Federal Court of Appeal

Cour d'appel fédérale

Date: 20210804

Docket: A-170-19

Citation: 2021 FCA 160

CORAM: STRATAS J.A.
WOODS J.A.
LASKIN J.A.

BETWEEN:

HER MAJESTY THE QUEEN

Appellant

and

DEANS KNIGHT INCOME CORPORATION

Respondent

Heard by online video conference hosted by the registry on March 22 and 23, 2021.

Judgment delivered at Ottawa, Ontario, on August 4, 2021.

REASONS FOR JUDGMENT BY: WOODS J.A.

CONCURRED IN BY: STRATAS J.A.
LASKIN J.A.

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REASONS FOR JUDGMENT

WOODS J.A.

A. Introduction

[1] This appeal concerns the application of the general anti-avoidance rule (the GAAR) under the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (the Act) to a tax loss monetization arrangement.

[2] Prior to the transactions at issue, the Respondent was a Canadian public corporation that had approximately $90 million of unused non-capital losses and other deductions (tax attributes). It sought to realize the value of these tax attributes and entered into an agreement with a corporation that had expertise in arranging such transactions.

[3] From 2009 to 2012, the Respondent deducted a majority of its tax attributes to reduce its tax liability. Following the issuance of reassessments to deny the deductions, the Respondent successfully appealed to the Tax Court (2019 TCC 76, *per* Paris J.).

[4] The Crown appeals. It submits that the GAAR is applicable to the monetization arrangement because it results in an abuse of the provisions of the Act which restrict the use of tax attributes following an acquisition of control by a person or group of persons.

[5] These reasons focus mainly on one of the Respondent’s tax attributes: non-capital losses. For reasons discussed by the Tax Court (at para. 87), the conclusions reached with respect to this tax attribute also apply to the others at issue.

[6] By way of background, one of the issues in the appeal is whether the object, spirit and purpose of the acquisition-of-control element in subsection 111(5) of the Act is fully reflected in the text of this provision. If it is, the GAAR would not apply to a transaction solely on the basis that the transaction frustrates the object, spirit and purpose of this element. As far as I am aware, this is the first time that this issue has come before this Court.

[7] For the reasons below, I have concluded that the Crown's appeal should be allowed.

B. Overview of facts

[8] A detailed description of the facts is included in the Tax Court's reasons. This section sets out an overview of the arrangement. Further facts as required are introduced in the analysis.

The plan to monetize the tax attributes

[9] In the years leading up to the transactions at issue, the Respondent carried on a drug research and food additives business under the name Forbes Medi-Tech Inc. Its shares were listed for trading on the Toronto Stock Exchange and NASDAQ.

[10] In 2007, the Respondent was experiencing serious cash flow difficulties and began to investigate opportunities to utilize its tax attributes so that their value could be realized. The arrangement that it settled on is described below.

The preliminary reorganization

[11] On February 27, 2008, the Respondent and its shareholders undertook a reorganization in the form of a share exchange that, in part, was intended to facilitate a tax loss monetization arrangement. The reorganization was effected by a court-approved plan of arrangement under which the Respondent's shareholders exchanged their shares for shares of a newly-incorporated

company (New Forbes). The result was that the shares of New Forbes were publicly traded in substitution of the shares of the Respondent, and the Respondent became a wholly-owned subsidiary of New Forbes.

Agreement with Matco Capital Ltd.

[12] On March 19, 2008, the Respondent and its new shareholder, New Forbes, entered into an agreement with Matco Capital Ltd. (Matco) which provided a framework for the tax attribute monetization arrangement (Investment Agreement, or Agreement). Matco is a venture capital company that had previously been involved in transactions similar to this.

[13] By way of overview, the Investment Agreement achieved the following:

(a) the Respondent’s existing business (except for its tax attributes) would be transferred to New Forbes;

(b) New Forbes would be entitled to receive a specified amount for the tax attributes ($3.8 million, with some potential upside). Of this amount, $3 million would be received up front and $800,000 would be received a year later; and

(c) New Forbes would turn the reins to the Respondent over to Matco.

[14] As described below, these arrangements were to be undertaken in a way that avoided Matco acquiring control of the Respondent, or a right to acquire control. This overview section does not describe all of the provisions of the Agreement relating to control. Some are discussed later in the reasons as part of the GAAR analysis.

[15] The up-front consideration, $3 million, would initially be paid by Matco to the Respondent as consideration for a convertible debenture to be issued by the Respondent. For simplicity, the $3 million amount, and other amounts stated in these reasons, are approximations. The difference between the approximations and actual amounts is not material to the appeal.

[16] The convertible debenture could be converted at Matco's option into voting and non-voting common shares of the Respondent that would provide Matco with 79 percent of the equity and 35 percent of the votes on a fully diluted basis. The consideration for the debenture represented 79 percent of the total amount ($3.8 million) that New Forbes was entitled to receive from Matco for the tax attributes.

[17] Upon issuance of the debenture, New Forbes would continue to own all of the issued shares of the Respondent, except for a nominal amount of shares that had been issued to avoid the Investment Agreement being a unanimous shareholders agreement, which might have affected control. As a result of the issuance of the debenture, the shares of the Respondent that were owned by New Forbes would represent 21 percent of the equity and 65 percent of the votes on a fully diluted basis.

[18] The Agreement also provided that the existing assets and liabilities of the Respondent and the $3 million consideration paid for the debenture would be transferred to New Forbes. As a result, the Respondent would retain its tax attributes and effectively become a shell with no assets and one liability — an obligation to pay principal and interest to Matco under the convertible debenture.

[19] The arrangement contemplated that Matco would use its expertise to arrange a takeover of the Respondent in an initial public offering (IPO) or similar transaction. The Agreement referred to this as a "Corporate Opportunity." The funds raised by a Corporate Opportunity would be used by the Respondent to commence a new business that would earn profits and utilize the tax attributes. An IPO or similar transaction was critical to the plan because the tax attributes would be extinguished if the Respondent was acquired by a "person or group of persons." As discussed below, an IPO provided an opportunity to ensure that such an acquisition did not take place.

[20] Upon entering into the Agreement, New Forbes issued a press release announcing that it had completed a transaction with a private investor in which New Forbes received $3 million of capital, to be followed by an additional $800,000 within one year, with a possible upside on the latter amount.

[21] The reference in the press release to the additional consideration to be received within one year was a reference to Matco's obligation within one year to either make an offer for New Forbes' 21 percent interest for at least $800,000 or to simply pay $800,000 without acquiring the

shares. Matco's option to pay the additional amount without acquiring shares was necessary to avoid Matco acquiring *de jure* control if Matco was not able to arrange an IPO or similar transaction.

[22] The reference to an upside potential on the $800,000 refers to the possibility that New Forbes might reject Matco's offer to purchase the shares of the Respondent. Instead, New Forbes might choose to continue to own the shares which, by this time, might be trading on a stock exchange at an amount greater than $800,000 by reason of an IPO.

The initial public offering and subsequent events

[23] After the initial steps described above were completed, Matco endeavoured to arrange an IPO or similar transaction.

[24] In December 2008, Matco commenced negotiations with Deans Knight Capital Management Ltd. (DK Capital Management) regarding a proposed takeover of the Respondent by way of an IPO. The Respondent changed its name to Deans Knight Income Corporation in February 2009, and the IPO closed approximately one month later.

[25] The Respondent raised $100 million in the IPO. According to the prospectus related to the offering, the proceeds were to be managed by DK Capital Management and invested in corporate debt securities. The prospectus stated that the Respondent had tax attributes that it expected would reduce the taxable income of the Respondent. It also stated that there was a risk

that "the CRA could successfully challenge the amount of such tax attributes or their availability to the Company." The Respondent was to have a limited five-year life after the IPO.

[26] Immediately prior to the closing of the IPO, Matco converted its debenture into voting and non-voting shares of the Respondent. Subsequent to the closing, Matco made an offer to New Forbes to purchase all of its shares of the Respondent for $800,000. The offer was accepted.

[27] As a result of these transactions, Matco invested $3.8 million and owned shares of the Respondent with a value of $5 million at that time. New Forbes no longer owned any shares of the Respondent and it had realized $3.8 million.

[28] As discussed earlier, the Respondent deducted the majority of the tax attributes in its 2009 to 2012 taxation years to reduce its tax liability from the debt-securities business. On July 16, 2014, the Respondent was reassessed for these taxation years to deny the deductions claimed.

C. Applicable legislation

[29] The relevant statutory scheme applicable to the taxation years at issue is discussed below. Extracts of these provisions are set out in Appendix A.

The general anti-avoidance rule

[30] Section 245 of the Act, the GAAR, was enacted in 1988 as a means to combat abusive tax avoidance in light of the failure of specific anti-avoidance rules to effectively accomplish this objective.

[31] The Supreme Court has provided significant guidance as to the proper interpretation of section 245. See for example *Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54, [2005] 2 S.C.R. 601 and *Copthorne Holdings Ltd. v. Canada*, 2011 SCC 63, [2011] 3 S.C.R. 721.

[32] As described in *Copthorne* (at para. 33), three questions must be determined under section 245:

- Was there a tax benefit?
- Was the transaction giving rise to the tax benefit an avoidance transaction? and
- Was the avoidance transaction giving rise to the tax benefit abusive?

[33] A tax benefit is defined in subsection 245(1) of the Act and includes a reduction of tax.

[34] An avoidance transaction is defined in subsection 245(3) of the Act. It includes a transaction that results in a tax benefit and is not undertaken primarily for *bona fide* non-tax

purposes. An avoidance transaction also includes a transaction that is part of a series of transactions that results in a tax benefit. Guidance on how to determine an avoidance transaction where there is a series is provided in *Copthorne* at para. 40:

> … [I]t is necessary to determine if there was a series, which transactions make up the series, and whether the tax benefit resulted from the series. If there is a series that results, directly or indirectly, in a tax benefit, it will be caught by s. 245(3) unless each transaction within the series could 'reasonably be considered to have been undertaken or arranged primarily for *bona fide* purposes other than to obtain [a] tax benefit.' …

[35] Where there is an avoidance transaction, the tax benefit that results from that transaction or from a series of transactions that includes that transaction is to be denied (subsection 245(2) of the Act).

[36] However, subsection 245(4) of the Act provides that a tax benefit is not to be denied unless the avoidance transaction is abusive. Although the term "abuse" is not defined in the Act, it has been extensively discussed in the jurisprudence.

[37] In determining whether a transaction is an abuse, the analysis is to proceed in two steps (*Copthorne* at paras. 69 and 71). The first step is to determine the object, spirit and purpose or underlying rationale of the relevant provisions of the Act. Then the court must determine if the avoidance transaction falls within or frustrates that underlying rationale.

[38] If the tax benefit results from a series of transactions and not from the avoidance transaction by itself, the court is to focus the abuse analysis on the avoidance transaction but view it in the context of the series of transactions (*Copthorne* at para. 71).

[39] At the second step of the abuse analysis, the Crown must clearly demonstrate that the transaction is an abuse of the Act (*Copthorne* at para. 72).

Non-capital losses

[40] The non-capital losses that are relevant in this appeal are losses from a business. This type of loss may be carried back three years and carried forward 20 years to reduce taxable income in those years (paragraph 111(1)(a) of the Act).

[41] If there has been an acquisition of control of the loss corporation by a person or group of persons, the non-capital loss carryover is restricted (subsection 111(5)). If the loss corporation no longer carries on the business that incurred the losses, the non-capital loss carryover is prohibited outright.

[42] Loss restriction provisions such as this have had a long history in the Act. They were first introduced in 1958 and were enhanced in 1963 by the introduction of an acquisition-of-control test. In 1963, the Minister of Finance stated that the purpose of the acquisition-of-control test was to stop a "practice [that] has developed of trafficking in the shares of companies whose businesses have been discontinued, but which technically have certain tax loss carry forward

entitlements" (Bill C-95, "An Act to amend the Income Tax Act", 2nd reading, *House of Commons Debates*, 26-1, No. 4 (16 October 1963) at 3637). The 1963 legislation prohibits the carrying forward of a business loss if "control of the corporation has been acquired … by a person or persons … [and] the corporation was not … carrying on the business in which the loss was sustained" (subsection 27(5) of the *Income Tax Act*, R.S.C. 1952, c. 148).

[43] This legislation has been fine-tuned over the years but the restriction that was introduced in 1963 remains today.

[44] The term "acquisition of control" in subsection 111(5) of the Act has been judicially determined to mean *de jure* control (*Duha Printers (Western) Ltd. v. Canada*, [1998] 1 S.C.R. 795, 159 D.L.R. (4th) 457). This generally means the ability, through the ownership of shares, to elect the majority of the board of directors (*Duha Printers* at para. 36).

[45] In order for multiple shareholders to collectively exercise *de jure* control of a corporation, there must be a sufficient common connection between them, such as in a voting agreement, an agreement to act in concert, or business or family relationships (*Silicon Graphics Ltd. v. Canada*, 2002 FCA 260, [2003] 1 F.C. 447 at para. 36). Accordingly, an IPO which results in a corporation being widely held may achieve a takeover without an acquisition of *de jure* control.

[46] The reach of subsection 111(5) was expanded effective in 1979 to include, among other things, an acquisition of a right to acquire shares if one of the main purposes for the acquisition

was to avoid the application of subsection 111(5) (subsection 256(8) and paragraph 251(5)(b) of the Act).

[47] The Act also includes other deeming rules that expand the reach of subsection 111(5) in specified circumstances. These provisions are described in the reasons of the Tax Court (at paras. 111-125).

D. The Tax Court decision

[48] The Tax Court considered two issues: whether there was an acquisition of control by Matco pursuant to subsection 256(8), and whether the GAAR applied.

[49] The first issue required the Tax Court to determine whether Matco acquired a right to purchase the majority of the voting shares of the Respondent such that losses were extinguished by a combination of subsection 256(8), paragraph 251(5)(b) and subsection 111(5) of the Act. The Tax Court determined that Matco did not obtain a right of this nature. Neither party has challenged this conclusion.

[50] The second issue concerned the GAAR. The first two questions in the GAAR analysis were determined in favour of the Crown. There was a tax benefit and an avoidance transaction. These findings are not in dispute.

[51] The Tax Court then considered whether the relevant transactions were an abuse. It first addressed the object, spirit and purpose of paragraph 111(1)(a), subsection 111(5) and subsection 256(8). The Court undertook a textual, contextual and purposive interpretation of these provisions and concluded that (emphasis added):

- The object, spirit or purpose of paragraph 111(1)(a) "is to provide relief to taxpayers who have suffered losses, given that the government, through income tax, shares in the income of a taxpayer" (at para. 99);

- The object, spirit or purpose of subsection 111(5) "is to target manipulation of losses of a corporation by a new person or group of persons, <u>through effective control over the corporation's actions</u>" (at para. 134); and

- The object, spirit or purpose of subsection 256(8) "is to prevent a taxpayer from circumventing the listed avoidance provisions <u>by acquiring control over shares or share voting rights</u> in order to achieve effective control of the corporation" (at para. 138).

[52] The Tax Court was then required to consider whether such purposes had been frustrated. The Court ultimately concluded that the underlying rationale of subsection 111(5) and subsection 256(8) had not been defeated and accordingly there was no abuse.

[53] With respect to subsection 111(5), the abuse analysis turned on whether Matco had effective control over the actions of the Respondent. The Tax Court rejected the Crown's submission that changes in management, business activity, assets and name post-IPO are relevant in determining whether there is a change of effective control. The Tax Court also rejected the submission that the change in shareholders post-IPO was relevant because there likely was no common connection among the public shareholders.

[54] The Tax Court went on to conclude that there was no attempt to disguise what rights Matco had and that Matco simply did not have effective control over the Respondent or need such control to make the arrangement work. The Respondent participated freely in the transactions that resulted in the use of the tax attributes. Further, the Respondent acting on its own could have arranged with DK Capital Management to raise funds by means of an IPO and to carry on the investment business without the assistance and participation of Matco.

[55] With respect to subsection 256(8), the abuse analysis turned on whether Matco had effective control over the shares of the Respondent owned by New Forbes. These shares represented *de jure* control. The Tax Court rejected the Crown's submissions that: (1) the Investment Agreement gave Matco effective control over the shares held by New Forbes, (2) Matco, New Forbes and the Respondent intended at all times that Matco would acquire those shares, and (3) Matco, New Forbes and the Respondent intended and acted as though Matco had effective control over the shares.

E. Positions of the parties

[56] In this Court, the Crown only made arguments concerning the GAAR, and specifically the requirement of abuse. The Crown addressed the object, spirit and purpose of paragraph 111(1)(a), subsection 111(5) and subsection 256(8) before turning to whether the transactions resulted in abusive tax avoidance.

[57] The Crown submits that the purpose of paragraph 111(1)(a) is to obtain a truer picture of a taxpayer's income over a period of years.

[58] As for subsection 111(5), the Crown argues that the object, spirit and purpose is part of a general policy in the Act to prohibit the transfer of losses between taxpayers, subject to specific exceptions. The Crown submits that the rationale for the acquisition of control test is to serve as a proxy for the degree of continuity of shareholder interest required to allow corporate losses to offset income from a new business.

[59] As for subsection 256(8), the Crown submits that the underlying rationale of this provision is to combat structures that are designed to avoid the acquisition of control test in subsection 111(5) in order to facilitate inappropriate loss trading.

[60] In its concluding submission, the Crown argues that "the transactions clearly circumvent, and are not in accord with, the underlying rationale of paragraph 111(1)(a), subsection 111(5) and subsection 256(8)." Further, "the transactions undertaken result in abusive tax avoidance

because they blatantly avoided an acquisition of control of the respondent, caused the cessation of the business that generated the Tax Attributes and completely severed the shareholder interest in that former business from the new business carried on as a result of the IPO."

[61] The Respondent also addressed the abuse requirement. It first addressed the object, spirit and purpose of subsection 111(5). It submits that the underlying rationale of subsection 111(5) is fully reflected in its text, which reflects a clear policy choice of Parliament. As for subsection 256(8), the Respondent submits that Parliament wanted to ensure that taxpayers do not artificially avoid acquisitions of control by having, but not exercising, rights that would put them in a position of *de jure* control.

[62] Regarding the transactions at issue, the Respondent takes the position that Matco did not acquire control of the Respondent under the Investment Agreement, or otherwise "seek to control its destiny to its own advantage." The Respondent characterizes the Investment Agreement as incentivizing mutually beneficial behaviour while providing consequences if either party pursues activities that harm another party's interests.

F. Analysis

Standard of review

[63] The appellate standard of review applies to this appeal. Questions of law are to be determined on the correctness standard, and questions of fact and questions of mixed fact and

law (excluding extricable questions of law) are to be determined on the basis of palpable and overriding error: *Housen v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235.

[64] With respect to the abuse requirement in subsection 245(4) of the Act, findings concerning the object, spirit and purpose of the legislation are subject to review for correctness and findings whether there is an abuse on the particular facts are subject to review for palpable and overriding error: *Canada v. Oxford Properties Group Inc.,* 2018 FCA 30, [2018] 4 F.C.R. 3 at para. 39.

The issue

[65] In this appeal, the Crown submits that the arrangement with Matco constitutes abusive tax avoidance.

[66] As mentioned earlier, a GAAR analysis involves three questions. The Tax Court's findings with respect to the first two are not in dispute. Accordingly, the following will be assumed for purposes of this analysis:

(a) The tax benefit is comprised of the reduction of the Respondent's tax liability that resulted from deducting the tax attributes (at para. 73); and

(b) The avoidance transactions consist of entering into the Investment Agreement, the Respondent's restructuring of itself, and all related transactions (at para. 83).

[67] A point of clarification should be made. In the Tax Court, the Crown did not allege that the IPO was part of the series of transactions. In this appeal, the parties now accept that the IPO is part of the series of transactions. This position is well supported by the evidence.

[68] I now turn to the third question in the GAAR analysis — whether there is abuse. This question involves two steps. The first is to determine the object, spirit and purpose of the provisions of the Act relied upon, and the second is to determine whether the transactions frustrate this purpose.

[69] The Crown argues that there is an abuse because the transactions circumvent the loss restriction on an acquisition of control under s. 111(5) and the deeming rule in s. 256(8). However, it is not necessary in this appeal to undertake an abuse analysis with respect to subsection 256(8). Subsection 111(5) of the Act is the more appropriate provision because it refers broadly to an acquisition of control of a corporation. Subsection 256(8) refers to a right with respect to a share that, if exercised, would result in an acquisition of control. It is sufficient in these reasons to focus on subsection 111(5).

Step 1 of abuse analysis – What is the object, spirit and purpose of subsection 111(5)?

[70] The Tax Court undertook a detailed textual, contextual and purposive analysis of subsection 111(5) and determined that the object, spirit and purpose of this provision is “to target manipulation of losses of a corporation by a new person or group of persons, through effective control over the corporation’s actions” (at para. 134).

[71] I agree with the Tax Court's conclusion as to the object, spirit and purpose of subsection 111(5), substantially for the reasons given (at paras. 100-134). The relevant parts of the reasons are reproduced in Appendix B.

[72] However, the Tax Court's statement of the underlying rationale of subsection 111(5) lacks clarity. This was evident in the submissions before this Court on what the Tax Court meant by "effective control". I would rearticulate the object, spirit and purpose of subsection 111(5) as follows: it is to restrict the use of specified losses, including non-capital losses, if a person or group of persons has acquired actual control over the corporation's actions, whether by way of *de jure* control or otherwise.

[73] I have replaced the term "effective control" with "actual control". In their submissions, the parties assumed that the Tax Court used the term "effective control" as a synonym for *de jure* control. As evident in the Tax Court's reasons at paragraph 144 and in the Court's reference to "manipulation" in paragraph 134, the Court did not intend that "effective control" mean *de jure* control. I have changed the terminology to avoid further confusion.

[74] I will now address some of the Respondent's arguments on this issue. The Respondent urges this Court to find that the object, spirit and purpose of subsection 111(5) of the Act is fully expressed by its text: that is, the object, spirit and purpose is to restrict loss carryovers only if there is an acquisition of *de jure* control. The Respondent refers to the text of subsection 111(5), the history of the provision, the re-introduction of an equity test in 2013 in section 256.1, the extensive use of a *de facto* control test in the Act (including the broad deeming rule introduced in

2017 in subsection 256(5.11)), and the restrictions in specified circumstances in subsection 256(7).

[75] The Respondent submits that these factors illustrate that Parliament designed careful and specific provisions to restrict loss carryovers, and that the policy choice selected in the taxation years at issue was that loss carryovers would be permitted unless there was an acquisition of control in accordance with the provisions of the Act.

[76] I disagree with this submission. Parliament has enacted several specific anti-avoidance rules that apply to a corporation that has unused non-capital losses, but these rules do not reflect a policy that the GAAR has no application to them. In particular, the various specific anti-avoidance rules address different circumstances. They do not work together to provide a comprehensive scheme that is fully reflected in the text of the provisions. Moreover, the position of the Respondent is inconsistent with this Court's determination that the GAAR is applicable to transactions that circumvented the specific anti-avoidance rules in subsection 256(7) of the Act (*Birchcliff Energy Ltd. v. Canada*, 2019 FCA 151 at paras. 54 and 55).

[77] In addition, in a GAAR analysis a court must apply a unified textual, contextual and purposive approach to a determination of the object, spirit and purpose of the relevant provisions (*Copthorne* at para. 70). The approach suggested by the Respondent fails to meaningfully consider the purposive element.

[78] There are two purposive factors that shed light on the underlying rationale of subsection 111(5): clear statements of government intent and jurisprudence acknowledging that the Act generally aims to prevent loss trading.

[79] I would refer to the statement made by the Minister of Finance in 1963 referred to above that explained the need for the acquisition-of-control provision. As set out in paragraph 42 above, the provision was introduced in order to prohibit arrangements which involve trafficking in shares of companies with loss carryovers.

[80] I would also refer to an article published in the Canadian Tax Journal in 1988 when the GAAR was introduced which refers specifically to loss carryforwards. A senior Department of Finance official, David Dodge, commented that one of the objectives of the GAAR was to deal with an erosion of tax revenues, including a large shortfall in expected tax revenues that "was considered to be caused largely by the unexpected application of loss carryforwards" (David Dodge, "A New and More Coherent Approach to Tax Avoidance" (1988) 36:1 Canadian Tax Journal 1 at p. 3). It could not be clearer that the government believed in 1988 that the text of the restrictions on the use of non-capital losses did not fully reflect the purpose of this legislation.

[81] As for what courts have said, as the Tax Court noted (at para. 142), the Supreme Court has recognized that "the general policy of the *Income Tax Act* is to prohibit the transfer of losses between taxpayers, subject to specific exemptions" and "that this policy is to be taken into account in determining Parliament's intent" (*Mathew v. Canada*, 2005 SCC 55, [2005] 2 S.C.R.

643 at para. 49). This is a purposive consideration that the Court must consider alongside the textual and contextual considerations raised by the Respondent.

[82] The Respondent further submits that if the object, spirit and purpose of subsection 111(5) of the Act is determined to be broader than *de jure* control, the result is a *de facto* control test. The Respondent points out that Parliament has enacted *de facto* control provisions in other parts of the Act, such as the associated company rules, and it has chosen not to do so with respect to subsection 111(5). It suggests that this is a reflection of Parliament's intent.

[83] It is true that the object, spirit and purpose of subsection 111(5) as articulated above does include forms of *de jure* and *de facto* control. However, the actual control test is different than the statutory *de facto* control test in subsection 256(5.1) of the Act. Moreover, it must be remembered that the GAAR is intended to supplement the provisions of the Act in order to deal with abusive tax avoidance. I see nothing inconsistent with the conclusion that the object, spirit and purpose of subsection 111(5) takes into account different forms of control even though the text of the provision is limited to *de jure* control.

[84] Reference may also be made to the Supreme Court's decision in *Duha Printers,* in which the Court considered transactions designed to circumvent the *de jure* control test in subsection 111(5) of the Act. The Court commented that the *de jure* control test was selected "because in some respects it is a relevant and relatively certain and predictable concept to employ in determining control" (at para. 58). The Court also commented (at para. 52) that if the distinction between *de jure* and *de facto* control is to be eliminated, this should be left for Parliament.

[85] Parliament did respond. While Parliament did not change the *de jure* control test in subsection 111(5), it did enact the GAAR to respond generally to abusive tax avoidance. I note that the GAAR was enacted a few years after the transactions in *Duha Printers* were implemented.

[86] Accordingly, I reject the Respondent's submission that the object, spirit and purpose of subsection 111(5) is fully reflected in its text.

[87] I would also briefly comment on two additional arguments that the Respondent emphasized at the hearing.

[88] First, the Respondent relies on a specific anti-avoidance provision, subsection 256.1(3) of the Act, that was enacted after the taxation years at issue. The Respondent submits that this provision implicitly recognizes that Parliament intends the transactions at issue to be acceptable as long as Matco does not acquire more than 75 percent of the equity of the Respondent.

[89] I disagree. Subsection 256.1(3) is another specific anti-avoidance rule that is aimed at trafficking in shares of loss companies. It specifically addresses circumstances involving equity acquisitions. The provision does not replace subsection 111(5) and it does not evidence a legislative intent that the transactions at issue would be acceptable if Matco's equity interest was within the limit set out in section 256.1.

[90] Second, the Respondent submits that the Court should consider the other tax attributes that are at issue. It points out that some of these attributes involve incentive provisions that are designed to generate economic activity which benefits Canada. The tax attributes that the Respondent referred to involve incentives for expenditures on scientific research and experimental development. I disagree with the Respondent's submission because it focusses only on the incentive aspect of the legislation and not on the anti-avoidance aspect that is relevant in this appeal.

[91] Turning to the Crown's submissions, the Crown urges the Court to consider that there is a general policy in the Act that losses are not transferrable. It submits that the object, spirit and purpose of subsection 111(5) engages circumstances where there is a lack of shareholder continuity. The focus is on a change of shareholders, not a change of control.

[92] The Tax Court rejected this argument, citing *Mathew* at para. 49: "This policy is but one consideration to be taken into account in determining Parliament's intent." I have concluded that it is not necessary in this appeal to address the Crown's argument because, even when the argument not is taken into account, the object, spirit and purpose of subsection 111(5) have been defeated. Accordingly, the Crown's argument as to the object, spirit and purpose of subsection 111(5) can be left for another day.

[93] For these reasons, I conclude that the object, spirit and purpose of subsection 111(5) is, at least in part, to restrict the use of specified losses, including non-capital losses, if a person or

group of persons has acquired actual control over the corporation's actions, whether by way of *de jure* control or otherwise.

Step 2 of abuse analysis – Does a transaction result in an abuse?

[94] In the second step of the abuse analysis, the Court must determine whether there is an avoidance transaction that results in an abuse of the Act. The Tax Court's decision is to be reviewed on the palpable and overriding error standard of review, unless the issue involves an extricable question of law.

[95] The Tax Court considered whether there was an abuse of subsection 111(5) of the Act, by itself, and also whether there was an abuse of subsection 256(8) of the Act together with subsection 111(5). As mentioned earlier, it is not necessary for purposes of this appeal to consider subsection 256(8).

[96] As discussed under step one, the object, spirit and purpose of subsection 111(5) is to restrict the use of non-capital losses if there has been an acquisition of actual control over the actions of the corporation, whether the acquisition is by way of *de jure* control or otherwise.

[97] In its analysis under step one, the Tax Court agreed with an author who suggested that "the acquisition of control test in subsection 111(5) is a reasonable marker between situations where the corporation is a free actor in a transaction and when it is only a passive participant …" (at para. 134). At step two, the Tax Court concluded that Matco had no effective control of the

Respondent and that the Respondent freely participated in the transactions that resulted in the use of the tax attributes (at paras. 150 and 152).

[98] With respect, the Tax Court's conclusion at step two is inconsistent with the terms of the Investment Agreement. These terms gave Matco actual control over the actions of the Respondent, including the approval of the Corporate Opportunity.

[99] The Investment Agreement deals separately with control in general, and control over the approval of the Corporate Opportunity.

[100] As for control in general, the Agreement provides severe restrictions on the actions that New Forbes and the Respondent may take (section 6.1 of the Agreement). The Agreement backs up these restrictions by providing that New Forbes' entitlement to the additional $800,000 payment within one year (the Guaranteed Amount) will be forfeited if New Forbes does not comply with its obligations (section 8.3(a) of the Agreement).

[101] Some of the key restrictions in section 6.1 of the Agreement are:

(i) New Forbes shall not enter into any contract or agreement in respect of the Respondent;

(ii) The Respondent shall not engage in any activity other than related to a Corporate Opportunity and New Forbes will ensure that the Respondent complies with this obligation; and

(iii) New Forbes shall use commercially reasonable efforts to satisfy (or cause the satisfaction of) its obligation to cooperate with Matco in the implementation of a Corporate Opportunity.

[102] As for terms in the Agreement relating to the approval of the Corporate Opportunity, the Agreement purports to allow New Forbes and the Respondent to accept or reject a Corporate Opportunity in their sole discretion (section 4.1 of Agreement). However, that is not the end of the matter. If a Corporate Opportunity is rejected by either New Forbes or the Respondent, the Guaranteed Amount is forfeited (section 5.5(d) of the Agreement).

[103] It is significant that the $800,000 Guaranteed Amount was not a trifling amount and it was an important part of the arrangement for New Forbes. As for the quantum, $800,000 is the full amount that Matco agreed to pay New Forbes for its 21 percent equity interest in the Respondent. As for its importance, New Forbes' entitlement to the Guaranteed Amount was the only assurance that it had that it would receive more than $3 million for the tax attributes. The Guaranteed Amount was payable to New Forbes regardless of whether or not a Corporate Opportunity materialized. This is significant because the evidence suggests that there was a real risk that a Corporate Opportunity might not be achieved. If that happened, there would be no public market for the shares owned by New Forbes, as there would be with an IPO.

[104] As a result, there was no realistic chance that a Corporate Opportunity would be rejected by New Forbes or the Respondent.

[105] As a consequence of all of these restrictions, the Investment Agreement resulted in New Forbes and the Respondent handing over actual control of the Respondent to Matco. New Forbes and the Respondent realistically could do nothing relating to the actions of the Respondent other than to ensure that they fulfilled their obligation to assist Matco with the implementation of the Corporate Opportunity. They were not free actors.

[106] As a point of clarification, the Tax Court made a general factual finding regarding the approval process for the IPO. Without further background, this finding might suggest that New Forbes and the Respondent behaved as free actors in the approval process. This was not the case.

[107] The Court stated (at para. 32) that the board of directors of the Respondent discussed the proposal, did some investigation into the background of DK Capital Management, and then approved the proposal.

[108] It should not be inferred from this finding that the Respondent and New Forbes behaved as free actors when it came to approving the IPO. The testimony reveals that New Forbes did investigate the background of DK Capital Management but this consisted of a very limited investigation to ensure that this company was not a fly-by-night operation since Forbes' name would be associated with it. Further, there were detailed discussions about the IPO but these discussions had nothing to do with the approval process. They related to the cooperation that

New Forbes was compelled to provide in implementing the IPO. Reference was made in this regard to the preparation of the 2008 tax returns and obtaining KPMG's sign off on the financial statements (Appeal Book at pp. 1659-1664).

[109] It is also convenient to mention here that the Tax Court commented that Matco did not need control for the tax plan to work. Instead, it would have been possible for New Forbes to arrange an IPO without Matco's assistance and participation (at para. 151).

[110] This comment is not relevant to the analysis. Whether there has been an abuse depends on whether the object, spirit and purpose of the relevant provisions have been frustrated by the transactions that were undertaken. It is not relevant whether there exists another potential transaction that was not pursued.

[111] In my view, the Tax Court's conclusion on step two is not supported the evidence. The standard of review that should be applied is whether there is a palpable and overriding error. In this case, the error meets this high threshold (*Hydro-Québec v. Matta*, 2020 SCC 37, 450 D.L.R. (4th) 547 at para. 33 and *Mahjoub v. Canada (Citizenship and Immigration),* 2017 FCA 157, [2018] 2 F.C.R. 344 at para. 62).

[112] The error is palpable because it is plain to see that the Court's conclusion is not consistent with the terms of the Investment Agreement and it is overriding because it affects the result.

[113] As mentioned earlier, the Crown has the burden to clearly demonstrate that the transactions are an abuse. In this Court, the Crown demonstrated that through the Investment Agreement the transactions "blatantly avoided an acquisition of control of the respondent." The Respondent appeared to suggest that this was an abuse of subsection 256(8) and subsection 111(5) working together. I have determined that there is an abuse of subsection 111(5) alone. However, this does not matter. The Crown has clearly demonstrated that the transactions are abusive.

Conclusion and disposition

[114] For the reasons given above, the statutory conditions for the application of the GAAR have been met. It is admitted and clear that there is a tax benefit that is comprised of the deduction of the tax attributes. It is also admitted and clear that there are avoidance transactions. In this regard, the transactions relating to the Investment Agreement are avoidance transactions because they are part of a series of transactions that results in the tax benefit and these transactions were not undertaken primarily for *bona fide* purposes other than to obtain the tax benefit. Further, the avoidance transactions circumvent subsection 111(5) of the Act in a way that frustrates the object, spirit and purpose of this provision. Accordingly, pursuant to subsection 245(2) of the Act, the tax benefit should be denied.

[115] Therefore, I would allow the appeal, set aside the judgment of the Tax Court, and dismiss the appeal to the Tax Court.

[116] The Respondent has requested an opportunity to make submissions as to costs. The normal rule is that costs follow the event. Accordingly, the Crown, as the successful party, should make its submissions first. Those submissions shall be no longer than 5 pages and shall be filed within 10 days from the date of these reasons. The Respondent may file responding submissions no longer than 5 pages within 10 days from the receipt of the Crown's submissions. The Crown may file a 2-page reply within 5 days from the receipt of the Respondent's submissions.

"Judith Woods"
J.A.

"I agree.
David Stratas J.A."

"I agree.
J.B. Laskin J.A."

APPENDIX A

***Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.)**

111(1) For the purpose of computing the taxable income of a taxpayer for a taxation year, there may be deducted such portion as the taxpayer may claim of the taxpayer's

> **(a)** non-capital losses for the 20 taxation years immediately preceding and the 3 taxation years immediately following the year;
>
> […]

111(5) Where, at any time, control of a corporation has been acquired by a person or group of persons, no amount in respect of its non-capital loss or farm loss for a taxation year ending before that time is deductible by the corporation for a taxation year ending after that time and no amount in respect of its non-capital loss or farm loss for a taxation year ending after that time is deductible by the corporation for a taxation year ending before that time except that

> **(a)** such portion of the corporation's non-capital loss or farm loss, as the case may be, for a taxation year ending before that time as may reasonably be regarded as its loss from carrying on a business and, where a business was carried on by the

***Loi de l'impôt sur le revenu*, L.R.C. (1985), ch. 1 (5e suppl.)**

111(1) Pour le calcul du revenu imposable d'un contribuable pour une année d'imposition, peuvent être déduites les sommes appropriées suivantes :

> **a)** ses pertes autres que des pertes en capital subies au cours des 20 années d'imposition précédentes et des 3 années d'imposition suivantes;
>
> […]

111(5) En cas d'acquisition, à un moment donné, du contrôle d'une société par une personne ou un groupe de personnes, aucun montant au titre d'une perte autre qu'une perte en capital ou d'une perte agricole pour une année d'imposition se terminant avant ce moment n'est déductible par la société pour une année d'imposition se terminant après ce moment et aucun montant au titre d'une perte autre qu'une perte en capital ou d'une perte agricole pour une année d'imposition se terminant après ce moment n'est déductible par la société pour une année d'imposition se terminant avant ce moment. Toutefois :

> **a)** la fraction de la perte autre qu'une perte en capital ou de la perte agricole subie par la société pour une année d'imposition se terminant avant ce moment qu'il est raisonnable de considérer comme résultant de l'exploitation d'une entreprise et, si la société

corporation in that year, such portion of the non-capital loss as may reasonably be regarded as being in respect of an amount deductible under paragraph 110(1)(k) in computing its taxable income for the year is deductible by the corporation for a particular taxation year ending after that time

(i) only if that business was carried on by the corporation for profit or with a reasonable expectation of profit throughout the particular year, and

(ii) only to the extent of the total of the corporation's income for the particular year from that business and, where properties were sold, leased, rented or developed or services rendered in the course of carrying on that business before that time, from any other business substantially all the income of which was derived from the sale, leasing, rental or development, as the case may be, of similar properties or the rendering of similar services; and

[…]

exploitait une entreprise au cours de cette année, la fraction de la perte autre qu'une perte en capital qu'il est raisonnable de considérer comme se rapportant à un montant déductible en application de l'alinéa 110(1)k) dans le calcul de son revenu imposable pour l'année, ne sont déductibles par la société pour une année d'imposition donnée se terminant après ce moment :

(i) que si, tout au long de l'année donnée, cette entreprise a été exploitée par la société en vue d'en tirer un profit ou dans une attente raisonnable de profit,

(ii) qu'à concurrence du total du revenu de la société provenant de cette entreprise pour l'année donnée et — dans le cas où des biens sont vendus, loués ou mis en valeur ou des services rendus dans le cadre de l'exploitation de l'entreprise avant ce moment — de toute autre entreprise dont la presque totalité du revenu est dérivée de la vente, de la location ou de la mise en valeur, selon le cas, de biens semblables ou de la prestation de services semblables;

[…]

256(8) Where at any time a taxpayer acquires a right referred to in paragraph 251(5)(b) in respect of a share and it can reasonably be concluded that one of the main purposes of the acquisition is

256(8) Pour ce qui est de déterminer, d'une part, si le contrôle d'une société a été acquis pour l'application des paragraphes 10(10) et 13(24), de l'article 37, des paragraphes 55(2), 66(11), (11.4) et (11.5), 66.5(3) et 66.7(10) et (11), de l'article 80, de l'alinéa 80.04(4)h), du sous-alinéa

88(1)c)(vi), de l’alinéa 88(1)c.3), des articles 111 et 127 et des paragraphes 181.1(7), 190.1(6) et 249(4) et, d’autre part, si une société est contrôlée par une personne ou par un groupe de personnes pour l’application de l’article 251.1, le contribuable qui a acquis un droit visé à l’alinéa 251(5)b) afférent à une action est réputé être dans la même position relativement au contrôle de la société que si le droit était immédiat et absolu et que s’il l’avait exercé au moment de l’acquisition, dans le cas où il est raisonnable de conclure que l’un des principaux motifs de l’acquisition du droit consistait :

(a) to avoid any limitation on the deductibility of any non-capital loss, net capital loss, farm loss or any expense or other amount referred to in subsection 66(11), 66.5(3) or 66.7(10) or 66.7(11),

a) à éviter une restriction à la déductibilité d’une perte autre qu’une perte en capital, d’une perte en capital nette, d’une perte agricole ou de frais ou d’autres montants visés aux paragraphes 66(11), 66.5(3) ou 66.7(10) ou (11);

[…]

[…]

the taxpayer is deemed to be in the same position in relation to the control of the corporation as if the right were immediate and absolute and as if the taxpayer had exercised the right at that time for the purpose of determining whether control of a corporation has been acquired for the purposes of […] sections 111 […].

251(5) For the purposes of subsection 251(2) and the definition Canadian-controlled private corporation in subsection 125(7),

[…]

251(5) Pour l’application du paragraphe (2) et de la définition de société privée sous contrôle canadien au paragraphe 125(7):

[…]

(b) where at any time a person has a right under a contract, in equity or otherwise, either immediately or in the future and either absolutely or contingently,

(i) to, or to acquire, shares of the capital stock of a corporation or to control the voting rights of such shares, the person shall, except where the right is not exercisable at that time because the exercise thereof is contingent on the death, bankruptcy or permanent disability of an individual, be deemed to have the same position in relation to the control of the corporation as if the person owned the shares at that time,

(ii) to cause a corporation to redeem, acquire or cancel any shares of its capital stock owned by other shareholders of the corporation, the person shall, except where the right is not exercisable at that time because the exercise thereof is contingent on the death, bankruptcy or permanent disability of an individual, be deemed to have the same position in relation to the control of the corporation as if the shares were so redeemed, acquired or cancelled by the corporation at that time;

(iii) to, or to acquire or control, voting rights in respect of shares of the capital stock of a corporation, the person is, except where the right is not exercisable at that time because its exercise is contingent on the death, bankruptcy or

b) la personne qui, à un moment donné, en vertu d’un contrat, en equity ou autrement, a un droit, immédiat ou futur, conditionnel ou non :

(i) à des actions du capital-actions d’une société ou de les acquérir ou d’en contrôler les droits de vote, est réputée occuper la même position relativement au contrôle de la société que si elle était propriétaire des actions à ce moment, sauf si le droit ne peut être exercé à ce moment du fait que son exercice est conditionnel au décès, à la faillite ou à l’invalidité permanente d’un particulier,

(ii) d’obliger une société à racheter, acquérir ou annuler des actions de son capital-actions dont d’autres actionnaires de la société sont propriétaires, est réputée occuper la même position relativement au contrôle de la société que si celle-ci rachetait, acquérait ou annulait les actions à ce moment, sauf si le droit ne peut être exercé à ce moment du fait que son exercice est conditionnel au décès, à la faillite ou à l’invalidité permanente d’un particulier,

(iii) aux droits de vote rattachés à des actions du capital-actions d’une société, ou de les acquérir ou les contrôler, est réputée occuper la même position relativement au contrôle de la société que si elle pouvait exercer les droits

permanent disability of an individual, deemed to have the same position in relation to the control of the corporation as if the person could exercise the voting rights at that time, or

(iv) to cause the reduction of voting rights in respect of shares, owned by other shareholders, of the capital stock of a corporation, the person is, except where the right is not exercisable at that time because its exercise is contingent on the death, bankruptcy or permanent disability of an individual, deemed to have the same position in relation to the control of the corporation as if the voting rights were so reduced at that time; and

[…]

de vote à ce moment, sauf si le droit ne peut être exercé à ce moment du fait que son exercice est conditionnel au décès, à la faillite ou à l'invalidité permanente d'un particulier,

(iv) de faire réduire les droits de vote rattachés à des actions, appartenant à d'autres actionnaires, du capital-actions d'une société est réputée occuper la même position relativement au contrôle de la société que si les droits de vote étaient ainsi réduits à ce moment, sauf si le droit ne peut être exercé à ce moment du fait que son exercice est conditionnel au décès, à la faillite ou à l'invalidité permanente d'un particulier,

[…]

245(1) 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;

245(1) 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.

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 includes an arrangement or event.

opération Sont assimilés à une opération une convention, un mécanisme ou un événement.

(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.

(3) An avoidance transaction means any transaction

(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

(3) 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 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.

(**4**) 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 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

(**4**) 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 :

(**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

regard to those provisions, other than this section, read as a whole.

présent article lues dans leur ensemble.

(5) 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, any income, loss or other amount or part thereof may be allocated to any person,

(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 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.

(5) 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 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.

APPENDIX B

Extracts of Tax Court's reasons

[…]

[100] Subsection 111(5) restricts a corporation's ability to deduct non-capital and farm losses after an acquisition of control of the corporation by a person or group of persons. Losses continue to be deductible where the corporation continues to carry on for profit or with a reasonable expectation of profit the business that gave rise to the losses, and the losses may only be used to offset income from that business and, in certain circumstances, from a similar business.

[101] Subsection 111(5) reads as follows:

> Where, at any time, control of a corporation has been acquired by a person or group of persons, no amount in respect of its non-capital loss or farm loss for a taxation year ending before that time is deductible by the corporation for a taxation year ending after that time and no amount in respect of its non-capital loss or farm loss for a taxation year ending after that time is deductible by the corporation for a taxation year ending before that time except that
>
> > *(a)* such portion of the corporation's non-capital loss or farm loss, as the case may be, for a taxation year ending before that time as may reasonably be regarded as its loss from carrying on a business and, where a business was carried on by the corporation in that year, such portion of the non-capital loss as may reasonably be regarded as being in respect of an amount deductible under paragraph 110(1)(k) in computing its taxable income for the year is deductible by the corporation for a particular taxation year ending after that time
> >
> > > (i) only if that business was carried on by the corporation for profit or with a reasonable expectation of profit throughout the particular year, and
> > >
> > > (ii) only to the extent of the total of the corporation's income for the particular year from that business and, where properties were sold, leased, rented or developed or services rendered in the course of carrying on that business before that time, from any other business substantially all the income of which was derived from the sale, leasing, rental or development, as the case may be, of similar properties or the rendering of similar services and

> *(b)* such portion of the corporation's non-capital loss or farm loss, as the case may be, for a taxation year ending after that time as may reasonably be regarded as its loss from carrying on a business and, where a business was carried on by the corporation in that year, such portion of the non-capital loss as may be reasonably be regarded as being in respect of an amount deductible under paragraph 110(1)(k) in computing its taxable income for the year is deductible by the corporation for a particular year ending before that time
>
> > (i) only if throughout the taxation year and in the particular year that business was carried on by the corporation for profit or with a reasonable expectation of profit, and
> >
> > (ii) only to the extent of the corporation's income for the particular year from that business and, where properties were sold, leased, rented or developed or services rendered in the course of carrying on that business before that time, from any other business substantially all the income of which was derived from the sale, leasing, rental or development, as the case may be, of similar properties or the rendering of similar services.

[102] The restriction on loss carryovers in subsection 111(5) is triggered when "control of a corporation has been acquired by a person or group of persons".

[103] The acquisition of control test is the means by which Parliament has determined that a loss has notionally been transferred to an unrelated party. While the Respondent contends that in the context of the GAAR the control aspect of subsection 111(5) is not an important part of its object, spirit and purpose, I disagree. The Federal Court of Appeal has pointed out that "the notion of control is central to the working of subsection 111(5)".[9] As, such, the test is relevant to the analysis of the object, spirit and purpose of that provision. To ignore it would amount to reading out the test, which is not permitted in interpreting legislation.

[104] The word "control" in the *Act* has long been held to mean *de jure* control. In *Duha Printers (Western) Ltd. v. Canada*, Iacobucci J. wrote:

> 35 It has been well recognized that, under the *Income Tax Act*, "control" of a corporation normally refers to *de jure* control and not *de facto* control. This Court has repeatedly cited with approval the following test, set out by Jackett P. in *Buckerfield's*, supra, at p. 507:
>
> > Many approaches might conceivably be adopted in applying the word "control" in a statute such as the *Income Tax Act* to a

> corporation. It might, for example, refer to control by "management", where management and the board of directors are separate, or it might refer to control by the board of directors. . . . The word "control" might conceivably refer to *de facto* control by one or more shareholders whether or not they hold a majority of shares. I am of the view, however, that in Section 39 of the *Income Tax Act* [the former section dealing with associated companies], the word "controlled" contemplates the right of control that rests in ownership of such a number of shares as carries with it the right to a majority of the votes in the election of the board of directors. [Emphasis added.]
>
> Cases in which this Court has applied the foregoing test have included, inter alia, *Dworkin Furs*, supra, and *Vina-Rug (Canada) Ltd. v. Minister of National Revenue*, [1968] S.C.R. 193.[10]

[105] Subsection 111(5) will only apply if control is acquired by "a person or group of persons". The phrase "group of persons" is not defined in the *Act* but the Federal Court of Appeal in *Silicon Graphics Ltd. v. Canada* held that "simple ownership of a mathematical majority of shares by a random aggregation of shareholders in a widely held corporation … without a common connection does not constitute de jure control as that term has been defined in the case law."[11]

[106] Subsection 111(5) is part of group of specific rules in subsections 111(4) to (5.3) that limit the carry-forward of non-capital losses, net capital losses, farm losses and unrealized losses on capital, depreciable and eligible capital property owned by the corporation and on doubtful debts. The application of these provisions is triggered by an acquisition of control of the taxpayer corporation by a person or group of persons.

[107] The forerunner to subsection 111(5), subsection 27(5), was added to the *Act* in 1958. It prevented losses from being carried over by a corporation to a future year where more than 50% of the share capital of the corporation had been acquired by a person or persons who did not, at the end of the preceding year, own any shares in the capital stock of the corporation (the "aggregate-change-in-shareholdings test"). This provision was added at the same time the *Act* was amended to permit the use of losses to offset income from any other business carried on by the taxpayer.

[108] In 1963, the *Act* was amended to add paragraph 27(5)(*a*) which provided that no loss carryovers would be permitted where "control of the corporation [was] acquired …by a person or persons who did not, at the end of [the] preceding year, control the corporation."

[109] In 1972, subsection 27(5) was replaced by subsection 111(5), which still limited carryovers in the case of an acquisition of control and required the same business in which the loss was sustained continue to be carried on, but allowed the loss carryovers to be offset against a taxpayer's income from any source. Notably, the aggregate-change-in-shareholdings test was not brought forward into subsection 111(5).

[110] Beginning in 1981 and continuing until 1987, new rules were introduced to tighten the carryover restrictions in certain respects, including a requirement that the loss business be carried on by the corporation for a profit or with a reasonable expectation of profit. The amount of the deduction was also restricted to the income generated from that business and other similar businesses. Since 1987, subsection 111(5) has remained mostly unchanged.

[111] Provisions have been introduced in the *Act* that deem *de jure* control to exist or not to exist in particular circumstances, and to create a different standard of control of a corporation for certain purposes of the *Act*.

[112] Subsection 256(8), discussed earlier in these reasons, expands the concept of *de jure* control beyond a determination based strictly on the ownership of the voting shares of a corporation by extending the circumstance in which an acquisition of control is considered to have occurred. It is aimed at preventing tax attribute trading in situations where a taxpayer seeks to use certain rights in relation to voting shares to avoid an acquisition of control.

[113] Again, subsection 256(8) provides that where a person acquires a right listed in paragraph 251(5)(b) and one of the main purposes for acquiring the right was to avoid the application of the loss streaming rules as well as certain other provisions, the taxpayer is deemed to be in the same position in relation to the control of the corporation as if the right had been exercised when it was acquired.

[114] For the years in issue, the following rights were included in paragraph 251(5)(*b*):

- a right to shares;

- a right to acquire shares;

- a right to control the voting rights of shares;

- a right to cause a corporation to redeem shares owned by other shareholders;

- a right to cause a corporation to acquire shares owned by other shareholders;

- a right to cause a corporation to cancel shares owned by other shareholders;

- a right to voting rights in respect of shares;

- a right to acquire voting rights in respect of shares;

- a right to control voting rights in respect of shares; and

- a right to cause the reduction of voting rights in respect of shares owned by other shareholders.

[115] Subsection 256(8) is thus intended to allow the Minister to look beyond the share registry of the corporation to determine who in substance has control over the voting rights in respect of the shares of a corporation and thus effective control of the corporation.

[116] Another contextual element to be considered is the *de facto* control test in subsection 256(5.1), which expands the factors that can be taken into account in determining control of a corporation for certain purposes in the *Act*. Subsection 256(5.1) was introduced into the *Act* in 1987, and provides that, (subject to certain exceptions not relevant in this case):

> …where the expression "controlled, directly or indirectly, in any manner whatever," is used in the Act, a corporation shall be considered to be so controlled by another corporation, a person or a group of persons…at any time where…the controller has any direct or indirect influence that, if exercised, would result in control in fact of the corporation..."

[117] Along with the enactment of subsection 256(5.1), a number of provisions of the *Act* were amended so that the *de facto* control test would apply to those provisions. However, it was not adopted for the purposes of subsection 111(5).

[118] At the heart of the *de facto* control test is, once again, the notion of control of affairs of a corporation through control over the board of directors. In *McGillivray Restaurant Ltd. v. Canada*, Ryer J.A. stated that:

> *De facto* control, like *de jure* control, is concerned with control over the board of directors and not with control of the day-to-day operations of the corporation or its business. Paragraph 256(1)(b) and subsection 256(5.1) specifically refer to control of a corporation and not to control of the corporation's business or operations.[12]

[119] Referring to the Court's earlier decision in *Silicon Graphics Ltd. v. Canada*, Ryer J.A. reiterated that:

> in order for there to be a finding of *de facto* control, a person or group of persons must have the clear right and ability to effect a significant change in the board of directors or the powers of the board of directors or to influence in a very direct way the shareholders who would otherwise have the ability to elect the board of directors.[13]

[120] Thus, the *de jure* and *de facto* control tests are differentiated only by the breadth of factors that can be looked at to determine who has ultimate control over the board of directors.

[121] The Appellant argued that the introduction of section 256.1 into the *Act* in 2013 should also be considered part of the relevant context of subsection 111(5) for the years in issue.

[122] Section 256.1 deems an acquisition of control of a corporation to occur for the purposes of certain sections of the *Act*, including subsection 111(5), when the value of the interest held by a person or group of persons in the corporation increases to more than 75% of the value of the outstanding shares of the corporation.

[123] The Appellant maintains that this represented a change to the law and, as such, previous to the enactment of section 256.1 there was no policy in the *Act* that the acquisition of a substantial economic interest in a corporation was sufficient to trigger an acquisition of control for the purposes of subsection 111(5).

[124] It is not necessary for me to address this submission, however, in light of the comments of the Federal Court of Appeal in *Oxford Properties Ltd. v. Canada* concerning the effect of subsequent amendments to the *Act* in a statutory interpretation exercise. In that decision, Noël C.J.A. wrote:

> Whether an amendment clarifies the prior law or alters it turns on the construction of the prior law and the amendment itself. As explained, the Interpretation Act prevents any conclusion from

> being drawn as to the legal effect of a new enactment on the prior law on the sole basis that Parliament adopted it. Keeping this limitation in mind, the only way to assess the impact of a subsequent amendment on the prior law is to first determine the legal effect of the law as it stood beforehand and then determine whether the subsequent amendment alters it or clarifies it.[14]

[125] Finally, subsection 256(7) contains rules deeming control to have been acquired in certain circumstances and not to have been acquired in others. It deals with situations involving transfers of shares between related persons and reorganizations within a group of related corporations, as well as amalgamations and reverse takeovers. These circumstances:

> reflect the intention that a dilution of control, or a loss of control by a person or group of persons to an undefined group, will not be considered offensive except in certain contexts, such as an amalgamation or a reverse takeover. In these circumstances only, wide shareholder bases are consolidated for the purpose of determining control.[15]

[126] Moving now to purpose, it is clear that subsection 111(5) was enacted to prevent tax loss trading. The restriction on the use of losses is subject to limited exceptions relating to the rehabilitation of the loss business and to the transfer of losses between corporations under common control.

[127] Subsection 111(5) reflects the general policy in the *Act* against loss trading between arm's length parties. In *Mathew v. Canada*, the Supreme Court of Canada held that "the general policy of the Income Tax Act is to prohibit the transfer of losses between taxpayers, subject to specific exceptions" and that "under such exceptions, Parliament intended to promote a particular purpose concerning a distinct relationship between the transferor and the transferee under specifically described circumstances."[16]

[128] It has been suggested that the reason underpinning the choice to deny loss carryovers after an acquisition of control is that after the acquisition of control, the corporation can be likened to a new taxpayer because it has different shareholders.

[129] This view has been expressed as follows:

> First and foremost, the carryover of losses following a change of control is not generally supported in tax policy terms. Normally, one taxpayer cannot avail himself of another taxpayer's losses. In the case of an artificial entity such as a corporation, when its control changes it is essentially regarded as a new taxpayer,

> because different shareholders then become entitled indirectly to enjoy the benefits of its financial success.[17]

[130] Another author puts it this way:

> It follows that losses should not normally be claimed by the corporation after a significant change of shareholders, on the basis that the former shareholders, who bore the economic costs of the losses, are no longer participants in the corporation's affairs.[18]

[131] Despite the tax policy basis for using a substantial change in equity investment test to restrict loss carryovers, though, this kind of test was removed from the predecessor section to subsection 111(5) in 1972 and a similar test in subsection 256.1 was not included until 2013. This gives rise to an inference that Parliament did not intend to target substantial equity acquisitions in a loss corporation as a basis for restricting the carryover of its losses.

[132] It appears that Parliament's aim in choosing the *de jure* control test was to achieve certainty and predictability. This was the conclusion of Iacobucci J. in *Duha*,:

> …At the outset, it is important to bear in mind the distinction between the tests of *de jure* and *de facto* control developed by the courts. In my view, the *de jure* standard was chosen because in some respects it is a relevant and relatively certain and predictable concept to employ in determining control. In general terms, *de jure* refers to those legal sources that determine control: namely, the corporation's governing statute and its constitutional documents, including the articles of incorporation and by-laws. The *de facto* concept was rejected because it involves ascertaining control in fact, which can lead to a myriad of indicators which may exist apart from these sources. See, for example, F. Iacobucci and D. L. Johnston, "*The Private or Closely-held Corporation*", in J. S. Ziegel, ed., *Studies in Canadian Company Law* (1973), vol. 2, 68, at pp. 108-12.[19]

[133] Iacobucci J. also made the point that the acquisition of control test was a means of determining effective or ultimate control of a corporation:

> …However, it must be recognized at the outset that this test is really an attempt to ascertain who is in effective control of the affairs and fortunes of the corporation. That is, although the directors generally have, by operation of the corporate law statute governing the corporation, the formal right to direct the management of the corporation, the majority shareholder enjoys

> the indirect exercise of this control through his or her ability to elect the board of directors. Thus, it is in reality the majority shareholder, not the directors per se, who is in effective control of the corporation. This was expressly recognized by Jackett P. when setting out the test in *Buckerfield's*. Indeed, the very authority cited for the test was the following dictum of Viscount Simon, L.C., in *British American Tobacco Co. v. Inland Revenue Commissioners*, [1943] 1 All E.R. 13, at p. 15:
>
> The owners of the majority of the voting power in a company are the persons who are in <u>effective control of its affairs and fortunes</u>. [Emphasis added.][20]

[134] It has been suggested that the acquisition of control test in subsection 111(5) is a reasonable marker between situations where the corporation is a free actor in a transaction and when it is only a passive participant whose actions can be manipulated by a new person or group of persons in order to utilize the losses or Tax Attributes of the corporation for their own benefit.[21] I agree with this analysis and find that the object, spirit and purpose of subsection 111(5) is to target manipulation of losses of a corporation by a new person or group of persons, through effective control over the corporation’s actions.

[…]

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9 *Canada v. Duha Printers (Western) Ltd.*, [1996] 50 DTC 6323 (FCA) at paragraph 4.

10 *Duha Printers (Western) Ltd. v. Canada*, [1998] 1 SCR 795 at paragraphs 35 and 36.

11 *Silicon Graphics Ltd. v. Canada*, 2002 FCA 260 at paragraph 36.

12 *McGillivray Restaurant Ltd. v. Canada*, 2016 FCA 99 at paragraph 46.

13 *Ibid* at paragraph 35.

14 *Oxford Properties Ltd. v. Canada*, 2018 FCA 30 at paragraph 86.

15 M. Munoz, "Loss Utilization in Arm's-Length Business Combinations", Canadian Tax Journal (2009) Vol. 547 No. 3, pp.660-698 at p. 692.

16 *Mathew v. Canada*, 2005 SCC 55 at paragraph 49.

17 W.J. Strain, D.A. Dodge, V. Peters, "Tax Simplification: The Elusive Goal", 1988 Conference Report, CTF, p. 4:1 at p. 4-52.

18 A. Nijhawan, "When Is "Loss Trading Permissible? A Purposive Analysis of Subsection 111(5)" Conference Report, CTF, p. 9:1-26 at p. 9:5.

19 *Duha*, *supra* note 10 at paragraph 58.

20 *Ibid* at paragraph 36.

21 M. Munoz, "Loss Utilization in Arm's-Length Business Combinations", Canadian Tax Journal (2009) Vol. 547 No. 3, pp.660-698 at p. 694.

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