

Canadian Insurance Accountants Association

Legal Update

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“A TALE OF THREE CASES”

Focus on three 2009 tax related decisions of the Supreme Court of Canada:

- *Lipson v. R*, 2009 DTC 5015
- *United Parcel Service Canada Ltd. v. R*, 2009 SCC 20
- *Caisse Populaire Desjardins de L'Est de Drummond v. Canada*, 2009 SCC 29

What is going on?

- Hotchpot of Tax Court and Federal Court of Appeal cases
 - Lehigh Cement*
 - Landrus*
 - Copthorne, Collins & Aikman Products*
 - Prevost*
 - Cascades*
 - OGT Holdings*
 - Tesainer*
 - Garron Family Trust*
- Changed composition of the Supreme Court of Canada

“It was the best of times,
it was the worst of times...”

Lipson v. R, 2009 SCC 1

What is GAAR—A Primer

- GAAR is broadly-worded anti-avoidance rule
- Where GAAR applies, tax consequences of an avoidance transaction may be altered
- Application of GAAR depends on three-part analysis—(i) is there a **tax benefit** that results from transaction or series, (ii) is transaction an **avoidance transaction**, ie., is the primary purpose of transaction to obtain tax benefit, and (iii) is there a **misuse or abuse** of ITA

What is GAAR—A Primer

- Key issue taxpayers and Courts struggle with is proper meaning of misuse or abuse requirement
- If you have **tax benefit**, and you have **avoidance transaction**, you still need a **misuse or abuse** of the ITA
- Think of an RRSP contribution—tax benefit (yes), avoidance transactions (yes) and misuse or abuse (no)

GAAR Today—What Courts Have Said

- In *OSFC Holdings*, FCA held that misuse or abuse requirement met if avoidance transaction contravenes a clear and unambiguous object, purpose or policy of provisions of ITA
- In *Canada Trustco, Kaulius (OSFC by another name) and Lipson*, SCC endorsed different approach—misuse or abuse requirement is an abusive tax avoidance test

SCC in *Canada Trustco/Kaulius*

- SCC set out guidelines to assist in identifying abusive tax avoidance
- Object, spirit or purpose of provisions determined by reference to the scheme of the ITA, the relevant provisions and permissible extrinsic aids
- Onus of establishing existence of abusive tax avoidance is on Crown and must be clear—if doubt, taxpayer wins

SCC in *Canada Trustco/Kaulius*

- GAAR a provision of last resort intended to address abusive tax avoidance, not to introduce uncertainty in tax planning
- Abusive tax avoidance—when a taxpayer relies on specific provisions of the Act in order to seek an outcome that those provisions seek to prevent, when a transaction defeats the underlying rationale of the provisions that are relied upon or circumvents the application of certain provisions, such as specific anti-avoidance rules, in a manner that frustrates or defeats the object, spirit or purpose of those provisions (*Canada Trustco*, par. 45)

Lipson v. R.

- Interest deductibility against background of aggressive tax planning
- Taxpayer and spouse entered into agreement of purchase and sale for new house
- Spouse borrowed money from bank to buy some of taxpayer's shares in a private company
- Taxpayer and spouse obtained a mortgage from bank on the closing date for the purchase of the new house and mortgage proceeds were used to repay share purchase loan.

Lipson v. R

- Under attribution rules, income (and loss) in respect of spouse's shares attributed to taxpayer (no election was made under 73(1))
- Thus, taxpayer claimed loss for interest expense on bank mortgage (net dividends on shares) based on the application of 74.1(1), 20(1)(c) and 20(3)
- TCC (confirmed by FCA) held that “overall” purpose of borrowing was personal use, to buy a house, not an income-earning purpose as required by 20(1)(c)
- This reasoning put in issue the “positive” Canadian jurisprudence (and CRA policy) on interest deductibility (at the heart of much tax planning)
- SCC held (in a 4-2-1 decision) that interest deduction was not subject to GAAR (and that spouse would be entitled to interest deduction) but improper use of attribution rules was subject to GAAR—*attribution of a loss was not what Parliament had in mind*

Lipson – “Singleton with a Spousal Twist”

- SCC held 20(1)(c) income-earning purpose test met—the relevant purpose in 20(1)(c) is the taxpayer’s purpose in using the money, not the *true economic or overall purpose* of the borrowing
- In *Ludco*, another interest case, SCC established interpretive approach to 20(1)(c) that Court said was consistent with the language, context and purpose of the provision
- The SCC stated that its interpretive approach “accords with the language of purpose in the section” and “furthers the policy objective of the interest deductibility provision aimed at capital accumulation and investment”

Lipson v. R.

- SCC found that the purpose of 74.1(1) is to prevent spouses from reducing tax by taking advantage of their non-arm's length status when transferring property between themselves
- using 74.1(1) to reduce taxpayer's income would frustrate the purpose of 74.1(1)
- SCC found that a specific anti-avoidance rule (74.1(1)) was used to facilitate abusive tax avoidance
- Overall purpose not relevant but it is useful to consider the overall result and to inquire whether such result frustrates the object, spirit and purpose of the relevant provisions

Lipson v. R.

- Dissenting opinion by Rothstein J held that GAAR did not apply because a specific anti-avoidance rule, 74.5(11) applied to the transaction and the Minister should have invoked that provision
- this approach rejected by the other judges
 - parties had agreed that 74.5(11) did not apply
 - courts should not refuse to apply GAAR on the grounds that a more specific anti-avoidance provision might also be applicable

What the SCC's decision tells us?

- Seminal decisions of SCC in *Canada Trustco* and *Kaulius* in 2005 and *Lipson* in 2009 confirm that GAAR is “real”
- textual, contextual and purposive test is here to stay (for now)
- CRA has taken an assertive attitude in applying GAAR—reflected in GAAR assessments and rulings

CRA GAAR Audit Focus

- Tax sparing/foreign tax credits
- Charitable leveraged donations
- Tax treaty avoidance
- Playing with tax attributes/value shifts/artificial capital losses
- Loss transfers
- RRSP strips
- Provincial tax arrangements (e.g., Quebec shuffles)
- Transactions based on different characterization in Canada and foreign jurisdiction

*United Parcel Service Canada Ltd. v. R,
2009 SCC 20*

United Parcel Services

- UPS imported goods for customers, and paid the GST owing at the border on behalf of consignees
- On occasion it overpaid the tax in error
- At issue - \$2.9 million in overpayments
- UPS credited overpaid amount back to customers, then netted overpayment against own tax owing – effectively getting a GST rebate

United Parcel Services – Courts Below

- Specific statutory provision for refund of overpayments
- UPS not liable to pay but nevertheless paid - could it get rebate?
- TCC (Bowman) held UPS could deduct the overpaid amount from GST owing
- FCA held only the person liable for the GST can obtain refund (*West Windsor Urgent Care Centre v. Canada*, 2008 FCA 11)

United Parcel Service

- Held in favour of taxpayer (9-0)
- Section at issue did not require inquiry into liability to pay
- “ Section 261(1) is worded broadly. There is no limitation of the kind argued for by the Minister in the language of the provision. Nothing in the context of s. 261(1) supports such a limitation, nor has the Minister pointed to any other provision of the *Excise Tax Act* or *Customs Act*, R.S.C. 1985, c. 1 (2nd Supp.), to support such a limitation. It would not be in accordance with the ordinary and grammatical meaning of the provision to read s. 261(1) in such a way as to preclude persons who have paid or overpaid GST in error from obtaining a rebate from the Minister.”

United Parcel Service

- SCC dismissed Minister's concern re risk of double recovery:
“With respect I do not think it lies in the mouth of the Minister to raise such an argument on the facts of this case where he has agreed there is an overpayment and where his position is that he is entitled to retain overpaid GST.”
- Comparatively speaking, pragmatic approach to plain meaning?
- Speculation as to legislative intent

*Caisse Populaire Desjardins de L'Est de
Drummond v. Canada, 2009 SCC 29*

Caisse Populaire Desjardins de L'Est de Drummond v. Canada

- “Super-priority” deals with rights of the CRA to collect vs. rights of secured creditors of the tax debtor
- Section 227(4.1) creates a deemed trust in favour of the Crown over property of employer that has withheld (but not remitted) source deductions
- Deemed trust also applies to property held by any secured creditor of the employer that, but for its security interest, would be property of the employer

Caisse Populaire Desjardins de L'Est de Drummond v. Canada

- Caisse granted Camvrac a line of credit up to \$277k which was drawn down
- Camvrac deposited \$200k in a “term savings agreement” and agreed to keep it there while LOC drawn down
- Camvrac granted Caisse right of “compensation” or “set off” between the credit agreement and the deposit
- Camvrac makes assignment into bankruptcy with unremitted source deductions
- CRA claims term deposit on basis that Caisse has “security interest”

Caisse Populaire Desjardins de L'Est de Drummond v. Canada

Definition in the ITA and EIA:

“*security interest*” means any interest in property that secures payment or performance of an obligation and includes an interest created by or arising out of a debenture, mortgage, hypothec, lien, pledge, charge, deemed or actual trust, assignment or encumbrance of any kind whatever, however or whenever arising, created, deemed to arise or otherwise provided for.”

Differs from provincial definitions, and across provinces

Caisse Populaire Desjardins de L'Est de Drummond v. Canada

SCC held (5-2) in favour of the Minister:

- expansive definition deliberately chosen for maximum recovery
- legislation does not require that the agreement take any particular form
- agreement to maintain deposit amounted to an encumbrance and together with set off right amounts to a security interest
- majority and minority disagreed as to whether a “negative pledge” could create a property interest

Caisse Populaire Desjardins de L'Est de Drummond v. Canada

- SCC finding plain meaning even in classic black letter law case
- both majority and minority consider legislative context and purpose of the provision

Mr. Cruncher's opinions?

Thank you!