidance Rule (GAAR) - *Income Tax Act* section 245.

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FACTS

The Taxpayer, through a series of transactions, packaged real-estate holdings into a number of limited partnerships on a tax-deferred basis (ITA s 97(2)). The properties retained their tax attributes and, by electing under paragraphs 88(1)(c) and (d) and subsection 98(3), pumped the adjusted cost base (ACB) of interests in the limited partnerships. This was done in preparation for sale to a tax-exempt entity.

The result was that the taxpayer avoided paying tax on capital gains and recapture that would have resulted had the properties been sold to the tax-exempt entities rather than the limited partnership interests.

Some of the re-organization was a term of the Support Agreement entered into as part of a takeover, and requires the Taxpayer to re-organize its business if requested, the request was reasonable, and the costs of the reorganization were paid for by the bidder. Other transactions occurred after.

ANALYSIS

The Court noted that GAAR is a broad provision intended to negate arrangments that would, but for it, be permitted under a literal interpretation of the Income Tax Act when it amounts to abusive tax avoidance - *Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54. It draws a fuzzy line between tax minimization and abusive tax avoidance. Ther are three questions to see if GAAR applies:

1. Was there a tax benefit from a transaction or event (or series)?
2. Was the transaction an avoidance transaction by not being arranged primarily for bona fide purposes other than to obtain a tax benefit? and
3. Was the avoidance transaction an abuse or misuse of the provision or the act?

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

In determining what constitutes a series of transactions and, therefore, what is potentially captured by GAAR, the court referred to the definition of "series of transactions" in subsection 248(1) of the ITA. A series is deemed to include any related transactions or events completed in contemplation of the series - whether prospective or retrospective. This requires a nexus between the series and the related transactions in the sense that the transactions were done "in relation to" or "because of" the series (this is a connection that is more than a "mere possibility") - *MIL (Investments*) *S.A. v. R*., 2006 TCC 460, at para. 62, aff'd 2007 FCA 236.

When determining whether a transaction is an abuse of the ITA, the court must make a two-step inquiry:

1. It must first identify the "Object, spirit, or purpose of the provisions of the ITA that are relied on to obtain the tax benefit (in light of the scheme of the act, relevant provisions, and permissible extrinsic aids); and
2. It must then examine the facts of the case to determine whether the avoidance transaction defeated or frustrated that object, spirit, or purpose.

Crown's Argument

The Minister relied on one main argument. The use of the roll-over in 97(2) is meant to defer tax not avoid it, and the use of the roll-over and bump allowed the taxpayer to bump depreciable properties indirectly where it could not do so directly (paras 81-86).

Taxpayer's Argument

The taxpayer argued that subsection s97(2), 69(11) and 100(1) show that parliament made a series of careful, deliberate policy choices respecting the transfer of properties to partnerships that would allow the tax benefits obtained by the taxpayer. Applying GAAR would frustrate Parliament's deliberate policy choice.

Court's Reasoning

The Court noted that the greater context in which abuse or misuse is to be found includes provisions that are grouped together or work together to give a coherent and plausible plan. Not all sections of the ITA are relevant.

Subsection 97(2) applies where certain property is disposed to a Canadian partnership of which the taxpayer is a member, and all members of the partnership elect to have the provision apply to the transfer. A Canadian partnership is one where all members are residents of Canada (s 102(1)). Where the conditions are met, paragraphs 85(1)(a) to (f) apply to the transfer. This allows the transferor to avoid immediate disposition at FMV resulting in recapture and taxation of any unrealized gains. The potential gain and recapture are preserved by the roll-over rules, and the transferor ends up with non-depreciable capital property (partnership interests) that has an accrued unrealized gain. The partnership is also left with property that has unrealized

accrued gains and potential recapture.

Where a partnership interest is subsequently purchased by an exempt entity, subsection 69(11) must be considered. That subsection is an anti-avoidance provision that applies to property rolled into a partnership using 97(2) followed by a subsequent sale of the partnership interest within 3 years of the roll-over. 69(11) applies where either it is reasonable to conclude that the rollover was part of a series, one of the purposes of which was to obtain the benefit of tax deductions or attributes of a non-related person on a subsequent disposition or the purpose is to obtain the benefit of the tax-exempt status of a person. Where applicable, the benefit of the roll-over is lost and the transfer of property is deemed to occur at FMV. Here the Minister did not apply GAAR because of the three-year rule and apply GAAR instead.

The Court concluded that the purpose of subsection 97(2) is to avoid or reduce the tax otherwise payable on a transfer of property to a partnership in return for a partnership interest. The gain to the transferor is deferred until a subsequent sale of the partnership interest, but that gain can be reduced or eliminated by a bump under 88(1)(c) and (d) and 98(3). The Bump only applies to non-depreciable property where certain conditions are met on an amalgamation. The bump doesn't apply to certain properties obtained in particular transactions (eg. property acquired in the course of a butterfly transaction, etc) - none of which apply here.

The purpose of subsections 88(1)(c) and (d) bump rules is to help alleviate potential double tax, by providing the parent with the opportunity, on vertical amalgamation, to push down the cost base of its shares in the subsidiary to qualifying non-depreciable property owned by the subsidiary when the parent last acquired control of the subsidiary (paras 144-45). Another purpose is to preserve the tax attributes of the transferred property.

In 2012, subparagraph 88(1)(d)(ii.1) was added to limit the amount of the bump. The upper limit of the bump decreased to a portion of the amount by which the FMC of the partnership interest at the time exceeds the cost amount attributable to: (i) the difference between FMV and the cost amount of depreciable property held by the partnership, (ii) FMV of resource property held by the partnership, and (iii) difference between FMV and the cost amount of non-depreciable property held by the partnership. Along with this amendment, new anti-avoidance rules were added in 88(1)(e) and 97(3) to make sure that the new provision is effective.

The court held that the new provision is relevant in determining whether the transactions are abusive.

Generally, on the dissolution of a partnership, the property is distributed to the partners at FMV by operation of subsection 98(2). Subsection 98(3) provides for a rollover for Canadian partnerships, the purpose of which is to avoid all or part of the tax that would otherwise be payable on the dissolution of the partnership where the conditions are satisfied. Paragraph 98(3)(c) allows for a bump of distributed capital property that is not depreciable property. The purpose of the bump is to preserve the partners' cost basis in the distributed property that would otherwise disappear.

Subsection 100(1) operated to deem a taxpayer's capital gain from the disposition of interest in

partnerships to tax-exempt persons under section 149 to be 50% of the gain reasonably attributed to increase in value of non-depreciable property and 100% of the gain reasonably attributed to the gain in value to depreciable capital property, inventory, or other property that is not depreciable capital property.

With the above in mind, the Court stated that abusive tax avoidance will be made out where the transaction:

1. achieves an outcome the provision was intended to prevent;
2. defeats the underlying rationale for the provision; or
3. circumvents the provision in a manner that frustrates or defeats it object, spirit or purpose.

These considerations may overlap and only where the Minister clearly demonstrates that the transaction is an abuse of the Act will the Court GAAR the transaction. Any doubt will go to the taxpayer. GAAR will not apply where the transactions are carried out in a manner consistent with the object, spirit or purpose of the provisions of the ITA interpreted in a textual, contextual, and purposive manner. The Court must consider the transactions of a series individually and as a whole.

The Court went through each transaction individually first and:

- did not find an abuse of subsection 97(2) since ts purpose was to defer accrued gains while maintaining the tax attributes of the properties transferred - the actual taxation depends on the tax attributes at the time of sale and the purpose of this provision is not to tax the subsequent sale of a partnership interest on the basis of the attributes of the property held by the partnership - Parliament was concerned with roll-overs and subsequent sales and specifically introduced subsection 69(11) with a three-year limit - a roll-over using 97(2) not captured by 69(11) because of the three-year limit is not going to be subject to GAAR;
- Did not find an abuse of the bump rules because to do so would require the court to find a policy statement that indirect bumping of depreciable property is not acceptable without grounding the policy in a specific provision of the ITA; and
- Did not find an abuse of subsection 100(1) as that provision was seen as clearly re-characterizing a gain otherwise calculated under the Act and not, as the Crown was suggesting, on the accrued gains of property held in the partnership.

The court replied in part on the existence of specific provisions (69(11) and 100(2)) that dealt with sales of partnership interest sold to tax-exempt entities. The court appears to have assumed that since none of the express anti-avoidance provisions applied, the transaction was not abusive and Parliament must have intended the outcome or at least not been opposed to it. The amendment introducing subparagraph 88(1)(d)(ii.1) was seen by the Court as signaling a change in policy by Parliament and supporting the lack of abuse. The Court did not see this as an amendment that clarified an existing objective (para 211).

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