Date: 20090416

Docket: A-265-08

Citation: 2009 FCA 113

CORAM: **DESJARDINS J.A.**
NOËL J.A.
TRUDEL J.A.

BETWEEN:

HER MAJESTY THE QUEEN

Appellant
(Respondent by Cross-appeal)

and

GARY LANDRUS

Respondent
(Appellant by Cross-appeal)

Heard at Toronto, Ontario, on March 26, 2009.

Judgment delivered at Ottawa, Ontario, on April 16, 2009.

REASONS FOR JUDGMENT BY: NOËL J.A.

CONCURRED IN BY: DESJARDINS J.A.
TRUDEL J.A.

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REASONS FOR JUDGMENT

NOËL J.A.

[1] This is an appeal and a cross-appeal from a decision of Paris J. of the Tax Court of Canada (the Tax Court Judge) allowing Gary Landrus' appeal (the respondent) from a reassessment issued by the Minister of National Revenue (the Minister) denying the deduction of a terminal loss in the

amount of $29,130 claimed in computing his income for the 1994 taxation year. In confirming the reassessment at the objection stage the Minister relied exclusively on the General Anti-Avoidance Rule (GAAR) set out in section 245 of the *Income Tax Act,* R.S.C. 1985, c. 1 (5th Supp.), as amended (the Act).

[2] It was conceded before the Tax Court that the deduction of the terminal loss pursuant to subsection 20(16) of the Act was a tax benefit within the meaning of subsection 245(1). Although the Tax Court Judge further found that the transactions which gave rise to this benefit where avoidance transactions, he held that the GAAR did not apply because there was no misuse of the provisions relied upon to claim the loss, and no abuse having regard to the Act read as a whole.

[3] On appeal, Her Majesty the Queen (the appellant) challenges the Tax Court Judge's conclusion that the transactions in issue did not give rise to a misuse or abuse of the provisions of the Act. The respondent by way of cross-appeal maintains that the Tax Court Judge committed a reviewable error in failing to recognize that the transactions were entered into primarily for business reasons. As such, the transactions in issue were not "avoidance transactions" within the meaning of subsection 245(3). Although this last argument is properly before us, it is useful to note that the respondent did not have to bring a cross-appeal in order to raise it since no order was made against him by the judgment under appeal.

STATUTORY PROVISIONS

[4] Section 245 and the provision pursuant to which the terminal loss was claimed provide respectively:

> **245.** [General Anti-Avoidance Rule — GAAR) —
> (1) **Definitions** -— In this section,
> "**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;
>
> "**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;
>
> "**transaction**" includes an arrangement or event.
>
> …
>
> (3) **Avoidance transaction** — An: avoidance transaction means any transaction

> **ARTICLE 245**: Définitions.
> (I) **Les définitions qui suivent s'appliquent au présent article**.
> « **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.
>
> « **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.

(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
(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,

(4) **Application of subsec. (2)** — Subsection (2) applies to a transaction only if it may reasonably be considered that, the transaction

(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

(i) this.Act,

(ii) the Income Tax Regulations,

(iii) the Income Tax Application Rules,

(iv) a tax treaty, or

(v) any other enactment that is relevant in computing tax

[…]

(3) **Operation d'évitement**. L'opération d'évitement s'entend:

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 effectué pour des objets véritables – l'obtention de l'avantage fiscal n'étant pas considérée comme un objet véritable;

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.

(4) **Application du par. (2).** Le paragraphe (2) ne s'applique qu'à l'opération dont il est raisonnable de considérer, selon le cas :

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 :

or any other amount payable by or refundable to a person under this Act or in determining any amount that is relevant for the purposes of that computation; or

(b) would result directly or indirectly in an abuse having regard to those provisions, other than this section, read as a whole.

(5) **Determination of tax consequences** — Without restricting the generality of subsection (2), and notwithstanding any other enactment, -

(a) any deduction, exemption or exclusion in computing income, taxable income, taxable income earned in Canada or tax payable or any part thereof may be allowed or disallowed in whole or in part.

(b) any such deduction, exemption or exclusion, ally income, loss or other amount or past thereof may be allocated to any

(c) the nature of any payment or other amount may be recharacterized, and

(d) the tax effects that would otherwise result from the application of other provisions of this Act may be ignored,

in determining the tax consequences to

(i) la présente loi,

(ii) le *Règlement de l'impôt sur le revenu*,

(iii) les *Règles concernant l'application de l'impôt sur le revenu*,

(iv) un traité fiscal,

(v) tout autre texte législatif qui est utile soit pour le calcul d'un impôt ou de toute autre somme exigible ou remboursable sous le régime de la présente loi, soit pour la détermination de toute somme à prendre en compte dans ce calcul;

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.

(5) **Attributs fiscaux à déterminer.** Sans préjudice de la portée générale du paragraphe (2) et malgré tout autre texte législatif, dans le cadre de la détermination des attributs fiscaux d'une personne de façon raisonnable dans les circonstances de façon à supprimer l'avantage fiscal, qui, sans le présent article, découlerait, directement ou indirectement, d'une opération d'évitement :

a) toute déduction, exemption ou exclusion dans le calcul de tout ou partie du revenu, du revenu

a person as is reasonable in the circumstances in order to deny a tax benefit that would, but for this section, result, directly or indirectly, from an avoidance transaction.

imposable, du revenu imposable gagné au Canada ou de l'impôt payable peut être en totalité ou en partie admise ou refusée;

b) tout ou partie de cette déduction, exemption ou exclusion ainsi que tout ou partie d'un revenu, d'une perte ou d'un autre montant peuvent être attribués à une personne;

c) la nature d'un paiement ou d'un autre montant peut être qualifiée autrement;

d) les effets fiscaux qui découleraient par ailleurs de l'application des autres dispositions de la présente loi peuvent ne pas être pris en compte.

20. (16) **Terminal loss.** – Notwithstanding paragraphs 18(1)(*a*), 18(1)(*b*) and 18(1)(*h*), where at the end of a taxation year,

(a) the total of all amounts used to determine A to D in the definition "undepreciated capital cost" in subsection 13(21) in respect of a taxpayer's depreciable property of a particular class exceeds the total of all amounts used to determine E to J in that definition in respect of that property, and

(b) the taxpayer no longer owns

20. (16) **Perte finale**. Malgré les alinéas 18(1)*a*), 18(1)*b*) et 18(1)*h*), lorsque, à la fin d'une année d'imposition :

a) d'une part, le total des montants utilisés pour le calcul des éléments A à D de la formule figurant à la définition de « fraction non amortie du coût en capital » au paragraphe 13(21) est supérieur au total des montants utilisés pour le calcul des éléments E à J de la même formule, au titre des biens amortissables d'une catégorie prescrite d'un contribuable;

any property of that class,

in computing the taxpayer's income for the year

(c) there shall be deducted the amount of the excess determined under paragraph 20(16)(*a*), and

(d) no amount shall be deducted for the year under paragraph 20(1)(*a*) in respect of property of that class.

b) d'autre part, le contribuable ne possède plus de biens dans cette catégorie,

dans le calcul de son revenu pour l'année :

c) il doit déduire l'excédent déterminé en vertu de l'alinéa 20(16)*a*);

d) il ne peut déduire aucun montant pour l'année en vertu de l'alinéa 20(1)*a*) à l'égard des biens de cette catégorie.

THE TRANSACTIONS IN ISSUE

[5] The matter proceeded before the Tax Court on the basis of a Partial Agreed Statement of Facts. Several witnesses were also heard. The Tax Court Judge in his reasons provides a detailed account of the evidence with respect to which neither party takes issue (Reasons, paras. 7 to 52). It suffices for present purposes to provide the following summary of the transactions which gave rise to the terminal loss claimed by the respondent.

[6] Roseland I was formed in 1988 as a limited partnership to acquire and operate a condominium building consisting of 94 residential suites located at 858 Commissioners Road East, London, Ontario (the Roseland I Building). Its general partner was Roseland Park (I) General Partner Ltd. until December 1991, at which time it was replaced by Roseland Park I Management Inc.

[7] Roseland II was formed in 1989 as a limited partnership to acquire and operate a condominium building consisting of 110 residential suites located next to Roseland I at 860 Commissioners Road East (the Roseland II Building). Its general partner was Roseland Park (II) General Partner Limited until June 23, 1993, when all of the outstanding shares of Roseland Park (II) General Partner Limited were acquired by Allied Canadian Corporation (ACC).

[8] In December of 1988, limited partnership units of Roseland I were offered for sale to the public pursuant to a prospectus. Roseland I acquired the Roseland I Building on December 30, 1988 and began its rental operations in February 1989. In the same way, limited partnership units of Roseland II were offered for sale in February 1989. Roseland II acquired the Roseland II Building on January 31, 1990 and began its rental operations in February 1990.

[9] The sale of units in Roseland I and Roseland II was marketed in accordance with the same model. Each interest in Roseland I and Roseland II had a particular condominium unit referenced to it. The price paid by the limited partner for a partnership interest varied depending on the attributes of the referenced condominium unit that was associated with the partnership interest (such as floor plan, the floor number, and view). On exercising their right to withdraw from the partnership, every partner in Roseland I and Roseland II had the right to receive their referenced condominium unit in satisfaction of his or her partnership interest.

[10] The rental income from all the units was pooled for each building respectively, and net profit was allocated to each limited partner based on his or her percentage interest in the partnership.

[11] On May 10, 1989, the respondent subscribed for one partnership unit in Roseland II for a purchase price of $107,650. His referenced condominium was unit 1005A. A certain Mr. Froio who was a witness at trial, together with three friends, acquired two units in Roseland I. Their referenced condominiums were units 101A and 508B.

[12] Soon after the respondent made his investment in Roseland II, and continuing into the early 1990s, real estate prices began to decline. Cash flow was less than anticipated and resale prices for condominium units fell below the prices paid originally for the partnership interests to which the units were referenced. By 1994 the fair market value of the units in both buildings had undergone the same decline and stood below their undepreciated capital cost (UCC).

[13] Certain partners also expressed dissatisfaction with the fact that they could not claim a terminal loss reflecting this decline in value until all of the condominium units were sold. They expected the income tax consequences of their investment to be those associated with a direct investment in real estate given the flow through nature of partnerships. At the initiative of ACC, a proposal was developed and presented to the limited partners of Roseland I and Roseland II which, among other things, was intended to address this concern.

[14] The proposal involved transferring the assets of both Roseland I and Roseland II to a new limited partnership at fair market value thereby triggering a terminal loss. The respondent and the other limited partners of both partnerships would continue as partners of the new partnership and

each of their limited partnership interest in this new partnership would continue to be referenced to their current condominium unit in the respective Roseland building.

[15] By special resolutions dated September 8, 1994 and September 22, 1994, the limited partners of Roseland I and Roseland II, including the respondent and Mr. Froio, approved the transfer of Roseland I and II Buildings to a new partnership at fair market value. The transfer was completed before year end.

[16] The steps involved in giving effect to the conveyance of the Roseland I and Roseland II Buildings in accordance with the plan were as follows:

- A new partnership named Roseland Park Master Limited Partnership (RPM) was formed and registered on December 21, 1994.

Roseland II Transactions

- On December 23, 1994, Roseland II subscribed for 4,448 limited partnership units in RPM. The subscription price was $4,448,000, being equal to the total fair market value of each of the Roseland II condominium units.

- On December 23, 1994, Roseland II directed RPM to issue the limited partnership units subscribed for in RPM to the limited partners of Roseland II in proportion to their existing interests in Roseland II.

- Pursuant to a Purchase Agreement dated December 28, 1994, Roseland II sold all of its condominium units to RPM for $4,448,000.

Roseland I Transactions

- On December 23, 1994, Roseland I subscribed for 3,243 limited partnership units in Roseland Park (I-A) Limited Partnership (Roseland I-A). The subscription price was $3,243,000, being equal to the total fair market value of each of the Roseland I condominium units.

- Pursuant to a Purchase Agreement dated December 28, 1994, Roseland I sold all of its assets to Roseland I-A for $3,243,000.

- On December 30, 1994, Roseland I subscribed for 3,243 limited partnership units in RPM. The subscription price was $3,243,000.

- On December 30, 1994, Roseland I directed RPM to issue the limited partnership interests subscribed for in RPM to the limited partners of Roseland I in accordance with their existing interests in Roseland I.

- On December 30, 1994, Roseland I transferred 3,243 units of Roseland I-A to RPM for $3,243,000.

- By general conveyance dated December 31, 1994 Roseland I-A transferred all of its assets to RPM.

- Roseland I-A was dissolved on December 31, 1994.

[17] The reorganization had the following two practical consequences: terminal losses of $1,709,454 and $2,916,612 resulted from the sale of the Roseland I and II Buildings respectively and the two buildings were now owned by a single partnership and subject to the same management. There was evidence that this resulted in improved performance both in terms of increased revenue per unit and reduced operating costs (Appeal Book, Vol. I, pp. 212, 217, 218, and 223; Vol. IV, p. 1235).

[18] The appellant withdrew from RPM in 2000, and exercised his option to take title to unit 1005A. He then sold that unit to an unrelated party for $63,500. He reported the difference between the sale price and his share of the cost at which RPM purchased the Roseland II assets in 1994 on income account. At the time of the hearing, Mr. Froio was still a member of RPM.

[19] In computing his income for the 1994 taxation year, the respondent deducted his *pro rata* share of the terminal loss resulting from the disposition of the Roseland II to RPM. The terminal loss represents the difference between the UCC of his referenced condominium unit and its selling price at fair market value.

[20] The Minister denied the terminal loss claimed by the limited partners of Roseland I and II, including the respondent's. The Minister initially took the position that there was no change in the beneficial ownership and that the "stop-loss" rules (subsection 85(5.1)) applied to deny the terminal loss. In the alternative, the Minister relied on the GAAR to justify the refusal. At the objection stage, the Minister confirmed the reassessment, relying only on the GAAR.

[21] The respondent appealed the reassessment made by the Minister to the Tax Court of Canada.

DECISION OF THE TAX COURT

[22] The Tax Court Judge identified the issue before him as follows:

> [6] Since the Appellant has conceded that there was a tax benefit, the issues in this appeal are whether the assets of Roseland II were transferred to RPM primarily to obtain the tax benefit, and if so, whether this constituted abusive tax avoidance. If both conditions are met, the GAAR would apply, and the Appellant concedes that the Minister would be entitled to deny the terminal loss deduction pursuant to subsection 245(5) of the *Act*.

[23] The Tax Court Judge first found that the disposition of the assets by Roseland Park II to RPM was an "avoidance transaction" within the meaning of subsection 245(3) of the Act on the basis that the disposition could not be considered to have been undertaken or arranged primarily for a purpose other than to obtain a tax benefit (Reasons, para. 96).

[24] Consistent with the guidelines set out by the Supreme Court in *Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54, [2005] 2 S.C.R. 601 (*Canada Trustco Mortgage*) (paras. 44 and 45), the Tax Court Judge first conducted a contextual and purposive analysis of the provisions relied upon by the respondent in order to claim the terminal loss, specifically subsection 20(16) (Reasons, paras. 98 and 99).

[25] He first noted that the disposition by Roseland I and Roseland II of the respective buildings to RPM triggered a terminal loss. As a result of this disposition, the two conditions set out in 20(16) were met since Roseland I and II no longer owned any property of the class to which the buildings belonged to (20(16)(*b*)), and the UCC in each case was a positive amount (20(16)(*a*)). Since the respective buildings were disposed of for an amount below their UCC, Roseland I and II were entitled to deduct the remaining balance as a terminal loss (Reasons, paras. 104 to 106).

[26] The Tax Court Judge earlier noted that although section 96 is also relevant in the sense that the terminal loss was calculated at the partnership level, that section in and of itself gave rise to no benefit (Reasons, para. 101).

[27] Turning to subsection 20(16), the Tax Court Judge first noted that there is no ambiguity in the wording of that provision. It is common ground that on the facts of the present case, the conditions precedent to the application of this provision are met (Reasons, para. 107).

[28] The Tax Court Judge further noted that there is no provision which restricts the right to claim a terminal loss where both the transferor and the transferee of depreciable assets are partnerships. He also noted that subsection 20(16) does not prevent a taxpayer from claiming a terminal loss where depreciable property is disposed of to a related party (Reasons, para. 108).

[29] According to the Tax Court Judge, the purpose of subsection 20(16) is to adjust the aggregate of annual deductions of capital cost allowance (CCA) taken by a taxpayer on a class of depreciable property when subsequent events demonstrate that the property in that class has been undepreciated. The adjustment occurs when a taxpayer no longer owns any property of that class at the end of a given taxation year and is predicated on the fact that the taxpayer is no longer able to use the property to earn income because that property is no longer available to him or her. It is intended to match the total CCA deduction under the Act in respect of property used to earn income by a taxpayer to the actual cost of that property to the taxpayer (Reasons, para. 112). As the

transactions in issue provided this exact result, no misuse of subsection 20(16) could be said to have arisen on the facts of this case.

[30] The Tax Court Judge acknowledged that there are a number of provisions that are designed to prevent the deduction of terminal losses in specific circumstances. In this respect, he referred to paragraph 40(2)(*e*), subsection 85(4) and subsection 85(5.1). He concluded from his review of these provisions that they create exceptions to the general policy of allowing losses on the disposition of depreciable assets where the conditions set out in subsection 20(16) are met (Reasons, paras. 115 to 121). These provisions do not evidence the existence of an overall policy prohibiting losses on a transfer between parties forming an economic unit as the Minister contended (Reasons, para. 122).

ALLEGED ERRORS

[31] The appellant reiterates before us each of the arguments made before the Tax Court Judge. The appellant submits that the Tax Court Judge erred in his analysis of the object, spirit and purpose of subsection 20(16) and the partnership provisions of the Act as well as the stop-loss rules including subsection 85(5.1). According to the appellant, the Tax Court Judge placed excessive importance on the wording of the relevant provisions of the Act and failed to give sufficient weight to the context and purpose of these provisions.

[32] In its supplementary submissions filed after the Supreme Court released its decision in *Lipson v. Canada*, 2009 SCC 1 (*Lipson*), the appellant maintains that the majority decision in that

case supports its view that two tax benefits result from the transactions in issue: first, the creation of a terminal loss; and second, the actual deduction of the loss claimed by the respondent in application of the partnership rules.

[33] The respondent for its part supports the misuse and abuse analysis conducted by the Tax Court Judge, relying essentially on the reasoning of the Tax Court Judge. It adds that the appellant's reliance on the *Lipson* decision to find two separate benefits is a misguided attempt to fit the present case within the decision of the majority in *Lipson*.

[34] By way of his cross-appeal, the respondent challenges the Tax Court Judge's finding that the transactions which gave rise to the terminal loss were avoidance transactions. In particular, the respondent contends that the evidence does not support the Tax Court Judge's conclusion that the transactions were entered into primarily in order to obtain a tax benefit.

<u>ANALYSIS AND DECISION</u>

[35] According to the appellant, the Tax Court Judge misconstrued the relevant provisions of the Act, and erred in failing to hold that subsection 20(16) had been misused on the facts of this case. In the words of the appellant (Memorandum of Fact and Law, para. 63):

> The transaction herein resulted in a misuse of subsection 20(16) of the Act when that provision is viewed in its context and in accordance with the scheme and intent of the Act in relation to:
>
> (i) the CCA regime of which subsection 20(16) forms a important part;

(ii) the partnership provisions contained in sections 96 of the Act; and

(iii) the specific anti-avoidance rules contained in the Act that limit or deny losses arising from certain dispositions of property.

[36] Two questions arise from this proposition. The first is whether the Tax Court Judge properly construed the provisions of the Act on which the respondent relied to obtain the tax benefit. This is a question of law which stands to be reviewed on a standard of correctness. The second issue is whether the Tax Court Judge properly determined that there was no misuse or abuse of the benefit conferring provisions on the facts of this case. Whether there has been a misuse or an abuse gives rise to a mixed question of fact and law which is necessarily fact intensive and therefore only reviewable if the Tax Court Judge can be shown to have omitted a palpable and overriding error (*Canada Trustco Mortgage, supra*, paras. 44 and 45; *Lipson, supra*, para. 25).

Object, spirit and purpose of subsection 20(16)

[37] In ascertaining the object, spirit and purpose of subsection 20(16), the Tax Court Judge considered the CCA regime within which subsection 20(16) operates, the partnership provisions contained in section 96 of the Act, as well as the anti-avoidance rules that limit or deny losses arising from certain dispositions in certain circumstances.

[38] The Tax Court Judge identified the scheme of the CCA system as follows (Reasons, para. 111):

> CCA is allowed as deduction under 20(1)(*a*) to the extent provided by the *Income Tax Regulations*.

> Eligible assets, referred to as "depreciable property", are grouped into prescribed classes in accordance with Schedule II of the *Regulations*.
>
> Regulation 1100 prescribes the rates of CCA that can be deducted each year for each class of depreciable property. This rate is a percentage of the "undepreciated capital cost" of the property in the class.
>
> "Undepreciated capital cost" is defined in subsection 13(21) and, roughly speaking, is the cost to the taxpayer of all of the property in that class minus the amount of any CCA taken on the property in that class in previous years and minus the proceeds from the disposition of any assets in the class before that time (up to the cost of the assets).
>
> On disposal of assets, to the extent that the proceeds of disposition exceed the "undepreciated capital cost" of the class, capital cost allowance previously taken is "recaptured" (i.e. added back into income) pursuant to subsection 13(1) of the *Act*.
>
> Upon disposal of all the assets in a particular class any remaining balance of "undepreciated capital cost" for the class is deductible in the year as a terminal loss under subsection 20(16).

[39] His assessment of the object, spirit and purpose of subsection 20(16) is summed up in the following passage:

> [112] The purpose of the terminal loss provision is to adjust the aggregate of the annual deductions of CCA taken by a taxpayer on a class of depreciable property when subsequent events demonstrate that the property in that class have been undepreciated. The adjustment occurs when a taxpayer no longer owns any property of that class at the end of a given taxation year and is predicated on the fact that the taxpayer is no longer able to use the property to earn income because that property is no longer available to him or her. It is intended to match the total CCA deduction under the *Act* in respect of property used to earn income by a taxpayer to the actual cost of that property to the taxpayer.

[40] In my respectful view, this is an accurate assessment of the object, spirit and purpose of subsection 20(16) (compare *Water's Edge Village Estates (Phase II) Ltd. v. Her Majesty the Queen*, 2002 FCA 291, [2002] F.C.J. No. 1031, paras 41 and 44). I do not understand the appellant to take issue with this assessment. Rather, the appellant contends that since subsection 20(16) is predicated

on the fact that the taxpayer is no longer able to use the property, this provision was misused since in this case the partnership property remained available to the partners despite the disposition. This issue is addressed below in the misuse analysis.

[41] The Tax Court Judge also considered the partnership rules embodied in section 96 of the Act:

> [101] While section 96 is relevant to the Appellant's claim in the sense that the terminal loss was calculated at the partnership level because the transaction involved the disposition of the partnership assets, that section, in and of itself, gives rise to no benefit. In this case its effect is limited to the flow through of the losses on the disposition of the partnership property to the partners of the limited partnership. In *Mathew v. Canada*, 2005 DTC 5538, the Supreme Court said at paragraph 51 that:
>
> > "The partnership rules under s. 96 are predicated on the requirement that partners in a partnership pursue a common interest in the business activities of the partnership, in a non-arm's length relationship. …"
>
> [102] It is not disputed that, at the time of the transfer of the partnership property by Roseland II to RPM, the partners of Roseland II were carrying on business in common in a non-arm's length relationship. The flowing of the terminal loss to the limited partners accords with the underlying purpose of the partnership rules. It is not necessary therefore to consider the context and purpose of the partnership rules beyond this point.

[42] The conclusion that Roseland II and RPM are genuine partnerships and that the flowing of the terminal loss to the limited partners accords with the underlying purpose of section 96 is correct. In particular, subsection 96(1) provides for the computation of partnership income "as if" the partnership was a person and contemplates that the income so computed be allocated to the partners. The appellant insists on the fact that although a terminal loss was recognized at the partnership level

the deduction of the loss was claimed by the limited partners (Appellant's Memorandum of Fact and Law, paras. 41 to 46). No doubt this is so, but the Tax Court Judge had this in mind when he noted that although the terminal loss is recognized at the partnership level the deduction flows through to the partners.

[43] The Tax Court Judge further considered the impact of the stop-loss provisions in subparagraph 40(2)(*g*)(i), subsection 85(4), paragraph 40(2)(*e*) and subsection 85(5.1) of the Act, and certain amendments thereto. These anti-avoidance rules are part of the legislative context within which subsection 20(16) is to be considered (Reasons, para. 114).

[44] Although it is common ground that none of these rules are applicable on the facts of this case, the argument advanced before the Tax Court Judge (and before us) is that they evidence a general policy to disregard dispositions of property to persons amongst related parties or parties within "the same economic unit" (Reasons, para. 114). The Tax Court Judge held that these stop-loss provisions fell short of evidencing such a policy (Reasons, para. 115). In his view, the precise and detailed nature of these provisions show that they are intended to deny losses in the limited circumstances set out in these provisions (Reasons, para. 117).

[45] In particular the variation as to the degree of connection required by these provisions, the different scope of their application, the restrictions based on the particulars of the property transferred, and the different range of transferees targeted, are such that it is reasonable to infer that Parliament intended to promote particular purposes rather than a general unexpressed policy

(Reasons, paras. 118 and 119). The specificity of these rules is indicative of the fact that they are exceptions to a general policy of allowing losses on all dispositions (Reasons, para. 120).

[46] With specific reference to subsection 85(5.1) (now subsection 13(21.2)), the Tax Court Judge noted that Parliament has chosen to define the circumstances in which the terminal loss will be denied on transfers of depreciable property between partnerships. The Tax Court Judge infers from this that Parliament has chosen to allow taxpayers who do not come within the ambit of this provision to claim their terminal losses (Reasons, para. 123).

[47] I agree with the appellant that the fact that specific anti-avoidance provisions can be demonstrated not to be applicable to a particular situation does not, in and of itself, indicate that the result was condoned by Parliament (*Canada v. Central Supply Company (1972) Ltd.*, [1997] 3 F.C. 674 (F.C.A.). However, where it can be shown that an anti-avoidance provision has been carefully crafted to include some situations and exclude others, it is reasonable to infer that Parliament chose to limit their scope accordingly.

[48] While the appellant takes issue with this conclusion, it has been unable to show any error in the Tax Court Judge's reasoning. The assessment of the object, spirit and purpose of subsection 20(16) made by the Tax Court Judge is, in my respectful view, correct.

Misuse and abuse

[49] The next task is to determine whether the Tax Court Judge properly held that the transactions in issue do not misuse subsection 20(16). As stated by the Supreme Court in *Canada Trustco Mortgage, supra*, at paragraph 46: “Once the provisions of the Act are properly interpreted, it is a question of fact for the Tax Court Judge whether the Minister, in denying the tax benefit, has established abusive tax avoidance under subsection 245(4).” (See also *Lipson, supra*, para. 22).

[50] The appellant’s attack is based on a variation of the same theme, i.e. that the limited partners continued to have available to them the partnership property, albeit through another partnership, after the disposition. According to the appellant this evidences a misuse of subsection 20(16) since, as was recognized by the Tax Court Judge, this provision contemplates that a terminal loss only be recognized when the property is no longer available to the taxpayer.

[51] In support of this position, the appellant makes the point that a partnership is not a person and cannot as a legal matter own property. As such, so called "partnership property" belongs to the partners and not to the partnership (Manzer R. Alison, *A Practical Guide to Canadian Partnership Law*, Aurora: Canada Law Book, 2007, para. 4.820; VanDuzer J. Anthony, *The Law of Partnerships and Corporations*, Toronto: Irwin Law, p. 27). It is only by reason of the fiction created by subsection 96(1), which requires that partnership income be computed "as if" the partnership was a separate person, that property can be said to belong to the partnership.

[52] According to the appellant, the limited partners did not finally end their investment when the terminal loss was recorded. They continued to own an interest in the Roseland II Building as part of their undivided interest in the RPM assets, and continued to earn rental income through RPM. As such the loss realized upon the disposition was not a "true" loss.

[53] The prime difficulty with the appellant's position is that it is inconsistent with its own concession. The appellant has conceded that Roseland II disposed of its legal and beneficial interest in the Roseland II Building to RPM with the result that it did not own property of that class at the end of its 1994 taxation year (Reasons, para. 107). It now suggests that the conveyance to RPM should be ignored.

[54] Obviously, a transaction cannot be ignored or overlooked in a misuse and abuse analysis on the ground that it was conducted in compliance of a specific statutory requirement. Subsection 96(1) contemplates that the Roseland II Building be treated as partnership property, and the limited partners complied with that requirement.

[55] The more cogent argument is that despite the transfer of the partnership property to a new partnership, nothing in fact has changed in that the Roseland partners, now as partners of RPM, continued to own an interest in the Roseland II Building as part of their undivided interest in the RPM assets and they continued to enjoy the right to acquire title to their referenced condominium units upon withdrawal from the partnership (Appellant's Memorandum of Fact and Law, paras. 66 to 71).

[56] I accept that the transactions in issue would be arguably abusive if they had given rise to the tax benefit in circumstances where the legal rights and obligations of the respondent were otherwise wholly unaffected. However, this is not what happened here.

[57] The transactions altered the respondent's legal rights and obligations. He ceased to be a partner in Roseland II and joined RPM, thereby becoming associated with the former partners of both Roseland I and Roseland II. As a result, he acquired an undivided interest in assets double in size and shared in an extended rental pool which accounted for the revenues generated by both Roseland I and Roseland II. These changes are material both in terms of risks and benefits. The appellant has a selective view of the evidence when it asserts that nothing changed as a result of the transactions.

[58] The burden of establishing abusive tax avoidance rested on the Minister (*Canada Trustco Mortgage, supra*, paras. 66 and 66(4)). The appellant has been unable to show that the Tax Court Judge committed a palpable or overriding error in concluding that the transactions in issue did not misuse subsection 20(16) or abuse the Act read as a whole.

Lipson

[59] The appellant contends that the *Lipson* decision provides additional support for its contention that the decision of the Tax Court Judge is flawed. A number of submissions have been made in this regard. In my respectful view only two need be addressed.

[60] In *Lipson*, Lebel J. writing for the majority identified two tax benefits: the deduction of the interest on the loan obtained by Mrs. Lipson to purchase the shares by virtue of the application of paragraph 20(1)(*c*) and subsection 20(3) of the Act, and the application of the attribution rule (subsection 74.1(1)) which allowed Mr. Lipson to deduct the interest paid on the mortgage loan (*Lipson*, *supra,* paras 22 and 23).

[61] Likewise, the appellant claims that two tax benefits were derived in the present case: the creation of the terminal loss on the transfer of the Roseland Buildings to RPM and the actual deduction of the loss by the respondent by virtue of his partnership interest and the application of the partnership rules (subsection 96(1)). As such, the Tax Court Judge erred in not conducting an object, spirit and purpose analysis of subsection 96(1) beyond demonstrating that this provision had been complied with at the time of the transfer.

[62] Even if I were to assume that the Tax Court Judge has failed to conduct the required analysis, the appellant has not identified any policy behind subsection 96(1) which was frustrated by the transactions in issue. In my respectful view, the Tax Court Judge correctly held that the tax benefit arose as a consequence of the interaction of subsection 20(16) with subsection 96(1). In particular, subsection 96(1) is the provision which allowed tax benefit arising from the operation of subsection 20(16) to be allocated to the limited partners. However, it is clear that the tax benefit arose under subsection 20(16).

[63] Relying on *Lipson*, the appellant further contends that subsection 85(5.1) was misused or abused because the transactions in issue were structured so as to avoid its application. However, *Lipson* establishes that the improper use of an avoidance provision in order to obtain a tax benefit gives rise to a misuse of that provision (*Lipson, supra*, para. 42). There is no suggestion in this case that subsection 85(5.1) was used in order to obtain a tax benefit.

[64] The appellant did raise the further argument that the transactions in issue were structured so as to avoid the application of subsection 85(5.1), thereby giving rise to an abuse (Appellant's Memorandum of Fact and Law, para. 56 and Appellant's Supplementary Memorandum of Fact and Law, para. 24). In this respect, reference is made to *Canada Trustco Mortgage* where it was suggested (para. 45) that an abuse may result from an arrangement entered in to in order to circumvent a specific anti-avoidance rule.

[65] This issue was not raised before the Tax Court Judge. Furthermore, subsection 85(5.1), which was initially advanced as a ground of assessment, was not relied upon at the confirmation stage. Counsel for the respondent indicated that material evidence going to the issue of whether an attempt was made to circumvent subsection 85(5.1) could have been filed, but was not. In these circumstances, I decline to consider this argument.

[66] In *Lipson*, Lebel J. confirmed the contextual and purposive approach to the GAAR analysis set out in *Canada Trustco Mortgage* (*Lipson, supra*, paras. 26 and 27). He also expressed the view that although the "overall purpose" of the transactions is not relevant to the analysis, it is useful to

consider the "overall result" and ask whether the result frustrates the object, spirit and purpose of the relevant provisions (*Lipson, supra*, paras. 34 and 38).

[67] In my respectful view, the overall result in this case does not frustrate the object, spirit and purpose of subsection 20(16). When the respondent made his investment in Roseland II, it was in the expectation that the real estate market would improve over time. A significant downturn occurred resulting in an important decrease in the value of the two Roseland Buildings. At that juncture, it became clear that the buildings were under depreciated.

[68] The amount of the terminal loss which resulted from the disposition of the buildings at fair market value reflects a real economic loss and the cost at which RPM acquired these assets (again fair market value) reflects their true economic value. It follows that any CCA claimed thereafter had to be computed by reference to that cost, and any subsequent sale beyond this cost would be recaptured. I can detect no misuse or abuse in that result.

[69] Another way to demonstrate the appropriateness of this result is to point out, as the Tax Court Judge did, that the same terminal loss would have been realized if the limited partners, rather than proceeding with the transactions in issue, had simply dissolved the partnership and distributed the partnership assets to the partners (Reasons, para. 52).

[70] The appellant has failed to establish that the Tax Court Judge erred in concluding that the transactions in issue are not abusive.

Cross-appeal

[71] Having concluded that the appeal cannot succeed, it is not necessary to dispose of the cross-appeal. However, in the event that the disposition of the appeal which I propose was found to be incorrect, it is useful to consider the merits of the cross-appeal.

[72] In support of its cross-appeal, the respondent maintains that the Tax Court Judge erred in concluding that the transactions were not entered into primarily for business reasons. In this respect, the respondent submits that the prime purpose of the transactions was saving costs and eliminating competition for the rentals. The respondent recognizes that the conclusion of the Tax Court Judge that this was not the prime purpose is a factual finding which cannot be overturned absent a palpable and overriding error.

[73] The respondent contends that the Tax Court Judge committed such an error by improperly focusing his analysis on the effect of the transactions rather than their purpose. Paragraphs 92, 93 and 95 of the Reasons are referred to as evidencing this error. In making this submission, the respondent relies on the decision of the Tax Court Judge in *MIL (Investments) S A v. The Queen*, (2006) 60 DTC 3307 (Can LII) at paragraphs 50 and 53 where it is explained that in assessing the prime purpose of a transaction, the “how” of the transaction is subordinate to the “why”. This decision was confirmed on appeal (2007 FCA 236), but on other grounds.

[74] The wording of subsection 245(3) makes it clear that it is the "purpose" of a transaction that is relevant to the analysis. It follows that 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.

[75] That said, the extent of the tax benefit obtained is a relevant consideration in determining the prime purpose of the transaction. For instance, the fact that the tax benefit achieved in this case dwarfed the costs to be saved supports the finding that tax benefit was the prime motivator. In addition, the Tax Court Judge considered documentary evidence which showed that at the planning stage, exclusive emphasis was placed on the "significant income tax benefits" which the proposal would produce (Reasons, paras. 85 and 86). There was also evidence that ACC had prior experience in obtaining the type of tax benefit which the transactions in issue procured (Reasons, para. 88).

[76] In my respectful view, there was evidence to support the Tax Court Judge's conclusion that the transactions were primarily motivated by the tax benefit.

[77] For these reasons, I would dismiss both the appeal and the cross-appeal with costs to the respondent.

"Marc Noël"

J.A.

"I concur.
Alice Desjardins J.A."

"I agree.
Johanne Trudel J.A."

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

DOCKET:	A-265-08

(APPEAL FROM A JUDGMENT OF THE HONOURABLE MR. JUSTICE PARIS OF THE TAX COURT OF CANADA, DATED MAY 2, 2007, NO. 2004-3026(IT)G.)

STYLE OF CAUSE:	HER MAJESTY THE QUEEN and GARY LANDRUS
PLACE OF HEARING:	Toronto, Ontario
DATE OF HEARING:	March 26, 2009
REASONS FOR JUDGMENT BY:	Noël J.A.
CONCURRED IN BY:	Desjardins J.A. Trudel J.A.
DATED:	April 16, 2009

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