

2022 Issue No. 38  
16 August 2022

## Tax Alert – Canada

### Finance releases general anti-avoidance rule consultation and paper

EY Tax Alerts cover significant tax news, developments and changes in legislation that affect Canadian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor or EY Law advisor.

On 9 August 2022, following through on its commitment first announced in the 2020 fall economic statement and reiterated in the 2021 and 2022 federal budgets, the Department of Finance (Finance) commenced its general anti-avoidance rule (GAAR) public consultation focused on modernizing the GAAR in the *Income Tax Act* (the Act). Finance is seeking views and accepting written representations from Canadians on its released paper, [Modernizing and Strengthening the General Anti-Avoidance Rule](#), which addresses different proposed approaches to further prevent aggressive tax planning.

Stakeholders and members of the public have until 30 September 2022 to provide feedback, which will be considered alongside the analysis of Finance officials in making informed policy decisions having regard to their overall objective of improving fairness and integrity in the tax system as initially stated in their 2020 fall economic statement.

Suggested options to address the issues raised include the imposition of a penalty based on a percentage of the tax benefit denied, amendments to both subsections 245(3) and (4) of the Act to provide for an extended definition of the concept of “avoidance transaction”, and clarification in determining whether there has been abusive tax avoidance, including whether a shift in the burden of proof is required.

## Background

In 1988, the GAAR was introduced and has been proven to be a reasonably effective tool for preventing and challenging abusive tax avoidance transactions. Generally, by applying the GAAR in section 245 of the Act, the Minister of National Revenue (the minister) can deny a tax benefit that resulted from an avoidance transaction (which also includes a transaction undertaken as part of a series of transactions) if it may reasonably be considered to have resulted directly or indirectly in misuse of the provisions of the Act or in an abuse having regard to those provisions read as a whole. However, under subsection 245(3) of the Act, a transaction will not be considered an avoidance transaction if it is reasonably considered to have been undertaken or arranged primarily for *bona fide* purposes other than to obtain the tax benefit. As with any tax dispute, the taxpayer typically bears the burden of refuting the factual assumptions that support the assessment, but for the purpose of establishing abusive tax avoidance, the current judicial approach has imposed the burden of establishing misuse or abuse on the minister. In 2005, the Supreme Court of Canada (SCC) decided its first GAAR case in *Canada Trustco*,<sup>1</sup> which established the analytical framework that has subsequently been followed. Since then, the SCC has decided five GAAR cases and on two of those occasions has concluded that the GAAR did not apply.<sup>2</sup>

Throughout the years since the GAAR was introduced, there has been a growing body of case law, and Finance has acknowledged that the GAAR has been successfully applied in a significant proportion of the cases.<sup>3</sup> Notwithstanding, Finance has identified several specific issues with the current GAAR framework in its consultation paper and has set out possible approaches for addressing such issues. In particular, the consultation paper acknowledges at the outset that one of the original objectives of the GAAR, being a reduction in the need for complex specific anti-avoidance measures, has not been achieved. Notable amongst the possible approaches in updating the GAAR are imposing a penalty, bolstering the concept of *avoidance transaction* and shifting the onus of proof onto the taxpayer in determining whether there has been abusive tax avoidance.

---

<sup>1</sup> *Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54 (*Canada Trustco*).

<sup>2</sup> *Canada Trustco*, supra note 1 and *Canada v. Alta Energy Luxembourg S.A.R.L.*, 2021 SCC 49 (*Alta Energy*). As noted by Finance, in *Fundy Settlement v. Canada*, 2012 SCC 14, the comments on the GAAR being inapplicable were made in *obiter* and the Crown was found to be successful on the technical issue of residency.

<sup>3</sup> Annex A of the consultation paper contains a table of all court cases since *Canada Trustco* where the GAAR was held not to apply. From a total of only 24 cases, the GAAR was said not to apply based on the absence of *tax benefit* in six cases, whereas the GAAR was found to be inapplicable on the basis of lack of avoidance transaction in seven cases and absence of abuse or misuse in 11 cases.

The consultation and paper have been released in the context of Finance's efforts to improve the integrity of the Canadian income tax system,<sup>4</sup> but also (perhaps coincidentally) after the most recent GAAR decision rendered by the SCC in favour of the taxpayer.<sup>5</sup>

## Issues identified

Finance identified five issues in relation to which they posed 15 specific consultation questions, all of which are thoroughly described in the paper.<sup>6</sup> While Finance is also interested in hearing about other issues with the GAAR, optimal approaches to addressing the issues identified and effectively modernizing the GAAR are set out for the purposes of the consultation.

The issues identified are:

1. A tax benefit not being identified in every appropriate case;
2. The GAAR failing to prevent abusive tax avoidance in the context of mixed-purpose transactions;
3. The difficulty in ascertaining the object, spirit and purpose of a provision of the Act for the purpose of determining whether there has been abuse or misuse;
4. The GAAR not taking sufficiently into consideration the economic substance of the transactions; and
5. The GAAR not being a sufficient deterrent for abusive tax planning.

## Suggested approaches to addressing the issues identified

### Definition of tax benefit

While Finance is not suggesting any specific changes to address the first issue in regard to the "tax benefit" element of the GAAR, it has acknowledged its concern with the concept being interpreted too narrowly and is seeking comments on whether its definition requires an amendment to ensure it applies appropriately. It should be noted that Finance released draft legislative proposals on 9 August 2022 that will broaden the definition of "tax benefit" to ensure that the GAAR will apply to transactions that affect tax attributes that have not yet become relevant to the computation of tax.<sup>7</sup>

---

<sup>4</sup> Other efforts to improve the integrity of Canada's income tax system include joining a two-pillar plan for international reform as part of the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting and proposed amendments to the federal mandatory disclosure rules.

<sup>5</sup> *Alta Energy*, supra note 2.

<sup>6</sup> See Annex C of the consultation paper.

<sup>7</sup> See EY Tax Alert 2022 Issue No. 37, [Finance releases draft legislation for remaining 2022 budget measures](#), for additional information.

## **Changes to the definition of “avoidance transaction”**

To address the second issue identified in the paper, Finance has identified for consultation changes to the definition of “avoidance transaction” found in subsection 245(3) of the Act, including specifying what should not be considered as a bona fide purpose. Generally, a transaction that results in a tax benefit is not subject to the GAAR if it can reasonably be considered as having been undertaken primarily for bona fide purposes. Following a thorough review of the jurisprudence since 2005, Finance found that the minister has been unsuccessful in applying the GAAR in approximately 29% of the cases because the courts ruled that there had not been an avoidance transaction. As such, Finance is looking for the community’s view on whether the “primarily” threshold is appropriate and whether certain purposes, such as foreign tax avoidance, should in fact be considered as a bona fide non-tax purpose. One of the potential changes suggested in the paper is to provide explicit exclusions for what is to be considered a “bona fide purpose” within the definition of the concept of “avoidance transaction”.

Another suggestion made is to extend the definition of “transaction” in subsection 245(1) of the Act to explicitly include choices made by a taxpayer or transactions with a prominent tax planning element. For example, this could include the choice to effect a transaction a certain way even when such choices are made in the broader context of a commercial decision. Although Finance acknowledges that such approach must be balanced with the *Duke of Westminster’s* long-standing principle - that taxpayers have the right to choose to organize their affairs in such way as to minimize tax - the consultation paper stresses that it should only be safeguarded where those choices do not result in an abuse or misuse of the legislation. Such proposals would effectively shift more importance to the last prong of the GAAR test, i.e., abuse or misuse.

Similarly, lowering the threshold under the purpose test is also being considered. According to Finance, a lower threshold would help address a number of issues including the inherent difficulty in ranking or quantifying the various purposes underlying an impugned transaction. Changing the definition of “avoidance transaction” with the intent that it would apply where “one of the main purposes” or perhaps even where “one of the purposes” (as opposed to the “primary purpose”) for undertaking the transaction or series of transactions is to obtain a tax benefit is also being contemplated.

## **Amendments to subsection 245(4) of the Act**

In addressing the third issue, Finance is considering different solutions, notably to remedy perceived difficulties in ascertaining the existence of a general scheme in the Act read as a whole, as well as the question of who bears the onus of proving (or disproving) abusive tax avoidance. Because the heart of the analysis under subsection 245(4) of the Act lies in a unified textual, contextual and purposive approach to interpretation,<sup>8</sup> the jurisprudence

---

<sup>8</sup> *Mathew v. Canada*, 2005 SCC 55 (*Mathew*) at para. 41 and 42.

highlights the difficulties surrounding the weight to be given to extrinsic aids or inferences to be drawn from the text and context of the legislation. As such, Finance is considering several solutions to this important interpretative issue, including a shift in the evidentiary burden, which, as it stands, is borne by the Crown. In such a scenario, taxpayers would be required to positively demonstrate that the tax benefit is consistent with the object, spirit and purpose of the provision(s) allegedly abused, which, presumably, would eliminate the current judicial view that GAAR is not applicable unless the minister can clearly identify an abuse of the Act and the benefit of the doubt is given to the taxpayer. Additionally, Finance listed other possibilities such as the inclusion of preambles and purpose statements in the legislation itself or acknowledging that greater emphasis should be afforded to purpose statements found in extrinsic aids. Such proposals may be impractical and burdensome, especially for the legislator, but not impossible to implement according to Finance. A simple example is provided in relation to specific anti-avoidance rules that are often introduced in the Act and that could also provide useful purpose statements to help in identifying the object, spirit and purpose of similar provision and, more importantly, in ascertaining general schemes of the Act.

Also noteworthy, the paper raises the concern that the single, unified approach to the misuse or abuse analysis adopted in *Canada Trustco*,<sup>9</sup> *Mathew*<sup>10</sup> and more recently in *Alta Energy*<sup>11</sup> has unduly weakened the relevance of considerations to be given to general schemes of the Act in the GAAR analysis. As such, Finance is considering further amending subsection 245(4) of the Act in order for said general schemes of the Act to be given appropriate weight, notwithstanding whether or not a misuse of specific provisions is identified. Suggestions to remedy this issue include improving the interpretative process under subsection 245(4), but comments are being sought on the best ways to achieve the intended result.

### **Economic substance of transactions**

The fourth issue raised for consultation relates to Finance's concern that insufficient weight has been given to the economic substance of the impugned transactions. As stated in the paper, Finance indicates that as a result of the SCC decision in *Canada Trustco*, courts have been hesitant in applying an "economic substance" test for the purpose of determining whether an avoidance transaction results in a misuse or abuse of provisions of the Act. This specific concern with the application of the current GAAR follows the SCC's finding that transactions cannot effectively be found abusive solely because they were lacking economic substance. To Finance, the limited role of economic substance in the GAAR analysis is unsatisfying from a policy perspective. As such, Finance is requesting comments as to how to best address this issue, which, in its opinion, would be to simply add an explicit economic substance rule to the GAAR, either by incorporating it into subsection 245(3) or (4) of the Act or by introducing a separate deeming rule. Consequences for transactions lacking economic

---

<sup>9</sup> *Canada Trustco*, supra note 1.

<sup>10</sup> *Mathew*, supra note 8.

<sup>11</sup> *Alta Energy*, supra note 2.

substance have also been suggested, and any consequence would have to be determined in accordance with other contemplated changes to the GAAR, since several of the issues identified have interrelated proposed solutions.

### **Imposition of a penalty**

Finally, the last issue raised above relates to the effectiveness - or perceived lack thereof - of the GAAR in preventing abusive tax avoidance. Amongst other more broadly construed solutions, Finance has suggested introducing a penalty based on a percentage of the tax benefit where the GAAR is applied. The consultation paper sets out various options, such as automatic penalties or circumstantial penalties. While Finance acknowledges challenges with each type of penalty, for example in situations of unutilized tax attributes, a purely discretionary penalty is not under consideration. However, the provision of a mechanism that could provide taxpayers with a way to protect themselves from the application of a penalty - similar to the approach adopted in Quebec<sup>12</sup> - is being considered. A mechanism where taxpayers would proactively disclose sufficient information about their transactions to the Canada Revenue Agency is an option raised by Finance to achieve a balance between deterring abusive tax planning and imposing excessive penalties. In this respect, Finance points out that the recently proposed federal mandatory disclosure rules announced in the 2021 budget are closely related to this consultation. For more information on the proposed mandatory disclosure rules, refer to EY Tax Alert 2022 Issue No. 37, [Finance releases draft legislation for remaining 2022 budget measures](#).

### **What's next?**

For each of the issues described above, Finance is considering possible solutions for which they are seeking consultation. Canadians are invited to review the consultation paper in full and provide their views through written representations to [GAAR-RGAE@fin.gc.ca](mailto:GAAR-RGAE@fin.gc.ca). All stakeholders have until 30 September 2022 to provide feedback on Finance's proposed approaches to modernize and strengthen the current GAAR.

---

<sup>12</sup> For more information on the approach adopted by Quebec, refer to EY Tax Alert 2021 Issue No. 14, [Quebec releases list of transactions for mandatory disclosure](#).

## Learn more

For more information with respect to this consultation paper and Finance's intent to modernize and strengthen the GAAR, please contact your EY or EY Law advisor, or one of the following professionals noted below.

### **Montreal**

Marie-Claude Marcil

+1 514 879 8208 | [marie-claude.marcil@ca.ey.com](mailto:marie-claude.marcil@ca.ey.com)

### **Toronto**

Daniel Sandler

+1 416 723 0016 | [daniel.sandler@ca.ey.com](mailto:daniel.sandler@ca.ey.com)

### **Calgary**

David Robertson

+1 403 206 5474 | [david.d.robertson@ca.ey.com](mailto:david.d.robertson@ca.ey.com)

## **EY | Building a better working world**

EY exists to build a better working world, helping to create long-term value for clients, people and society and build trust in the capital markets.

Enabled by data and technology, diverse EY teams in over 150 countries provide trust through assurance and help clients grow, transform and operate.

Working across assurance, consulting, law, strategy, tax and transactions, EY teams ask better questions to find new answers for the complex issues facing our world today.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. Information about how EY collects and uses personal data and a description of the rights individuals have under data protection legislation is available via [ey.com/privacy](https://ey.com/privacy). For more information about our organization, please visit [ey.com](https://ey.com).

### **About EY's Tax Services**

EY's tax professionals across Canada provide you with deep technical knowledge, both global and local, combined with practical, commercial and industry experience. We offer a range of tax-saving services backed by in-depth industry knowledge. Our talented people, consistent methodologies and unwavering commitment to quality service help you build the strong compliance and reporting foundations and sustainable tax strategies that help your business achieve its potential. It's how we make a difference.

For more information, visit [ey.com/ca/tax](https://ey.com/ca/tax).

### **About EY Law LLP**

EY Law LLP is a national law firm affiliated with EY in Canada, specializing in tax law services, business immigration services and business law services.

For more information, visit [eylaw.ca](https://eylaw.ca).

### **About EY Law's Tax Law Services**

EY Law has one of the largest practices dedicated to tax planning and tax controversy in the country. EY Law has experience in all areas of tax, including corporate tax, human capital, international tax, transaction tax, sales tax, customs and excise.

For more information, visit <http://www.eylaw.ca/taxlaw>

© 2022 Ernst & Young LLP. All Rights Reserved.

A member firm of Ernst & Young Global Limited.

*This publication contains information in summary form, current as of the date of publication, and is intended for general guidance only. It should not be regarded as comprehensive or a substitute for professional advice. Before taking any particular course of action, contact EY or another professional advisor to discuss these matters in the context of your particular circumstances. We accept no responsibility for any loss or damage occasioned by your reliance on information contained in this publication.*

[ey.com/ca](https://ey.com/ca)