Federal Court of Appeal  Cour d'appel fédérale

Date: 20140530

Docket: A-475-12

Citation: 2014 FCA 143

CORAM: **DAWSON J.A.**
TRUDEL J.A.
NEAR J.A.

BETWEEN:

HER MAJESTY THE QUEEN

Appellant

and

SPRUCE CREDIT UNION

Respondent

Heard at Vancouver, British Columbia, on December 11, 2013.

Judgment delivered at Ottawa, Ontario, on May 30, 2014.

REASONS FOR JUDGMENT BY: TRUDEL J.A.

CONCURRED IN BY: DAWSON J.A.
NEAR J.A.

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REASONS FOR JUDGMENT

TRUDEL J.A.

Overview

[1] This is an appeal of a decision of a judge of the Tax Court of Canada (the Judge), in which he allowed Spruce Credit Union's (Spruce or the respondent) appeal of the Minister of National Revenue's (the Minister) reassessment with regard to its taxation year ending December 31, 2005 (2012 TCC 357; [2012] T.C.J. No. 285 [Reasons]).

[2] Spruce had sought to claim an inter-corporate dividend deduction pursuant to subsection 112(1) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (the ITA) with regard to a dividend (Dividend B) that it had received from a deposit insurance corporation during its 2005 taxation year. The Minister denied this deduction, finding that Dividend B needed to be included in Spruce's income by virtue of paragraph 137.1(10)(*a*) of the ITA, or that, in the alternative, the General Anti-Avoidance Rule (the GAAR) applied to prevent Spruce from claiming this deduction.

[3] In a decision dated October 15, 2012, the Judge allowed Spruce's appeal with costs, finding that Dividend B qualified for the inter-corporate dividend deduction under subsection 112(1) of the ITA. Her Majesty the Queen (the appellant) consequently brought this appeal before our Court.

[4] The outcome of this appeal is of interest to approximately forty other credit unions in British Columbia, with appeals or with outstanding objections of the same nature as the parties

before us. These credit unions have agreed to be bound by the final result of this case (Reasons at paragraph 1).

[5] Having carefully reviewed the record and the parties' written and oral submissions, I propose to dismiss the appeal. The Judge did not commit any errors warranting our Court's intervention. Spruce was not required to include Dividend B in its income pursuant to paragraph 137.1(10)(*a*) of the ITA and the GAAR does not apply. Therefore, Dividend B may be deducted from Spruce's income pursuant to subsection 112(1) of the ITA.

A. *Factual Background*

[6] In order to understand the dispute between the parties, it is first necessary to describe the circumstances that led to the distribution of Dividend B.

[7] Since 1989, the Credit Union Deposit Insurance Corporation (CUDIC) and the Stabilization Central Credit Union of British Columbia (STAB) have been responsible for insuring the deposits of credit union members in British Columbia. It is agreed that both CUDIC and STAB are "deposit insurance corporations" for the purposes of the ITA.

[8] CUDIC is a taxable Canadian corporation that is controlled and operated by the Financial Institutions Commission (the FI Commission), an agency of the government of British Columbia. CUDIC protects consumers against losses on their deposits and non-equity shares. British Columbia's *Financial Institutions Act*, R.S.B.C. 1996, c. 141 (the FI Act) requires CUDIC to maintain a deposit

insurance fund guaranteeing deposits and non-equity shares in the event of the default or failure of a credit union.

[9] STAB, also a taxable Canadian corporation, is a central credit union under British Columbia's *Credit Union Incorporation Act*, R.S.B.C. 1996, c. 82 (CUIA) and a stabilization authority designated under the FI Act. STAB is required to supervise credit unions as delegated by the FI Commission to ensure stability and avoid runs, failures or defaults. BC credit unions are required to be members of STAB and to hold 'Class A' shares as determined by STAB's board of directors.

[10] In 2005, 54 BC credit unions, including Spruce, were members and shareholders of STAB. The STAB shares were equity shares under subsection 85(2) of the CUIA and fully participating shares in respect of dividends and on the distribution of property on the winding up of STAB (Partial Agreed Statement of Facts, appeal book, volume 7, tab 8, pages 000980-000981). Individual credit unions' *pro rata* shares of STAB's annual assessment changed yearly as a result of relative performance and industry consolidation. Moreover, on occasion STAB would rebalance its members' shareholdings to reflect the current relative size of its members.

[11] Both CUDIC and STAB were funded primarily by assessments paid by BC credit unions. CUDIC levied its assessments based on the size of the deposit accounts maintained and the non-equity shares issued by each credit union, while STAB's assessments were levied based on the size of the assets of each credit union. From 1989 to the end of 2002, STAB had assessed BC credit unions for a total of approximately $82,900,000. Of that total, Spruce had paid $205,493.

[12] Under section 261 of the FI Act, CUDIC was uniquely responsible for administering and operating the statutory deposit insurance fund. However, from 1989 until 2005, CUDIC and STAB jointly levied and maintained this fund, with the FI Commission's knowledge and consent. CUDIC and STAB agreed in 1991 that each would hold one half of the fund, and in the years that followed they discussed and coordinated annual assessments. In some years, both CUDIC and STAB assessed the BC credit unions while in others, only CUDIC assessed and STAB did not.

[13] In April 1997 and again in June 2002, STAB and CUDIC signed Depositor Protection Agreements in which STAB pledged a portion of its deposit insurance fund to CUDIC in the event that CUDIC found itself with insufficient financial resources to meet its statutory obligations to repay guaranteed deposits with a credit union or non-equity shares of a credit union (appeal book, volume 2, tab 4, page 000087; tab 18, page 000140). More specifically, these agreements, along with their companion Deposit Protection Assessments and Rebates Agreements, provided that if CUDIC's level of equity falls below 0.30% of deposits with credit unions and non-equity shares of credit unions (aside from central credit unions), STAB would provide financial support in order to replenish CUDIC's portion of the fund to 0.30%, before CUDIC turned to the credit unions for assessments.

[14] In 2003, the FI Commission determined that CUDIC required exclusive control over 85 basis points (or 0.85%) of the deposit insurance fund in order to satisfy its statutory obligations. This percentage represented nearly double the amount of CUDIC's fund at that time. In order to meet this obligation, it was recognized that funds had to be transferred either directly or

indirectly out of STAB and into CUDIC to avoid an unnecessary financial burden on the credit unions.

[15] The FI Commission, CUDIC, STAB and a joint committee considered directly transferring funds from STAB to CUDIC. However, CUDIC did not control STAB and did not have any legal claim to its assets. In turn, CUDIC was not a shareholder or member of STAB, and STAB had no obligation to transfer its assets to CUDIC, aside from the pledge STAB made in the Depositor Protection Agreements. A direct transfer could have presumably been undertaken if an agreement had been reached by CUDIC, STAB and their respective members, or if the BC government had introduced legislation to this effect; however, neither of these events took place. In addition, a direct transfer between STAB and CUDIC, two deposit insurance corporations under the ITA, would have had significant tax consequences for CUDIC, as it would have bore the brunt of the taxation on the approximately $83 million transferred. Once taxes were taken out of that amount, CUDIC would most probably still find itself below the required 85 basis points, forcing it to assess Spruce and the other credit unions anew.

[16] They also considered, and ultimately elected, to transfer funds indirectly from STAB to CUDIC. While CUDIC did not have the statutory power to assess STAB, it had the ability to further assess the BC credit unions. STAB, in turn, had the power to make distributions to its member credit unions – by way of dividends or refunds of premiums.

[17] When it became clear that CUDIC would assess the credit unions for the amount sought, STAB started to consider how to reduce its deposit protection fund by the appropriate amount

and how best to advance those funds to the credit unions in order to assist them in paying the new CUDIC assessments.

[18] On September 8, 2005, CUDIC's board of directors passed a resolution to undertake a deposit insurance assessment against the credit unions in order to meet its new statutory obligations (appeal book, volume 4, tab 68, page 000463). Spruce was assessed for $198,859.34.

[19] On September 21, 2005, STAB's board of directors declared two dividends to its shareholders to allow them to satisfy CUDIC's assessment (appeal book, volume 4, tab 76, page 000482). A charge was made against STAB's retained earnings account, which was composed of its gross revenue earned over the years from its investments and from the assessments received from its members. Dividend A was paid from STAB's aggregate cumulative investment income while Dividend B was paid from STAB's aggregate cumulative assessment income. The aggregate amount of the dividends that STAB paid to its shareholders was $83,131,145. Spruce received $78,557 for Dividend A and $114,466 for Dividend B, for a total of $193,023.

[20] Spruce paid its assessment to CUDIC and claimed an equivalent deduction under subsection 137.1(11) of the ITA. As well, in computing its taxable income for the 2005 taxation year, Spruce included both dividends in its income under paragraph 12(1)(*j*) of the ITA and claimed a deduction pursuant to subsection 112(1) of the ITA.

[21] Subsection 112(1), known as the "inter-corporate dividend deduction" enables a corporation that has received a taxable dividend from a taxable Canadian corporation in a

taxation year, to deduct from its income an amount equal to that dividend in computing its taxable income for that taxation year. This provision states:

112. (1) Where a corporation in a taxation year has received a taxable dividend from	**112.** (1) Lorsqu'une société a reçu au cours d'une année d'imposition, un dividende imposable:
(*a*) a taxable Canadian corporation, or	*a*) soit d'une société canadienne imposable;
(*b*) a corporation resident in Canada (other than a non-resident-owned investment corporation or a corporation exempt from tax under this Part) and controlled by it,	*b*) soit d'une société résidant au Canada (autre qu'une société de placement appartenant à des non-résidents et une société exonérée d'impôt en vertu de la présente partie) et dont elle a le contrôle,
an amount equal to the dividend may be deducted from the income of the receiving corporation for the year for the purpose of computing its taxable income.	une somme égale au dividende peut être déduite du revenu pour l'année de la société qui le reçoit, dans le calcul de son revenu imposable.

B. *The Minister's Reassessment*

[22] On March 16 2009, the Minister reassessed Spruce, allowing the inter-corporate dividend deduction for Dividend A but not for Dividend B.

[23] The Minister found that subsection 137.1(10) of the ITA applied to Dividend B and thus precluded the deduction sought by Spruce under subsection 112(1) of the ITA. Paragraph 137.1(10)(*a*) of the ITA, read together with paragraph 137.1(4)(*c*) and subsection 137.1(2), provides that where a taxpayer is a member institution it is required to include in its income for a taxation year any amounts received in that year from a deposit insurance corporation as allocations in proportion to any premiums or assessments that the member institution had paid to

that deposit insurance corporation in the taxation year. Subsection 137.1(5) defines "member institution" as a credit union that qualifies for assistance from a deposit insurance corporation or a corporation whose liabilities in respect of deposits are insured by a deposit insurance corporation.

[24] The relevant provisions of the ITA read as follows:

Amounts paid by a deposit insurance corporation	Sommes versées par une compagnie d'assurance-dépôts
137.1(10) Where in a taxation year a taxpayer is a member institution, there shall be included in computing its income for the year the total of all amounts each of which is	137.1(10) Le contribuable qui est une institution membre au cours d'une année d'imposition doit inclure dans le calcul de son revenu pour cette année le total des montants suivants :
(*a*) an amount received by the taxpayer in the year from a deposit insurance corporation that is an amount described in any of paragraphs 137.1(4)(*a*) to 137.1(4)(*c*), to the extent that the taxpayer has not repaid the amount to the deposit insurance corporation in the year,	*a*) tout montant visé à l'un des alinéas (4)*a*) à *c*) et qu'il a reçu au cours de l'année d'une compagnie d'assurance-dépôts, dans la mesure où il n'a pas remboursé ce montant à la compagnie au cours de l'année;
Limitation on deduction	Restrictions
137.1(4) No deduction shall be made in computing the income for a taxation year of a taxpayer that is a deposit insurance corporation in respect of	137.1(4) Aucune déduction ne peut être faite, dans le calcul du revenu, pour une année d'imposition, d'un contribuable qui est une compagnie d'assurance-dépôts, à l'égard :
…	[…]
…	[…]
(*c*) any amounts paid to its member institutions as allocations in proportion to any amounts described	*c*) de tout montant versé à ses institutions membres à titre d'allocations proportionnelles aux

in subsection 137.1(2);	montants visés au paragraphe (2);
Amounts not included in income	Sommes exclues du revenu
137.1(2) The following amounts shall not be included in computing the income of a deposit insurance corporation for a taxation year:	137.1(2) Les sommes ci-après ne sont pas à inclure dans le calcul du revenu d'une compagnie d'assurance-dépôts pour une année d'imposition :
(*a*) any premium or assessment received, or receivable, by the corporation in the year from a member institution; and	*a*) toute prime ou cotisation reçue ou à recevoir par elle au cours de l'année de ses institutions membres ;
(*b*) any amount received by the corporation in the year from another deposit insurance corporation to the extent that that amount can reasonably be considered to have been paid out of amounts referred to in paragraph (*a*) received by that other deposit insurance corporation in any taxation year.	*b*) toute somme reçue par elle, au cours de l'année, d'une autre compagnie d'assurance-dépôts dans la mesure où il est raisonnable de considérer qu'elle a été payée sur des sommes visées à l'alinéa *a*) que l'autre compagnie a reçues au cours d'une année d'imposition.

[25] In the alternative, the Minister found that subsection 245(2) of the ITA, the GAAR, applied to preclude the deduction of Dividend B under subsection 112(1) of the ITA. Section 245 provides that where a transaction is an avoidance transaction – *i.e.* a transaction whose primary purpose was to obtain a tax benefit – the resulting tax benefit will be denied, unless the avoidance transaction would not result in an abuse or misuse of the ITA.

[26] The applicable legislative provisions state:

PART XVI TAX AVOIDANCE	PARTIE XVI ÉVITEMENT FISCAL
Definitions	Définitions
245. (1) In this section,	245. (1) Les définitions qui suivent

s'appliquent au présent article.

"tax benefit"	« attribut fiscal »
« *avantage fiscal* »	"*tax consequences*"
"tax benefit" means a reduction, avoidance or deferral of tax or other amount payable under this Act or an increase in a refund of tax or other amount under this Act, and includes a reduction, avoidance or deferral of tax or other amount that would be payable under this Act but for a tax treaty or an increase in a refund of tax or other amount under this Act as a result of a tax treaty;	« attribut fiscal » S'agissant des attributs fiscaux d'une personne, revenu, revenu imposable ou revenu imposable gagné au Canada de cette personne, impôt ou autre montant payable par cette personne, ou montant qui lui est remboursable, en application de la présente loi, ainsi que tout montant à prendre en compte pour calculer, en application de la présente loi, le revenu, le revenu imposable, le revenu imposable gagné au Canada de cette personne ou l'impôt ou l'autre montant payable par cette personne ou le montant qui lui est remboursable.
"tax consequences"	« avantage fiscal »
« *attribut fiscal* »	"*tax benefit*"
"tax consequences" to a person means the amount of income, taxable income, or taxable income earned in Canada of, tax or other amount payable by or refundable to the person under this Act, or any other amount that is relevant for the purposes of computing that amount;	« avantage fiscal » Réduction, évitement ou report d'impôt ou d'un autre montant exigible en application de la présente loi ou augmentation d'un remboursement d'impôt ou d'un autre montant visé par la présente loi. Y sont assimilés la réduction, l'évitement ou le report d'impôt ou d'un autre montant qui serait exigible en application de la présente loi en l'absence d'un traité fiscal ainsi que l'augmentation d'un remboursement d'impôt ou d'un autre montant visé par la présente loi qui découle d'un traité fiscal.
"transaction"	« opération »
« *opération* »	"transaction"

"transaction" includes an arrangement or event.	« opération » Sont assimilés à une opération une convention, un mécanisme ou un événement.
General anti-avoidance provision	Disposition générale anti-évitement
(2) Where a transaction is an avoidance transaction, the tax consequences to a person shall be determined as is reasonable in the circumstances in order to deny a tax benefit that, but for this section, would result, directly or indirectly, from that transaction or from a series of transactions that includes that transaction.	(2) En cas d'opération d'évitement, les attributs fiscaux d'une personne doivent être déterminés de façon raisonnable dans les circonstances de façon à supprimer un avantage fiscal qui, sans le présent article, découlerait, directement ou indirectement, de cette opération ou d'une série d'opérations dont cette opération fait partie.
Avoidance transaction	Opération d'évitement
(3) An avoidance transaction means any transaction	(3) L'opération d'évitement s'entend:
(*a*) that, but for this section, would result, directly or indirectly, in a tax benefit, unless the transaction may reasonably be considered to have been undertaken or arranged primarily for *bona fide* purposes other than to obtain the tax benefit; or	*a*) soit de l'opération dont, sans le présent article, découlerait, directement ou indirectement, un avantage fiscal, sauf s'il est raisonnable de considérer que l'opération est principalement effectuée pour des objets véritables — l'obtention de l'avantage fiscal n'étant pas considérée comme un objet véritable ;
(*b*) that is part of a series of transactions, which series, but for this section, would result, directly or indirectly, in a tax benefit, unless the transaction may reasonably be considered to have been undertaken or arranged primarily for *bona fide* purposes other than to obtain the tax benefit.	*b*) soit de l'opération qui fait partie d'une série d'opérations dont, sans le présent article, découlerait, directement ou indirectement, un avantage fiscal, sauf s'il est raisonnable de considérer que l'opération est principalement effectuée pour des objets véritables — l'obtention de l'avantage fiscal n'étant pas considérée comme un objet véritable.
Application of subsection (2)	Application du par. (2)

(4) Subsection (2) applies to a transaction only if it may reasonably be considered that the transaction	(4) Le paragraphe (2) ne s'applique qu'à l'opération dont il est raisonnable de considérer, selon le cas :
(*a*) would, if this Act were read without reference to this section, result directly or indirectly in a misuse of the provisions of any one or more of	*a*) qu'elle entraînerait, directement ou indirectement, s'il n'était pas tenu compte du présent article, un abus dans l'application des dispositions d'un ou de plusieurs des textes suivants :
(i) this Act,	(i) la présente loi,
…	[…]
or	
(*b*) would result directly or indirectly in an abuse having regard to those provisions, other than this section, read as a whole.	*b*) qu'elle entraînerait, directement ou indirectement, un abus dans l'application de ces dispositions compte non tenu du présent article lues dans leur ensemble.

[27] In reassessing Spruce, the Minister assumed that declaring and paying Dividend B was part of a series of transactions which led to the respondent receiving a tax benefit and that these transactions were not undertaken or arranged primarily for any *bona fide* purpose other than to avoid or reduce income tax. More specifically, she assumed that these "avoidance transactions" were intended to avoid the application of paragraph 137.1(10)(*a*) of the ITA and to obtain a second deduction for amounts deducted as deposit insurance premiums in years prior to 2005. Moreover, according to the Minister, these transactions could "reasonably be considered to have resulted directly or indirectly in a misuse of sections 112 and 137.1 of the [ITA]" or in an abuse of the ITA as a whole (appeal book, volume 1, tab 4, page 00061; confirmed as the series of transactions for the purposes of GAAR in the correspondence from counsel for the appellant, appeal book, volume 7, tab B, page 001049).

[28] Therefore, the Minister found that the requisite criteria for paragraph 137.1(10)(*a*) of the ITA and the GAAR were met and that Spruce was precluded from claiming a deduction for Dividend B under subsection 112(1) of the ITA.

[29] Spruce appealed the Minister's reassessment to the Tax Court of Canada.

C. *The Tax Court Decision*

[30] In a comprehensive set of reasons, the Judge allowed Spruce's appeal. He concluded that neither subsection 137.1(10) of the ITA nor the GAAR applied to preclude the deduction. Rather, he found that all of the requirements of the inter-corporate dividend deduction in subsection 112(1) of the ITA were met (Reasons at paragraph 41).

[31] The Judge explained that for subsection 137.1(10) to apply, the amount of the dividend STAB paid to Spruce would need to have been paid "in proportion to assessments" that Spruce paid to STAB. He reasoned that "[a] proportion is a comparative ratio that is a part considered in comparative relation to a whole" and that "[f]or two things to be in proportion to one another there must be an equality of ratios" (Reasons at paragraph 49). In other words, the Judge was looking for mathematical equivalence. In this case, Spruce's contribution to STAB's aggregate amount of assessments was 0.26%, while the assessments returned to Spruce amounted to 0.23% of Spruce's contribution to the aggregate amount of assessments. Since these amounts were not equivalent percentages, they were not "proportionate", and thus, according to the Judge, would not meet the requirements of paragraph 137.1(10)(*a*).

[32] The Judge found that the evidence before him did not support the Crown's position that subsection 137.1(10) applied to prevent the deduction of Dividend B. He explained that STAB had paid the dividends to its members in proportion to their shareholdings and that shareholdings in STAB "were a function of each member credit union's current asset size (and had recently been rebalanced to reflect current asset size)" (Reasons at paragraph 47). Thus he concluded that STAB did not pay the dividends "in proportion to the assessments received" from its members as "[r]elative current asset size differed from relative cumulative aggregate assessments paid for a number of reasons, most obviously because of differing annual assessment rates, differing annual relative performance as well as consolidation and other changes in the sector." As a result, he found that he did not need to decide whether or not the dividend amounts were "allocations", and also did not need to address whether section 137.1 is a "complete code with respect to amounts paid as allocations in proportion to assessments received" (Reasons at paragraphs 52- 53).

[33] The Judge also dismissed the subsidiary argument that the GAAR prevented recourse to subsection 112(1) of the ITA. He provided a thorough review of the GAAR's legal framework and explained that in order for the GAAR to apply, three fundamental criteria must be met: (1) there needs to have been a tax benefit; (2) the transaction giving rise to the tax benefit needs to be an avoidance transaction; and (3) the avoidance transaction needs to be abusive. He noted that Spruce had conceded that it received a tax benefit by obtaining the inter-corporate dividend deduction pursuant to subsection 112(1) and thus the first criterion was met. However, he disagreed with the Minister that an "avoidance transaction" was used to obtain this tax benefit.

[34] The Judge explained that in order to be characterized as an "avoidance transaction," a transaction must be undertaken primarily for tax purposes. However, he found on the evidence before him that STAB had paid dividend amounts to its member credit unions in order to allow for its members to pay CUDIC's extraordinary assessment while reducing STAB's deposit protection and stabilization fund. He explained that this is clearly a *bona fide* non-tax purpose and that the Crown admitted that there was "an overall non-tax objective of transferring funds from STAB to CUDIC" (Reasons at paragraph 91).

[35] Furthermore, he concluded that the decision to effect the distribution through dividends instead of a return of assessments was not a transaction, even within the extended and inclusive definition of transaction in subsection 245(1) of the ITA (Reasons at paragraph 100). He noted that "[t]he act of choosing or deciding between or among alternative available transactions or structures to accomplish a non-tax purpose, based in whole or in part upon the differing tax results of each, is not a transaction" (Reasons at paragraph 93). By choosing the method of transferring funds that would result in member credit unions paying the least amount of tax, STAB was making a decision that was consistent with the Duke of Westminster principle – that taxpayers are entitled to select courses of action that will minimize their tax liability – but was not engaging in an avoidance transaction. The Judge said this in answer to the Minister's assumption that the first step in the alleged series of transactions is "the decision by [STAB] to return premiums to the member credit unions in the form of a dividend" (Minister's reply in the Tax Court of Canada, appeal book 1, tab 4 at page 000060).

[36] The Judge was unable to identify any step or transaction that was not undertaken primarily for a non-tax purpose and thus would bring into effect the GAAR (Reasons at paragraph 101). He noted, in particular, that the fact that STAB divided the dividends into A and B and rebalanced the members' shareholdings in 2005 did not affect the tax consequences of Dividend B. The division simply afforded Spruce and the other credit unions the option of avoiding a dispute with the CRA and the discretion to declare the amount of Dividend B in their income, while the rebalancing was "done periodically to ensure credit unions' shareholdings aligned with their current relative asset sizes" (Reasons at paragraph 102).

[37] The Judge concluded that it was unnecessary for him to proceed to the third step of the GAAR analysis and consider if the deduction resulted in the abuse or misuse of sections 137.1 or 112 of the ITA, given his finding that there was no avoidance transaction in this case.

[38] The Crown is now appealing the Judge's decision to our Court.

D. *Analysis*

(1) Issues and Standard of Review

[39] The appellant raises two grounds of appeal. First, she argues that the Judge erred in his interpretation of paragraph 137.1(10)(*a*) of the ITA and thus in finding that Dividend B need not be included in the respondent's income pursuant to this provision. Second, she contends that the Judge did not apply the proper test for determining whether there was an avoidance transaction

and thus erred in finding that the GAAR did not apply to preclude the respondent from deducting Dividend B pursuant to subsection 112(1) of the ITA.

[40] It should be noted that at the hearing, the appellant clarified that she was not contesting any of the Judge's findings of fact.

[41] The alleged errors are subject to the standard of review set out in *Housen v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235 [*Housen*] . Questions of law are reviewable on a standard of correctness. Questions of fact or mixed fact and law are only reviewable for palpable and overriding error, unless they contain an extricable question of law, in which case a correctness standard applies (*Housen* at paragraphs 8, 10 and 26).

[42] For the reasons that follow, I am not persuaded that the Judge committed any errors of law that warrant our Court's intervention, or committed any palpable and overriding errors in his application of the law to the facts at hand.

(2) Issue 1**:** Dividend B and section 137.1 of the ITA

[43] Paragraphs 137.1(10)(*a*), 137.1(4)(*c*) and subsection 137.1(2) provide collectively that where a taxpayer is a member institution, it is required to include in its income for a taxation year any amounts received in that year from a deposit insurance corporation as allocations in proportion to any premiums or assessments that the member institution had paid to that deposit insurance corporation in a taxation year. As a corollary, when a member institution pays premiums or assessments to a deposit insurance corporation, the member is entitled to deduct the

amounts paid from its income under paragraph 137.1(11)(*a*). In other words, if Spruce had paid premiums or assessments to STAB in a taxation year, Spruce would have received a deduction on paying those premiums or assessments. If STAB subsequently provided Spruce with allocations in proportion to those premiums or assessments, Spruce would have been required to include the amounts it received from STAB in its income for that taxation year.

[44] Since Dividend B was paid out of STAB's aggregate cumulative assessment income, Spruce and the other member institutions presumably received deductions on the assessments paid to establish that account. In turn, the crux of the appellant's argument is that Spruce should have to include Dividend B in its income, lest it retain a deduction for assessments that were ultimately returned and would normally have been included in Spruce's income under section 137.1.

[45] In particular, the appellant takes issue with the Judge's definition of the words "allocation in proportion to", criticizing his interpretation of the relevant provisions of the ITA. The appellant explains that in *The Civil Service Co-operative Credit Society Limited v. Her Majesty The Queen*, 2001 D.T.C. 790 [*Civil Service Co-operative Credit Society*] the Tax Court held that the term "allocation" in paragraph 137.1(4)(*c*) denotes that a member institution may not necessarily be repaid the whole amount that it originally paid as a premium or assessment. Thus, according to the appellant, the amount returned to a credit union ought to be included in income under paragraph 137.1(10)(*a*) of the ITA regardless of whether it represents all or only some of the premiums that this credit union had originally paid. The appellant also relies upon *Her Majesty The Queen v. Consumers' Co-operative Refineries Ltd.*, [1987] F.C.J. No 931, [1987] 2

C.T.C. 204 [*Consumers' Co-operative Refineries*] for the proposition that the phrase "in proportion to" ought not to be interpreted as requiring a mathematical ratio as a prerequisite for a return of premiums to be taxable. The appellant notes that if the Judge's interpretation of "in proportion to" is correct, this would lead to absurd results as paragraph 137.1(10)(*a*) would never apply in situations where premiums are returned to only one credit union.

[46] The appellant also argues that the Judge erred by only engaging in a textual interpretation of the ITA's provisions. According to the "modern approach" to statutory interpretation "the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament" (Elmer A. Drieger, *The Construction of Statutes*, 2nd ed. (Toronto: Butterworths, 1983) at page 87; cited with approval in *65302 British Columbia Ltd. v. Canada*, [1999] 3 S.C.R. 804 at paragraph 50 and *Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54, [2005] 2 S.C.R. 601 at paragraph 10 [*Canada Trustco*]). Where the words of a statute are unequivocal, their ordinary meaning ought to play a dominant role in statutory interpretation; where the words are ambiguous, their ordinary meaning is to be given less weight.

[47] The appellant maintains that Parliament intended that section 137.1 would be a complete code governing the tax treatment of assessments and premiums to credit unions and deposit insurance corporations, and would preclude the application of the ITA's general provisions regarding the receipt and deductibility of dividends. Thus the appellant argues that "[i]n order to be in line with the purpose of the provision and consistent with the rest of the scheme, the phrase "allocations in proportion" in paragraph 137.1(4)(*c*) merely requires that such allocations

represent a proportion of past premiums or assessments paid by the credit unions" [emphasis in the original] (appellant's Memorandum of Fact and Law at paragraph 41). Essentially, identifying the source of revenue suffices to bring the amount of Dividend B under the legislative scheme adopted for credit unions. As long as Dividend B can be traced back to the assessments pool, it must be reported as income under paragraph 137.1(10)(*a*).

[48] The appellant therefore argues that the $114,466 STAB returned to Spruce as Dividend B qualifies as an "allocation in proportion to" any premiums or assessments STAB received from Spruce during that taxation year. Dividend B came from STAB's aggregate cumulative assessment income and thus simply represented "a proportion of past premiums or assessments". Consequently, Spruce was required to include Dividend B in its income for that taxation year, and this dividend could not be deducted pursuant to subsection 112(1) of the ITA. Dividend A, however, could be deducted under subsection 112(1) as it came from STAB's aggregate cumulative investment income.

[49] I accept the appellant's position that the interpretation of a statutory provision must be made according to a textual, contextual and purposive analysis and ought to be consistent with prior jurisprudence; however, I find that in this case I need not determine whether the Judge erred in his interpretation of the phrase "allocations in proportion to". The appellant agrees that Dividend B was clearly, in fact and in law, a dividend. The appellant must also accept the concession she made at the hearing of this appeal that even if the Judge had erred in his interpretation of the words "in proportion to", the error would be immaterial if our Court accepts the Judge's finding that Dividend B was paid in proportion to shareholdings. On the facts of this

case, if Dividend B was paid in proportion to shareholdings then it could not have been paid "in proportion to assessments" and thus Dividend B would clearly not fall within the ambit of paragraph 137.1(10)(*a*) of the ITA. The terms shareholdings and assessments are not synonymous and thus, as the Judge notes, in order to support the appellant's position, the word "assessments" in section 137.1 would need to be replaced with "shareholdings".

[50] The Judge found that Dividend B was paid to each of STAB's shareholders in proportion to their respective shareholdings, and was not paid by STAB in proportion to the assessments received from its members (Reasons at paragraphs 47 - 48). This is a finding of fact that is subject to deference by our Court and the appellant has not persuaded me that the Judge committed any palpable and overriding errors in coming to this conclusion. Rather, I find that the evidence on record more than adequately supports the Judge's finding of fact that Dividend B was paid to each of STAB's shareholders in proportion to their respective shareholdings.

[51] I therefore find that the Judge did not err in concluding that paragraph 137.1(10*)(a*) does not apply to Dividend B. I turn now to the appellant's arguments regarding the interpretation and application of the GAAR.

(3) Issue 2**:** The GAAR

[52] Section 245 of the ITA enables the Minister to deny the tax benefits of transactions which fit within the relevant provisions relied upon by the taxpayer, but which run counter to the ITA's object, rationale, purpose or spirit (*Copthorne Holdings Ltd. v. Canada*, 2011 SCC 63, [2011] 3 S.C.R. 721 at paragraph 66 [*Copthorne*]; *Canada Trustco* at paragraph 16). As the

Supreme Court of Canada explained in *Canada Trustco*, three requirements must be met in order for the GAAR to apply. First, there must be a tax benefit resulting from a transaction or a series of transactions (subsections 245(1) and 245(2)). Second, one of the transactions giving rise to the tax benefit must be an avoidance transaction, such that it cannot be said to have been reasonably undertaken for a *bona fide* non-tax purpose (subsection 245(3)). Third, the tax benefit must result in an abuse or misuse of the object, spirit or purpose of the provisions relied on by the taxpayer (subsection 245(4)). The burden rests with the taxpayer to refute the first two requirements, while the Minister must establish the third (*Canada Trustco* at paragraph 66).

[53] Spruce conceded that it received a tax benefit by obtaining the inter-corporate dividend deduction pursuant to subsection 112(1). Thus the issue before our Court is whether the Judge erred by failing to find that there was an avoidance transaction that would trigger the GAAR. Importantly, the appellant does not contest the Judge's finding that a direct transfer between STAB and CUDIC was not a viable option; rather STAB needed to distribute funds to its member institutions in order to achieve the non-tax objectives of satisfying CUDIC's extraordinary assessment and lowering its deposit protection and stabilization funds (Reasons at paragraph 91).

[54] The appellant contends that the Judge committed two primary legal errors. First, she maintains that he erred in law by concluding that "it was inappropriate to consider whether the taxpayer chose the particular transaction among alternative transactions primarily based on tax considerations" in assessing whether an avoidance transaction exists at the second stage of the GAAR analysis (appellant's Memorandum of Fact and Law at paragraph 88). The appellant

points out that our Court's prior jurisprudence establishes that one way to assess whether a transaction was undertaken primarily in order to obtain a non-tax objective is to consider whether that objective could have been accomplished without that particular transaction or through an alternative transaction (*Canada v. MacKay*, 2008 FCA 105; *1207192 Ontario Limited v. Canada*, 2012 FCA 259). In other words, according to the appellant, if a transaction was not *required* in order to achieve a *bona fide* non-tax objective, it is reasonable to assume that the transaction's primary purpose was to obtain a tax benefit and thus that this is an avoidance transaction.

[55] Second, the appellant argues that the Judge's conclusion that tax considerations "may play *a primary role in a taxpayer's choice* of available structuring options without necessarily making the chosen transaction itself primarily tax motivated" is inconsistent with the Supreme Court's explanation in *Canada Trustco* that subsection 245(3) requires "an objective assessment of the relative importance of the driving forces of the transaction" (appellant's Memorandum of Fact and Law at paragraph 90).

[56] The appellant also alleges that the Judge erred in finding that STAB had paid dividend amounts to its member credit unions for the "primary purpose" of allowing for its members to pay CUDIC's extraordinary assessment while reducing STAB's deposit protection and stabilization funds. Rather, according to the appellant, the evidence on record demonstrates that the primary purpose for the declaration and payment of Dividend B was to obtain the admitted tax benefit of a deduction under subsection 112(1) of the ITA.

[57] To support this argument, the appellant first points to the aforementioned Depositor Protection Agreements and Deposit Protection Assessments and Rebates Agreements, which she argues demonstrate that STAB was not required to declare and pay dividends in order to transfer funds to CUDIC. These agreements stipulated explicitly that if funds needed to be transferred from STAB to CUDIC in order to fulfill STAB's pledge to replenish CUDIC's funds, this would be accomplished by "a refund of premiums from STAB to the credit unions followed by an assessment by CUDIC to the credit unions for a like amount" (appellant's Memorandum of Fact and Law at paragraph 85). According to the appellant, Dividend B was therefore not a "required transaction" in order to achieve a *bona fide* non-tax objective. Rather, the appellant maintains that STAB, CUDIC and the credit unions explored the option to refund premiums, but rejected this alternative, as it would not provide the same tax benefits as declaring dividends.

[58] The appellant also points to a petition, commenced in the Supreme Court of British Columbia, and a related affidavit signed by Mr. Corsbie, STAB's Chief Executive Officer in 2005, as evidence that the decision to declare and pay dividends was undertaken primarily for tax purposes. After STAB paid Dividend A and B to its member credit unions, STAB learned that because it had not amended its Rules to remove the fixed redemption price of Class A shares, the payment of these Dividends could result in an unintended tax liability for STAB of approximately $17-20 million. STAB's board of directors resolved to convene a meeting on December 19, 2005 to vote on two special resolutions in order to correct this omission, but also commenced the aforementioned petition in order to apply for a declaration that the Rules of STAB be deemed to have been amended retroactively from September 20, 2005, and thus *prior* to the declaration of Dividend A and B (appeal book, volume 5, tab 92, pages 000631- 000632).

The petition indicates that when determining how best to transfer a portion of STAB's stabilization fund to the member credit unions so they could pay CUDIC's assessment, "the dominant consideration in structuring the Proposed Transaction was to minimize any adverse tax consequences for STAB and its members" (appeal book, volume 5, tab 92, page 000630 at paragraph 14). The petition also explains that "STAB determined that the most tax-effective method to effect the Proposed Transaction and to distribute the excess portion of the Stabilization Fund was for STAB to pay dividends to its members" [emphasis added] (*ibidem* at paragraph 15). It further notes that in structuring and implementing the transaction to return to member credit unions a portion of the Stabilization Fund, "the predominant intention of both STAB and its members was to minimize any potentially adverse tax consequences" of this transaction (*ibidem*, page 000631, paragraph 23). In his affidavit, Mr. Corsbie states at paragraph 3 that the facts expressed in paragraphs 1 through 30 of the Petition are true (appeal book, volume 5, tab 93, page 00635).

[59] The appellant has failed to convince me that the Judge erred in interpreting section 245 of the ITA or in applying the GAAR to the facts of this case.

[60] First, the appellant is misconstruing the Judge's statement regarding the appropriateness of engaging in a comparative analysis of the taxpayer's chosen transaction and other structures. The Judge does note, at paragraph 69 of his reasons, that in *Canada Trustco* and *Copthorne* the Supreme Court "does not suggest that it is appropriate at the avoidance transaction stage of the analysis to compare the taxpayer's chosen transaction or series to other available structures to see if the taxpayer chose among the alternatives primarily based on tax considerations or

consequences." However, an examination of the paragraphs preceding and following this statement demonstrates that the Judge was not suggesting that it is wholly improper to compare alternative transactions in assessing whether there exists an avoidance transaction. Rather, he was explaining correctly that the existence of an alternative transaction is but one factor to consider in assessing whether the requirements for an avoidance transaction are met. At paragraph 68, the Judge explains that while the Supreme Court has stated that identifying an alternative transaction that would have achieved an equivalent result, but that would have resulted in the payment of more tax, can *determine* whether there was a tax benefit at the first step of the GAAR analysis (*Canada Trustco* at paragraph 20; *Copthorne* at paragraph 35), this comparison is not *sufficient* to establish an avoidance transaction (*Canada Trustco* at paragraph 30). In turn, at paragraph 69, the Judge notes that this is logical because according to the Duke of Westminster principle, taxpayers are entitled to enter into transactions that will minimize their tax liability (*Commissioners of Inland Revenue v. Duke of Westminster*, [1936] A.C. 1 (H.L.); cited with approval and applied in *Canada Trustco* at paragraph 11 and *Copthorne* at paragraph 65). Thus if the possibility of an alternative transaction with greater tax consequences could serve as a litmus test for the presence of an avoidance transaction, this would render the Duke of Westminster principle meaningless.

[61] Second, the Judge also did not err in stating that tax considerations may play a primary role in the choices a taxpayer makes without the chosen transaction being "primarily" tax motivated. This statement is not inconsistent with the Judge's requirement to objectively assess the relative importance of the driving forces of the transaction. In applying the GAAR, the Judge needs to consider not only whether a series of transactions may reasonably be considered to have

been undertaken for *bona fide* non-tax purposes, but also whether each of the transactions within this series were undertaken for these purposes, or whether any of them were undertaken primarily for tax purposes (*MacKay* at paragraph 21). The focus is on the primary purpose of each transaction, its *raison d'être*. The need to determine the 'primary' purpose implies that multiple purposes can coexist and that both tax and non-tax purposes can be intertwined. For instance, as our Court explained in *Canada v. Landrus*, 2009 FCA 113 at paragraph 74 "if a transaction was entered into primarily for business reasons, the fact that it also procures one or more tax benefits does not alter that purpose." The fact that tax implications played a role, and potentially even an important role, in the choice of transaction does not necessarily mean that the primary purpose of the transaction was to obtain a tax benefit and that this was an avoidance transaction.

[62] The Supreme Court explained in *Canada Trustco* that in examining whether there is an avoidance transaction, a Tax Court judge must consider and weigh objectively *all* the evidence available and the different interpretations of the events to determine "whether it is reasonable to conclude that the transaction was not undertaken or arranged primarily for a non-tax purpose." This is a factual inquiry, which is subject to deference (*Canada Trustco* at paragraph 29). Thus "[w]here the Tax Court judge has proceeded on a proper construction of the provisions of the *Income Tax Act* and on findings supported by the evidence, appellate tribunals should not interfere, absent a palpable and overriding error" (*Canada Trustco* at paragraph 66).

[63] In my view, the appellant has shown no palpable or overriding error allowing for our Court's intervention. I disagree with the appellant that the Deposit Protection Agreements, the

petition, or Mr. Corsbie's affidavit demonstrate that Dividend B was a transaction undertaken primarily for tax purposes. As mentioned previously, the Supreme Court has clarified that the mere existence of an alternative transaction that would have resulted in greater tax implications is not sufficient to establish an avoidance transaction, and that individuals are permitted to order their affairs to minimize their tax liability in accordance with the Duke of Westminster principle (*Canada Trustco* at paragraphs 30-31).

[64] These documents are only part of the evidentiary record that the Judge was required to consider and, after weighing all of the evidence before him, the Judge was obviously not persuaded that these documents proved that Dividend B was declared "primarily" for tax purposes. I am similarly unmoved by this evidence and find, on the contrary, that the evidentiary record supports the Judge's conclusion that Dividend B was declared and paid primarily for *bona fide* non-tax purposes. For instance, Mr. Corsbie testified at trial that STAB would not have paid the dividends if CUDIC had not assessed the credit unions (appeal book, volume 7, tab 10, page 001196 at lines 1-7) and added that the reason a declaration of dividends was chosen was that it aligned more closely with the CUDIC assessments on an individual credit union basis than a return of assessments. According to Mr. Corsbie, had STAB chosen a return of assessments there would have been a large difference between the amounts returned and the CUDIC assessments (appeal book, volume 7, tab 10, page 001204 at lines 1-15). Indeed, the total assessments Spruce paid to STAB were $205,493 while the total dividends Spruce received were $193,023 (appeal book, volume 4, tab 74 at page 000474). The amount Spruce received was thus closer to the respondent's CUDIC assessment of $198,859.34 (*ibidem*, tab 72 at page 000469).

[65] As the appellant has failed to convince me that the Judge erred in finding that there does not exist an avoidance transaction, he was correct that it is not necessary to proceed to the third step of the GAAR analysis and consider the issue of abuse or misuse.

II. Proposed Disposition

[66] For these reasons, I propose to dismiss the appeal with costs.

"Johanne Trudel"

J.A.

"I agree
Eleanor R. Dawson J.A."

"I agree
D.G. Near"

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

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