Triad Gestco Ltd v The Queen, 2012 FCA 258

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"Value Shifting" in Capital Gains Caught by GAAR

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At issue was whether the deduction of capital loss arising from the implementation of a planning technique known as "value shift" results in a misuse or abuse of the provisions relied on within the meaning of s 245(4).

The FCA held that although there was no underlying policy discernible to disallow capital losses within "an economic unit", the Capital gains and loss system deals with real capital gains and losses (increases and decreases in economic power), and therefore paper losses that are used part of the "value shift" strategy" are a misuse and abuse of the provisions relied on within the meaning of subsection 245(4).

[**NOTE**: further analysis will be posted in near future]

FACTS

This is an appeal by Triad from the decision of the TCC dismissing its appeal from the reassessment for its 2001-02 tax years by the MNR which relied on s 245 (GAAR).

The Court stated that the lower court decisions contain all the facts, and only repeated the following:

In 2001 Triad realized a CG in the amount of $7,799,545 on the disposition of an arm's length sale of a commercial building at the selling price of $32,650,000. Subsequently, the following transactions were entered into:

- the incorporation on July 25, 2002 of Rcongold Systems Inc. (Rcongold) whose sole director was Peter Cohen;
- the settlement on August 20, 2002 of the Peter Cohen Trust for the benefit of Peter Cohen by a person not related to him;
- the subscription by the appellant on August 27, 2002 for 8,000 common shares of Rcongold for a consideration of $8,000,000;
- the declaration of a stock dividend by Rcongold on August 28, 2002 of $1 payable to the appellant as the shareholder holding all common shares issued or outstanding by the

issuance of 80,000 preferred shares with a redemption price of $100 each; and
- the sale by the appellant to the Peter Cohen Trust on August 29, 2002 of the 8,000 common shares which it held in Rcongold for the amount of $65 thereby resulting in a capital loss of $7,999,935.

In its 2002 tax year Triad claimed an allowable capital loss of $3,932,998 which resulted in a capital loss of $143,063, which was applied to reduce the tax liability for the 2001 tax year.

The MNR reassessed in 2006, which denied the loss on the basis that there was no economic loss, and thus warranted the GARR being applied to deny the tax benefit claimed by the appellant, and the loss carry-back.

TCC Below

The TCC reviewed the history of the legislation, beginning with the introduction of CG in 1972, and considered specific anti-avoidance provisions relating to capital losses (55(1) and (40(2)(g)), and 54). The TCC said that the repeal of former subsection 55(1) in 1988 upon the introduction of GARR didn't signal a policy shift, but "confirmed the continued intention of Parliament" that capital losses not be deducted where the loss is created artificially - relying on the Technical Notes in conjunction with the introduction of GAAR - because GAAR's scope is broad enough to cover the transactions to which subsection 55(1) was intended to apply. The TCC held that there was a policy to prevent the deduction of artificial capital losses within the same economic unit. The amended section 251.1 brought trusts into the definition of "affiliated persons", which indicate that the result achieved by the appellant was contrary to the object, spirit, and purpose of the Act.

ARGUMENTS

The Appellant argued:

- the provisions of the ITA work merely mechanically, and in applying ss 3, 38, 39, and 40, there is no doubt that the loss is deductible. There is no requirement in the ITA that the loss be "real" or "economic", cannot be inferred from the context especially in light of the ITA producing results that could be called "artificial" but are given effect to (eg. flow-through share rules in 66.3).
- the TCC didn't follow interpretive approach under s 245, as established in *Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54 (*Canada Trustco*) and *Lipson v. Canada*, 2009 SCC 1, requiring that any overarching policy must be rooted in specific provisions of the ITA. Specifically, its not possible to ground policy against "artificial capital loss' in former subsection 55(1) as it was repealed.
- the Technical notes relied on are 10 years old and that provision has been amended

numerous time, diminishing their value
- There is no general policy against deduction of capital losses on dispositions within the "economic unit", and neither of the stop-loss rules in ss 40(2)(g)(i) or 40(4.3) refer to the concept, but only refer to "affiliated person" and only suspend not deny the loss
- that the TCC's reliance on the amendment in 2005 of s 251.1, but says that the inclusion of Trusts in 2005 shows that they were not included before, as it would have been a retroactive amendment if they were always meant to be included

The Crown Argued that:

- the computation of CG of CL is purely mechanical
- relies on former 55(1) and case law interpreting it to disallow losses created artificially or unduly.
- that the 1988 technical notes to say that repeal of 55(1) was simply a reflection that it was no longer necessary with 245, and didn't signal a legislative intent against artificial capital losses
- replies on SCC decisions in *Mathew v. Canada*, 2005 SCC 55, which confirmed the abusive nature of a transaction by reference to its artificial nature and *Copthorne Holdings Ltd. v. Canada*, 2011 SCC 63 (*Copthorne Holdings*)

ANALYSIS

The FCA began by reviewing the history of CG. Before 1972, CGs were not taxable and CL's were not deductible. The determination of CG or CL is through the interaction of numerous specific provisions in Part I ITA, many of which consist of mathematical formulas. A CG generally occurs where the property is sold for "proceeds of disposition" in excess of the ACB (ss 39(1)(b) and 40(1)(b)) - as defined in s 54. There are a number of specific provisions in the ITA that preclude taxpayer's claiming tax relief for CLs, including the "stop loss rules" that deem a loss to be Nil, paired with relieving provisions (eg. 40(3.4)).

The FCA said that the amended definition of "affiliated person" is of significance, as it included trusts. If the amendment was applicable when the transaction occurred it would have suspended the loss claimed. " It is useful to point out that the definition of “affiliated persons” to this date does not operate to suspend losses resulting from transactions between parent and child or between siblings. It follows that subject to the application of the GAAR, the loss resulting from a value shift could still be claimed if triggered by a sale between such persons" (para 36)

<u>GAAR analysis</u>

The Appellant admits that there claimed loss resulted in a "tax benefit" and didn't challenge the

TCC finding that the transactions (payment of stock dividend, creation of trust, sale of common shares to trust) were "avoidance transaction's".

The only issue is whether the transactions, if given effect to, would defeat the underlying rationale of the provisions relied on to obtain the tax benefit (ss 3(b)(ii), 38(b), 39(1)(b), 40(1)(b)(ii) and 54) - the burden of which is with the Crown. There is also no issue that the loss is only a paper loss - ie no real economic loss - all that happened is that the high inherent value of the common shares was left with a nominal value and a high cost allowing a loss to be realized on a sale to the trust.

The FCA said that the result sought by the Appellant is counter intuitive as the CG and CL are meant to apply to real gains or losses, as stated by the HL in *WT Ramsay Ltd. v. Inland Revenue Commissioners*, [1981] 1 All ER 865:

> The capital gains tax was created to operate in the real world, not that of make-believe. As I said in Aberdeen Construction Ltd. v. Inland Revenue Comrs, [1978] 1 All ER 962 at 996, [1978] AC 885 at 893, [1978] STC 127 at 131, it is a tax on gains (or, I might have added, gains less losses), it is not a tax on arithmetical differences.

The CG in Canada has been understood to be taxing increases in "economic power" - *Carter Commission Report, 1966*, p. 325 - which is unaffected by paper losses.

The FCA dealt with the argument that the ITA deals with artificial matters, such as deemed sales on change of use with resultant of CG and CL's that are given effect to, by saying that these (and others referred to) are policy orientated and their treatment is dictated solely by the policy objectives they seek to achieve. They do not detract from the underlying policy preventing the deduction of paper losses, if such a policy exists.

The Court referred to the Paris J's decision and stated:

> [50] … I agree with his conclusion that these provisions, in particular paragraph 38(b), provide relief as an offset against capital gain where a taxpayer has suffered an economic loss on the disposition of property. I also agree with his further conclusion that offsetting a capital gain with the paper loss that was claimed results in an abuse and a misuse of the relevant provisions, specifically paragraphs 38(b), 39(1)(b) and 40(1)(b) …
>
> [51] … Given their purpose – i.e. to tax the net realized increase in the value of capital assets – it is not possible, in my view, to read the relevant provisions otherwise.

The FCA then dealt with the former subsection 55(1) and whether it could be relied on to establish an overarching policy aimed at defeating "artificial transactions". The FCA notes that the repeal of this provision was accompanied by Technical Notes that indicated that the hole was filled by GAAR, but the FCA said that there is no need to reply on this subsection to identify a policy to prevent the deduction of paper loss.

The FCA dealt with the alternative conclusions in the TCC decisions below (companion cases). The FCA said that subparagraph 40(2)(g)(i) doesn't reveal a policy against the deduction of capital losses on dispositions "within an economic unit" (para 56), and stated:

> When Parliament introduced the notion of “affiliated persons” back in 1995, it had to be aware that trusts could be used to counter the operation of subparagraph 40(2)(g)(i) and subsection 40(3.4). It is therefore reasonable to infer that a deliberate choice was made not to bring trusts within the definition. The fact that Parliament decided to alter this policy by including trusts on a prospective basis in 2005 cannot be relied on to infer that a policy to that effect was in place before the amendment (compare Water’s Edge Water’s Edge Village Estates (Phase II) Ltd. v. Canada, 2002 FCA 291, [2003] 2 F.C. 25, para. 47, where in contrast an amendment was held to be relevant because it had been enacted in order to close a blatant loophole).

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