Docket: 2012-1087(IT)G

BETWEEN:

BIRCHCLIFF ENERGY LTD.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on November 18, 19, 20 and 21, 2013,
at Calgary, Alberta.

Decided by: The Honourable Justice Robert J. Hogan

Appearances:

Counsel for the Appellant:	Patrick Lindsay Jean-Philippe Couture
Counsel for the Respondent:	Robert Carvalho Neva Beckie Jonathan Wittig

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JUDGMENT

In accordance with the attached reasons for judgment, the appeal from the reassessment made under the *Income Tax Act* for the 2006 taxation year is dismissed with costs.

Signed at Ottawa, Canada, this 1st day of October 2015.

"Robert J. Hogan"

Hogan J.

Citation: 2015 TCC 232
Date: 20151001
Docket: 2012-1087(IT)G

BETWEEN:

BIRCHCLIFF ENERGY LTD.,

Appellant,

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REASONS FOR JUDGMENT

Hogan J.

I. Overview

[1] The present case is an appeal from a reassessment made by the Minister of National Revenue (the "Minister") for the 2006 taxation year of Birchcliff Energy Ltd. (the "Appellant"). The genesis of this appeal is a dispute regarding the disallowance by the Minister of a deduction of $16,226,489 of non-capital losses claimed by the Appellant for its 2006 taxation year in the circumstances described below. The losses were incurred by a predecessor corporation, Veracel Inc. ("Veracel"), which was amalgamated with Birchcliff Energy Ltd. ("Birchcliff") to form the Appellant as the last step of a complex series of transactions (the "Amalgamation Transactions") implemented pursuant to the terms of a court-sanctioned plan of arrangement.

[2] The Respondent defends the reassessment on the grounds that control of Veracel was acquired by a person or "group of persons" either upon or immediately prior to its amalgamation with Birchcliff. As a result, the Appellant is barred from using the losses by virtue of the restrictions (the "Loss Streaming Restrictions") contained in subsection 111(5) of the *Income Tax Act* (the "Act") because it did not carry on the business that gave rise to Veracel's losses. In the alternative, the Respondent argues that the Appellant abusively circumvented the Loss Streaming Restrictions by avoiding a special rule that deems control to have

been acquired, such that the general anti-avoidance rule in section 245 of the Act (the "GAAR") applies with a similar effect to that of the Loss Streaming Restrictions.

[3] This appeal was originally heard by Justice Jorré of this Court. With the consent of both parties, the appeal is to be decided by me on the basis of the transcript and the record.[1]

II. Factual Background

[4] The facts are essentially as set out in a partial agreed statement of facts, which reads as follows:

> The parties agree for the purposes of the determination of the issues herein that the following facts may be accepted as evidence without further proof thereof. Numerical references in brackets refer to the relevant tab in the Agreed List of Documents.
>
> **Veracel**
>
> 1. Veracel Inc. ("Veracel") was incorporated on August 10, 1994 as Morphometric Technologies Inc. under the *Business Corporations Act* of Ontario.
>
> 2. Veracel's business was to develop, manufacture and market automated diagnostic instruments for medical applications (the "Medical Business").
>
> 3. In April 2001, the company changed its name to Veracel.
>
> 4. On November 15, 2002, Veracel filed a proposal under the Ontario *Bankruptcy and Insolvency Act* that was accepted by the Ontario Superior Court of Justice. [2] On November 19, 2003, the Trustee certified that Veracel had fully performed the proposal.
>
> 5. Veracel ceased its Medical Business in 2002. No income was earned from the Medical Business after 2002.
>
> 6. In February 2004, Veracel solicited proposals in connection with its existing tax attributes. [4] Soon thereafter, Veracel started to work with David Tonken and Greg Matthews.

[1] The parties' consent was given in a letter dated July 16, 2015.

7. On November 5, 2004, Veracel, David Tonken, Greg Matthews and Emerging Equities Inc. executed a letter agreement in connection with a proposed transaction. [5] The proposed transaction was not completed.

8. As at the end of 2004, Veracel had the following tax attributes: non-capital losses of $16,226,489; scientific research and experimental development expenses of $15,558,003; and, investment tax credits of $1,874,979 (the "Tax Attributes").

9. The issued and outstanding Veracel shares, as at December 31, 2004, consisted of 10,280,461 Common Shares and 7,299,424 Class A Preference Shares. [9; 44, Exhibit B]

10. Class A Preference shareholders were entitled to receive notice of and attend meetings, and vote at such meetings, on a 1:1 basis with holders of Common Shares. [64]

11. Veracel shareholders included the Business Development Bank of Canada, Ontario Development Corp., AGF and HSBC. [44, Exhibit B]

Birchcliff

12. On July 6, 2004, Birchcliff was incorporated as 1116463 Alberta Ltd. That company changed its name to Birchcliff Energy Ltd. on September 10, 2004.

13. On January 18, 2005, Scout Capital Corp. ("Scout"), a publicly listed company, amalgamated with the company then named Birchcliff Energy Ltd. (the "Scout Amalgamation"). The amalgamated company adopted the name Birchcliff Energy Ltd. ("Birchcliff"). When Birchcliff and Veracel amalgamated on May 31, 2005, as set out below, that company also adopted the name Birchcliff Energy Ltd. ("Amalco").

14. On January 19, 2005, the common shares of this newly amalgamated company were listed for trading on the TSX Venture Exchange under the trading symbol "BIR".

15. The Scout Amalgamation was done by way of a court approved Plan of Arrangement and involved the issuance of subscription receipts. [11]

16. David Tonken was the President and CEO of Scout from 1998 to 2002.

17. David Tonken is the brother of Jeff Tonken, the President and CEO of Birchcliff and of Amalco.

Purchase of initial oil and gas property

18. On February 14, 2005, Birchcliff entered into a letter agreement to purchase properties in the Peace River Arch area of Alberta for $2.75 million.

19. This purchase closed on May 5, 2005.

Agreement to purchase major oil and gas property

20. On March 9, 2005, Birchcliff entered into a letter agreement in connection with the purchase of oil and natural gas properties in the Peace River Arch area of Alberta for $255 million (the "Devon Properties"). [14] The related purchase agreement was executed on March 29, 2005 for a purchase price of $243 million.

21. It was anticipated that the acquisition of the Devon Properties would close on or before May 31, 2005.

22. Birchcliff approached several financial institutions including Scotia Capital in connection with financing the acquisition of the Devon Properties.

23. On March 29, 2005 Birchcliff and Scotia Capital signed a Commitment Letter wherein Scotia Capital committed financing in the form of a Revolving Loan in the amount of $70 million and a Bridge Loan in the amount of $149 million, to purchase the Devon Properties. [21] The Bridge Loan was never advanced.

24. KPMG prepared a schedule of revenue and expense for the Devon Properties identifying that, in 2004, the Devon Properties generated revenue exceeding $85 million which, after the payment of royalties and operating costs, generated net profit of more than $50 million. [10]

Veracel and Birchcliff sign a letter agreement

25. David Tonken brought Veracel and Birchcliff together for a possible transaction. He contacted Jim Surbey at Birchcliff and discussed Veracel's situation with him. [132, 133]

26. On March 18, 2005, Birchcliff directors approved of entering into a purchase agreement for the Devon Properties and approved a proposed Arrangement Agreement with Veracel. [19]

27. Negotiations between Veracel and Birchcliff included the exchange of draft agreements, and revisions to such agreements, in correspondence dated March 21, 23, and 29, 2005.

28. On March 29, 2005, a Birchcliff press release announced that Birchcliff had entered into an acquisition agreement for the purchase of the Devon Properties for approximately $240 million. The press release described the Devon Properties and identified that the parties anticipated that the transaction would be completed by May 31, 2005. [25]

29. John Anderson of Veracel sent a letter dated March 29, 2005 to the shareholders of Veracel regarding "Reorganization of Veracel Inc." [24]

30. On April 1, 2005, Birchcliff and Veracel signed a Letter Agreement. [27]

31. On April 3, 2005, Birchcliff issued a press release announcing that Veracel and Birchcliff had signed the Letter Agreement. [39]

32. By April 4, 2005, the new financing proposed in the letter agreement is being marketed. [34]

Steps to implement letter agreement

33. On April 12, 2005, Olympia Trust Company ("Olympia") on behalf of Birchcliff advised the TSX Venture Exchange ("TSXV") and the securities commissions in British Columbia, Alberta, Saskatchewan, Ontario and Nova Scotia that the annual and special meeting was set for May 24, 2005.

34. On April 14, 2005, GMP Securities Ltd. signed a letter of offer to Veracel to agree to place subscription receipts. [32]

35. On April 14, 2005, the Underwriting Agreement became effective, among Veracel and GMP Securities Ltd., as lead underwriter, Sprott Securities Inc. and Scotia Capital Inc. (collectively the "Underwriters"), with respect to an equity financing of up to $136,000,000 plus a further $10,000,000 in a separate flow-through equity financing. [42]

36. On April 18, 2005, Veracel and Birchcliff executed the Arrangement Agreement. Exhibit A to the Arrangement Agreement is the Plan of Arrangement. [44]

37. During April 2005, Veracel received concurrence of shareholders to proceed with the Arrangement Agreement. [40]

Notices and approvals

38. On April 18, 2005, Birchcliff notified the TSXV in connection with the proposed transactions. [45]

39. On April 18, 2005, Veracel notified shareholders of a special meeting in connection with proposed transactions. [46]

40. On April 19, 2005, Birchcliff notified the Alberta Securities Commission ("ASC") that counsel to Birchcliff would attend the Alberta Court on April 22, 2005 to apply for an Interim Order in connection with the Plan of Arrangement.

41. On April 21, 2005, the Veracel directors approved the Arrangement Agreement, the Private Placement, the "New Equity Financing" and other matters. [47]

42. On April 21, 2005, the Birchcliff directors approved of the Information Circular and other matters. [48]

43. On April 21, 2005, in accordance with the Arrangement Agreement, Birchcliff filed a Petition with the Alberta Court applying for an Interim Order directing that a shareholders meeting be called to vote on the proposed Arrangement. [49] An affidavit of Jim Surbey was filed in connection with this Petition. [52]

44. On April 21, 2005, an MRRS Decision document was issued. [50]

45. On April 22, 2005, the Alberta Court issued the Interim Order.

46. A copy of the Interim Order and related documents [was] provided to the ASC by letter dated April 22, 2005.

47. On April 22, 2005 the Information Circular was published. [51]

48. A corporate administrator from Olympia declared, on May 5, 2005, that the Information Circular and a Proxy were mailed to each Birchcliff Shareholder on April 26, 2005 and confirmation of same was provided to the TSXV and to securities commissions in British Columbia, Alberta, Saskatchewan and Ontario.

49. An April 25, 2005 press release announced that the Underwriters had exercised their option to sell the additional 8 million Veracel Subscription Receipts, to increase the equity financing up to $136,000,000. [54] The Underwriters' confirmation of same was issued May 4, 2005. [68]

50. On April 26, 2005, Birchcliff by letter applied to the Committee on Uniform Security Identification Procedures ("CUSIP") for approval of a new CUSIP number for the Common Shares of Amalco that were to be issued in exchange for shares of Veracel and Birchcliff on the amalgamation.

51. The new CUSIP number was issued on May 2, 2005. A specimen Amalco Common Share certificate with the new CUSIP number and a specimen Amalco Series 1 Preferred Share certificate were prepared on May 20, 2005.

Further Veracel approvals

52. On April 29, 2005, the shareholders and investors of Veracel met and passed the following resolutions: [56]

    a. to elect Robert Allan, John Anderson and David Tonken as directors;
    b. to issue 3,775,000 [common shares] to each of David Tonken and Greg Matthews on condition of the Arrangement closing (the "Private Placement");
    c. to amend then terminate the Unanimous Shareholders Agreement;
    d. to authorize the Letter Agreement with Birchcliff;
    e. to approve the amendment to the articles of Incorporation to create Class B common shares;
    f. to transfer all assets to Newco in exchange for Newco shares and then to distribute those shares to Veracel shareholders;
    g. to continue to Alberta;
    h. to authorize the Arrangement Agreement with Birchcliff;
    i. to authorize the "New Equity Financing"; and
    j. to waive rights, privileges and conditions attached to Class A Preferred Shareholders.

53. On April 29, 2005, the directors of Veracel passed the following resolutions: [55]

    a. to approve the Letter Agreement and Arrangement with Birchcliff;
    b. to transfer all assets to Newco in exchange for Newco shares and then to distribute those shares to Veracel shareholders;
    c. to authorize David Tonken and John Anderson to implement the "Arrangement";
    d. to issue 3,775,000 [common shares] to each of David Tonken and Greg Matthews; and
    e. to authorize the "New Equity Financing".

54. On April 29, 2005, Veracel filed Articles of Amendment to allow for the issuance of Class B Common Shares.

55. On April 29, 2005, Veracel share certificates were issued representing 3,775,000 [common shares] to each of David Tonken and Greg Matthews in accordance with the Private Placement. [57]

56. On May 2, 2005, Veracel continued from Ontario to Alberta. [64]

Financing to raise $136,000,000

57. On May 2, 2005 Veracel completed a "Due Diligence Questionnaire" for the Underwriters regarding the transaction with Birchcliff. [61]

58. On May 2, 2005 Birchcliff completed a "Due Diligence Questionnaire" for the Underwriters regarding the transaction with Veracel. [62]

59. On May 4, 2005, the Subscription Receipt Indenture among Veracel, the Underwriters and Olympia became effective. [69]

60. On May 4, 2005, the Representation Agreement between Birchcliff and the Underwriters became effective. [70]

61. A memorandum was issued regarding the transfer of $130,500,000, to be received by the Underwriters for the sale of 32,625,000 Subscription Receipts, which provided that, once all parties and counsel agreed the closing documentation had been tabled, such funds would be wire transferred from the Underwriters' account to Olympia's account. [73] The other $5,500,000 was to be received from the President's List subscribers. [67]

62. On May 4, 2005, the Subscription Receipt financing closed and 34,000,000 Subscription Receipts were issued to 133 investors. [111]

63. On May 4, 2005, the closing of the $136,000,000 financing was announced. [71]

64. A Subscription Receipt Agreement was completed by each of the 133 investors [60, 80, 81] and each investor was issued a Subscription Receipt. [58, 66, 77, 78, 82]

65. On May 4, 2005, by Treasury Order, Veracel directed Olympia to issue the Subscription Receipts. [74]

66. On May 4, 2005, Veracel and Olympia acknowledged receipt by Olympia of $136,000,000 in aggregate from the Underwriters ($130,500,000) and from the President's List subscribers ($5,500,000). [75, 76, 79]

Further Birchcliff approvals

67. On May 10, 2005, Birchcliff warrant holders and stock option holders approved the Arrangement and the Arrangement Agreement. [84, 85]

68. On May 16, 2005, Birchcliff notified the ASC that Birchcliff intended to apply to the Court on May 24, 2005 for a Final Order.

69. On May 24, 2005, the Birchcliff shareholders' meeting was held and Olympia, as scrutineer, issued a report identifying that holders of more than 50% of the outstanding shares of Birchcliff attended the meeting in person or by proxy and that 100% of the 54 votes cast were in favour of the Amalgamation and acquisition of the Devon Properties.

Completion of the plan of arrangement and related matters

70. On May 24, 2005, an Affidavit was sworn in support of the Final Order. [90]

71. On May 24, 2005, the Court approved the Final Order, which provided that the Arrangement was approved and would be effective in accordance with its terms, and binding on all persons, upon the filing of the Articles of Arrangement. A copy of the Order was provided to the ASC.

72. On May 25, 2005, Veracel directors approved of the form and allotment of the Veracel Class B Common Shares and other matters. [91]

73. On May 25, 2005, Veracel and the Underwriters directed Olympia to deposit the $136,000,000 into Olympia's account at the Bank of Nova Scotia. [92]

74. On May 30, 2005, Birchcliff directors approved the filing of Articles of Amendment to create Series 1 Preferred Shares dated May 30, 2005. [95]

75. On May 30, 2005, Articles of Amendment were filed, creating Series 1 Preferred Shares, and a Certificate of Amendment was issued by the Alberta Corporate Registrar (the "Registrar"). [96]

76. The Series 1 Preferred Shares provided for redemption and retraction at a price equal to $1,500,000, less certain liabilities, divided by the total number of Veracel Common Shares and Veracel Class A Preference Shares outstanding prior to filing of the Articles of Arrangement. [96]

77. On May 30, 2005, the Depositary Agreement between Veracel and Olympia became effective. [97]

78. Veracel and Birchcliff jointly confirmed for Olympia that the redemption price for the Series 1 Preferred Shares of Amalco was $0.05969 and confirmed the exchange ratio for each holder of Veracel Common Shares and Class A Preference Shares that elected to receive Amalco Common Shares would have an exchange ratio of 1:0.01492. [114]

79. Veracel shareholders issued Letters of Transmittal in order to elect whether to receive Amalco common shares or Amalco Series 1 Preferred Shares. [94]

80. On May 31, 2005, Veracel and the Underwriters issued the Transaction Notice and Direction which is received by Olympia. [102, 103]

81. On May 31, 2005, Birchcliff issued a Certificate, acknowledged by Olympia, confirming that the capital stock of Birchcliff at the close of business on May 30, 2005 continued to consist of 20,248,337 Common Shares.

82. On May 31, 2005, Veracel issued a Certificate, confirming that the issued and outstanding Veracel shares continued to consist of 17,830,461 Common Shares and 7,299,424 Class A Preference Shares for a total of 25,129,885 outstanding shares. [108]

83. On May 31, 2005, Articles of Arrangement were filed by Veracel and Birchcliff and the Registrar confirmed such filings.

84. On May 31, 2005, Gordon Cameron, Werner Siemens, Larry Shaw and Jeffery Tonken signed consents to act as directors of Amalco.

85. On May 31, 2005 John Anderson, Robert Allan, and David Tonken resigned as officers and directors of Veracel. These directors and Veracel signed mutual releases effective on the same day. [107, 109, 110]

86. On May 31, 2005, Olympia acknowledged receipt of the Treasury Order. [116, 117]

87. On May 31, 2005, the Underwriters were paid, and acknowledged receipt of payment [of], their fee of $6,580,475, in accordance with the Underwriters' agreement with Veracel. [99]

88. On May 31, 2005, Olympia received $1,031,884.87, representing the redemption price for the outstanding Amalco Series 1 Preferred Shares. [100]

89. On May 31, 2005, Amalco filed the Articles of Arrangement [115], Final Order, Plan of Arrangement, and Articles of Amalgamation with the TSXV and the securities commissions in British Columbia, Alberta, Saskatchewan, Ontario and Quebec.

90. On June 3, 2005, Amalco issued a press release announcing that Amalco had completed the Flow-Through Financing. [122]

91. On June 3, 2005, Amalco issued a TSXV Bulletin announcing that Amalco shares were issued in exchange for Veracel and Birchcliff shares and identifying that the Amalco Common Shares would commence trading on the TSXV on June 6, 2005. [123]

Reassessment and related matters

92. The Appellant claimed a portion of the Tax Attributes in its 2006 taxation year.

93. By Notice of Reassessment dated November 30, 2011, the Minister reassessed Birchcliff to disallow the deduction of $16,226,489 of non-capital losses (the "Reassessment") claimed in the 2006 taxation year.

94. The Reassessment was based on assumptions related to allegations of sham and acquisition of control. GAAR was not a basis for the Reassessment.

95. The Appellant filed a Notice of Objection dated December 2, 2011.

96. By Notice of Appeal filed March 13, 2012, the Appellant appealed the 2006 taxation year to this Court.

[5] All defined terms used herein have the meaning given in the partial agreed statement of facts unless otherwise indicated.

[6] The cursory description of the transaction steps provided in the partial agreed statement of facts is not helpful without a good understanding of the background context of these transactions. In this regard, the Appellant and the Respondent paint a very different picture of the circumstances and objectives that influenced the transaction steps leading up to and culminating in the amalgamation of Veracel and Birchcliff. Each party's position regarding the factual context is summarized below.

III. Respondent's Position

[7] The Respondent points out that there is no dispute that Veracel was a dormant corporation that had accumulated a large amount of non-capital losses, scientific research and experimental development expenses and investment tax credits (the "Tax Attributes") from the Medical Business that it had previously carried on. The evidence shows that Veracel sent out a request for proposals to sell its Tax Attributes for the benefit of its existing shareholders. The Respondent contends that in early 2004 David Tonken and his partner, Greg Matthews, were engaged as advisors to Veracel to market the Tax Attributes.

[8] David Tonken and Greg Matthews were the managing directors of Cavalon Capital Partners Ltd. ("Cavalon"). The Respondent states that Cavalon was in the business of the monetization of tax losses.

[9] David Tonken sought out potential partners in a transaction with Veracel who might be interested in acquiring Veracel's Tax Attributes. He brokered an initial transaction with Emerging Equities Inc. ("EEI"), which ultimately fell through. David Tonken then contacted Jim Surbey, the vice-president of corporate development and corporate secretary of Birchcliff, to inform him of Veracel's Tax Attributes and Veracel's willingness to make the Tax Attributes available to a profitable company.[2]

[10] Birchcliff, the other predecessor corporation in the amalgamation, was a public entity that had entered into an agreement to purchase the Devon Properties. At that time, it was already on a successful path in establishing its oil and gas business. Prior to the amalgamation, Birchcliff had obtained a commitment for financing for the Devon Properties acquisition in the form, *inter alia*, of the Bridge Loan. Birchcliff did not intend to draw on the Bridge Loan. The plan was to raise equity rather than draw on the Bridge Loan, or to use the proceeds from the equity financing to repay the Bridge Loan if the Devon acquisition was closed prior to completion of the equity financing.

[11] The Respondent reasons that David Tonken was quite familiar with how a loss utilization transaction could be implemented. A direct acquisition by Birchcliff of the issued and outstanding shares of Veracel was not an option as that would trigger an acquisition of control of Veracel. As a result, the Loss Streaming Restrictions would have barred the Appellant from using Veracel's non-capital losses by reason of the fact that the Medical Business which gave rise to the losses was not being carried on by the Appellant with a reasonable expectation of profit.

[12] The Respondent also notes that, had Birchcliff and Veracel simply been amalgamated without further tax planning, Veracel would by virtue of the special deeming rule set out in subparagraph 256(7)(*b*)(iii) of the Act have been deemed to have undergone an acquisition of control prior to the amalgamation.

[13] The Respondent reasons that, to overcome this obstacle, an elaborate tax plan was developed, culminating in Veracel's amalgamation with Birchcliff. The Respondent observes that the deeming rule in subparagraph 256(7)(*b*)(iii), which deems control of a particular predecessor corporation to have been acquired on an amalgamation, does not apply if the shareholders of that corporation collectively receive a majority of the voting shares of the amalgamated entity (the "Majority Voting Interest Test") as consideration for the exchange of their shares in the

[2] Transcript of November 18, 2013, pages 70, 71 and 123.

particular predecessor corporation.[3] According to the Respondent, this is where clever but nonetheless ineffective tax planning came into play. To avoid an acquisition of control of Veracel, the Amalgamation Transactions were implemented in such a way as to allow the Appellant to argue, at least on paper, that Veracel's shareholders received a majority of the voting shares of the Appellant. To achieve this purpose, the equity financing required by Birchcliff to acquire the Devon Properties was arranged through Veracel with the assistance of Birchcliff's representatives. The new investors (the "New Investors") were presented with Birchcliff's business plan.[4] They invested on the strength of Birchcliff's business. Pursuant to the tax plan, Veracel rather than Birchcliff issued subscription receipts to the New Investors. These receipts were then exchanged for Class B common shares of Veracel (the "Class B shares") immediately prior to its amalgamation with Birchcliff. The Class B shares were then exchanged for common shares of the Appellant upon amalgamation. Because the New Investors required assurance that they would own shares in the corporation that carried on the oil and gas business, the Amalgamation Transactions were carried out in sequential order under the terms of a court-sanctioned plan of arrangement implemented only after all securities approvals and other approvals had been obtained. Under the plan of arrangement, the New Investors became shareholders of Veracel for a fleeting moment.

[14] The Respondent argues vigorously that the Appellant failed to avoid the Loss Streaming Restrictions because the issuance of the Class B shares by Veracel immediately prior to the amalgamation was a sham. In that regard, the Respondent contends that the parties to the Amalgamation Transactions did not intend that the New Investors acquire shareholder rights in Veracel. As a result, the Class B shares must be ignored. On that basis, the amalgamation triggered an acquisition of control of Veracel because the Veracel shareholders did not receive shares representing a Majority Voting Interest in the Appellant.

[15] In the alternative, if the Court concludes that the sham doctrine does not apply such that the Class B shares are found to have been effectively issued, the

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[3] Clause 256(7)(*b*)(iii)(B) requires the reader to suppose that the shares of the amalgamated entity acquired by the shareholders of a particular predecessor corporation were all acquired by a single hypothetical person. The provision then requires the reader to determine whether that hypothetical person would have acquired *de jure* control of the amalgamated entity given that hypothetical situation. If the answer is no, then control of the particular predecessor is deemed to have been acquired immediately prior to the amalgamation. If the answer is yes (in which case there exists what is hereinafter referred to as a "Majority Voting Interest"), then the particular predecessor is not deemed to have been the object of an acquisition of control. My view of the purpose of the provision is set out in paragraphs 96 to 106 of my reasons for judgment.

[4] The shareholders of Veracel immediately prior to the introduction of the New Investors as Class B shareholders are referred to herein as the "Original Veracel Shareholders".

Respondent argues that an acquisition of control of Veracel nonetheless occurred because the New Investors constituted a "group of persons" that acquired control of Veracel immediately prior to its amalgamation with Birchcliff.

[16] Finally, in the further alternative, the Respondent claims that the GAAR applies to override the Amalgamation Transactions designed to avoid an acquisition of control of Veracel. The GAAR argument was raised only after the Minister confirmed the reassessment.

IV. Appellant's Position

[17] Relying principally on David Tonken and Jim Surbey's testimony, the Appellant alleges that David Tonken and Greg Matthews were tasked with more than the monetization of Veracel's Tax Attributes. Their mandate called for the implementation of a so-called "restart" transaction whereby Veracel would raise new capital for the purpose of pursuing a new business opportunity. Because the capital was raised from a large number of unrelated investors acting independently, Veracel did not undergo an acquisition of control. The underlying suggestion is that it was pure happenstance that Veracel's plan to restart, which the Appellant claims was developed prior to David Tonken's first meeting with Birchcliff's executives, was complementary to Birchcliff's desire to raise new capital for the Devon Properties acquisition.

[18] With that contextual background in mind, the Appellant argues that the issue by Veracel of the Class B shares to the New Investors cannot be ignored under the sham doctrine. For a sham to exist, there must be deceit. The New Investors intended to become and did become Class B shareholders of Veracel.

[19] Furthermore, the New Investors did not act as a "group of persons" that acquired control of Veracel. The Respondent alleges that they constitute a "group of persons" because they entered into the Subscription Agreement, which endorsed the plan of arrangement and granted a proxy to Jeff Tonken or Jim Surbey to vote all of the subscription receipts or Class B shares in favour of the plan of arrangement. That, according to the Appellant, is not enough to congeal the New Investors into a "group of persons". The New Investors acted independently in acquiring their shares and granting the proxy.

[20] Finally, the Appellant invoked a number of arguments to rebut the Respondent's claim that the GAAR applies in support of the Minister's reassessment.

V. Credibility and Factual Findings

[21] There are between David Tonken's testimony and the documentary evidence relied on by the Respondent significant inconsistencies, which serve to undermine his credibility. The first inconsistency relates to the nature of Cavalon's business and its participation in the transactions at issue in this appeal. David Tonken contended that tax loss monetization was only a small part of Cavalon's advisory business. During cross-examination, he was confronted with the contents of a memorandum to the Original Veracel Shareholders written by John Anderson. Mr. Anderson was the former chief financial officer of Veracel. He was hired to act as a consultant to Veracel on the transactions proposed by Mr. Tonken and his partner. Mr. Anderson wrote:

> The historical background to the proposed Plan of Arrangement is as follows. The Veracel/XYZ transaction has been arranged by Cavalon Capital Partners Ltd. ("Cavalon"). Cavalon is a private company engaged in the business of the monetization of tax losses through reorganizing public and private companies and has assembled the parties to the proposed transaction and will oversee the transaction. . . .[5]
>
> [Emphasis added.]

[22] Mr. Tonken maintained that the memorandum was inaccurate. Mr. Tonken also testified that Cavalon was an "unrelated party" to the transactions.

[23] However, Mr. Anderson specifically names Cavalon as the party who put together the initial proposed transaction between Veracel and EEI:

> Cavalon originally proposed to combine Veracel with oil and gas assets and a management group as way of maximizing value for the Veracel shareholders. . . . Most recently, Cavalon arranged for a transaction with an oil well service company through Emerging Equities Inc. ("EEI"), a transaction that was described in a previous memorandum sent to the Veracel shareholders. . . .

[24] Mr. Tonken's testimony that Cavalon was not involved is further undermined by a chain of emails between him, Mr. Anderson and Bob Allan[6] which indicates otherwise. In an email to Mr. Allan, David Tonken writes:

> Gentlemen:

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[5] Memorandum to the shareholders of Veracel dated March 29, 2005, Exhibit A-1, Tab 24, Book of Agreed Documents.

[6] Bob Allan was the chairman and a director of Veracel at that time (Exhibit A-1, Tab 17, Book of Agreed Documents).

> We are working on a letter of intent with Birchcliff Energy Ltd.
>
> . . .
>
> They are interested in using Veracel as part of a financing they are working on. A draft will be provided likely by Thursday. Birchcliff will cover all reorganization costs and net them against a total value of $1,984,200 for Veracel. Present shareholders will receive 70% and Cavalon will receive 30%, in cash or shares of Birchcliff, as elected by each shareholder.
>
> John, please call me to discuss . . . .
>
> . . .
>
> Regards,
>
> David[7]
>
> [Emphasis added.]

[25] When this email was put to David Tonken, he acknowledged that this is what the email said and made no further observation.[8]

[26] Another inconsistency relates to Veracel's motivation in undertaking the Amalgamation Transactions. Mr. Tonken's testimony suggested that Veracel wanted to restart in the oil and gas industry and minimized the importance of monetizing Veracel's Tax Attributes. He disagreed with the statement that Veracel wished to wind up its affairs and monetize its tax pools. He was then confronted with another letter, from Mr. Anderson to the Canada Revenue Agency appeals officer, Beverley Philipp, from which he again distanced himself. The letter reads, in part, as follows:

> . . . My involvement in this transaction was initially to advise the Board of Veracel as to their attempt at monetizing their tax pools. The company was at a point where they wished to wind up their affairs. . . .
>
> . . . They had accumulated tax pools in excess of $30 million and wanted to somehow monetize the value of these pools.[9]
>
> [Emphasis added.]

[7] Exhibit A-1, Tab 17, Book of Agreed Documents.
[8] Transcript of November 18, 2013, page 128.
[9] Exhibit A-3, Tab 131.

[27] Mr. Tonken testified that this letter may have reflected Mr. Anderson's position and beliefs, but it did not coincide with his own view of Veracel's intention, which was that Veracel wanted to restart in the oil and gas industry. Mr. Tonken's explanation is inconsistent with Mr. Anderson's explanation to the appeals officer.

[28] Other documentary evidence demonstrates that the monetization of the Tax Attributes was a more significant motivating factor than suggested by Mr. Tonken.

[29] The evidence shows that David Tonken and Veracel first became acquainted shortly after February 24, 2004 when Mr. Tonken received a Request for Proposal letter[10] written by Veracel, which sought the utilization of Veracel's tax losses. The request reads as follows:

> This is a request for a proposal to utilize the tax losses of Veracel Inc.
>
> . . .
>
> After several years of development work and pre-clinical trials, it was decided by the Shareholders that unless a suitable clinical development partner could be found, the Company would need to suspend operations. . . .
>
> The Company is now dormant; it continues to own its intellectual property, prototype units, and data. The Company files, records, and physical embodiments are in safe storage in a suitably secure facility. The Company has no operations at this point.
>
> Tax losses totaling some $34.8 million including R & D carry-overs, plus $1.9 million Investment Tax credits are available and the Shareholders of the Company want proposals for utilization of these losses.
>
> . . .
>
> The Shareholders will only entertain proposals that are not contingent on utilization of the future losses and involve compensation, which includes an upfront cash component and equity in the transaction.
>
> The current Shareholders are prepared to continue in a role to support an arrangement and transaction that would utilize the losses.

[10] Exhibit A-1, Tab 4.

[30] I observe that the request for proposal does not mention any intention on Veracel's part to "restart". The letter only states that Veracel is soliciting offers to use its tax pools.

[31] David Tonken wrote an email to Mr. Allan on March 2, 2005[11] in which he stated that Birchcliff was looking for a "loss co" and that this was the role Veracel would play in the transaction:

> Dear Bob:
>
> We have another group looking at the Veracel pools. They have bid on a $200 million asset package and want to include a loss co. They are aware of the USA issue and their lawyers at BLG have requested a copy of the most recent executed USA along with the 2001 federal tax return.
>
> We believe we should pursue this opportunity. Would you please call me . . . to discuss.
>
> . . .
>
> David
>
> [Emphasis added.]

[32] When this email was put to David Tonken in cross-examination, he confirmed that the pools referred to tax pools, that the group was Birchcliff and that the "loss co" was Veracel.

[33] As alluded to above in the statement of the Respondent's position, a deal had initially been arranged between EEI and Veracel, which ultimately failed. Mr. Tonken similarly understated the importance of the Tax Attributes to the EEI transaction. Mr. Tonken testified that EEI had financing problems and that the deal failed because EEI could not raise a deposit. Notably, however, the memorandum from Mr. Anderson to the Original Veracel Shareholders dated March 29, 2005[12] states that the EEI transaction failed due to issues with Veracel's Tax Attributes:

> . . . Most recently, Cavalon arranged for a transaction with an oil well service company through Emerging Equities Inc. ("EEI"), a transaction that was described in a previous memorandum sent to the Veracel shareholders. Cavalon fully disclosed to EEI the issues relating to the Veracel tax pools and the financial risks relating to the tax pools were reflected in the terms of the proposed

[11] Exhibit A-1, Tab 13.
[12] Exhibit A-1, Tab 24, memorandum from John Anderson to the shareholders of Veracel.

> transaction. Nevertheless, the EEI transaction did not proceed because the professionals reviewing the tax pools on behalf of the oil well service company advised that the issues relating to the tax pools could not be resolved in sufficient time to complete the transaction. . . . As well, Cavalon has expended considerable time and effort in examining and clarifying the issues relating to Veracel's tax pools.
>
> Cavalon is confident that the XYZ transaction can be completed notwithstanding the difficulties associated with Veracel's tax pools and its corporate structure.
>
> [Emphasis added.]

[34] When this letter was put to David Tonken in cross-examination, he denied that the EEI transaction failed due to problems with the Tax Attributes and maintained that it failed due to financing issues. He was unable to point to any documentary evidence that the deal failed due to financing problems. He did, however, admit that questions and issues relating to Veracel's Tax Attributes were raised in the deal with Birchcliff, namely, the existence of backup records establishing the expenditures and the possible tax effects of the Unanimous Shareholders Agreement among the Original Veracel Shareholders.

[35] After the failed EEI transaction, David Tonken went back to the drawing board to try to broker another transaction. He ultimately began discussions with Birchcliff. The discussions led to Veracel and Birchcliff signing a letter agreement on April 1, 2005[13] which set out their agreement with respect to the reorganization of Veracel and its amalgamation with Birchcliff. In the letter agreement, Veracel undertook to use all commercially reasonable efforts to raise new equity financing. The equity financing would be done by issuing subscription receipts which would be exchangeable for Class B shares of Veracel, which would then be exchanged for Amalco common shares. The Amalco preferred shares, on the other hand, would be redeemable for cash upon the closing of the plan of arrangement, up to a maximum of $1.5 million. The Original Veracel Shareholders could opt for these preferred shares if they did not want to follow Birchcliff into the oil and gas industry. The evidence shows that all but three Original Veracel Shareholders pursued this option,[14] which calls into question Mr. Tonken's testimony that the transactions with Birchcliff were intended to be a "restart".

[36] On April 14, 2005, Veracel entered into an underwriting agreement[15] with the Underwriters who were engaged to raise money through 26,000,000

[13] Exhibit A-1, Tab 27.
[14] Exhibit A-3, Tab 124.
[15] Exhibit A-1, Tab 42.

subscription receipts at the price of $4 per receipt. The Respondent highlighted various disclosures and representations required of Veracel, which demonstrated the Underwriters' concern with the Appellant's ability to utilize and have access to the Tax Attributes. Veracel represented in the underwriting agreement that it had not previously undergone an acquisition of control and that the arrangement agreement would not result in any direct or indirect acquisition of control such that Amalco would not have access to Veracel's Tax Attributes.

[37] As a result of hiring the Underwriters, Veracel had to complete a due diligence questionnaire[16] to ensure honest and full disclosure. Several sections of the due diligence questionnaire pertained to the availability of Veracel's Tax Attributes and were cited by the Respondent in her cross-examination of David Tonken. The Respondent highlighted question 9 of the due diligence questionnaire, which reads as follows:

> 9. Please confirm that prior to the Effective Time of the Arrangement, Veracel will have no Veracel Assets, that the only assets in Veracel will be the tax pools as disclosed in the Veracel Financial Statements contained in the Birchcliff Information Circular and that as at the Effective Date of the Arrangement, Veracel will have no liabilities except in respect of Transaction Costs as set forth in Section 4.1(s) of the Arrangement Agreement.
>
> **Answer**
>
> ***Confirmed.***

[38] The Respondent also highlighted questions 11 and 12, which read as follows:

> 11. Please confirm that the available losses for Canadian income tax purposes, the non-refundable investment tax credits and the eligible scientific and development expenditures incurred by Veracel as contained in the Veracel Financial Statements will be enabled to be utilized by Amalco to reduce future income tax payable by Amalco or, in the case of eligible scientific and development expenditures, be able to be deducted from taxable income in future years of Amalco.
>
> **Answer**
>
> ***Veracel confirms that, to the best of its knowledge, information and belief, the available losses for Canadian income tax purposes, the***

[16] Exhibit A-2, Tab 61.

non-refundable investment tax credits and the eligible scientific and development expenditures incurred by Veracel as disclosed in the Veracel December 31, 2004 audited financial statements should be available to be utilized by Amalco to reduce future income tax payable by Amalco or, in the case of eligible scientific and development expenditures, be able to be deducted from taxable income in future years of Amalco subject to the possibility of the Canada Revenue Agency and Canadian provincial tax authorities making arbitrary assessments and rulings and arbitrarily imposing anti-avoidance rules to the deductibility of tax losses.

12. Please confirm that the Veracel Subscription Receipt Financing will not result in an acquisition of control of Veracel for purposes of the *Income Tax Act* (Canada).

Answer

Veracel has no knowledge of the persons who will become the beneficial owners of the Veracel Subscription Receipts and the Veracel Class B Shares and therefore has no way to determine the effect the Veracel Subscription Receipt Financing will have on the control of Veracel.

[39] I observe that Veracel was also required to make representations and provide warranties, in the arrangement agreement with Birchcliff, concerning the availability of its Tax Attributes and its status as a liability-free dormant company.[17] Veracel represented and warranted that prior to the arrangement it would have no assets and liabilities and that, since its incorporation, there had not been a direct or indirect acquisition of control of Veracel. The arrangement agreement also contained a provision giving Birchcliff the ability to unilaterally terminate the plan of arrangement if the Supreme Court of Canada rendered a decision that made it unlikely that Veracel's Tax Attributes would be available for use by the Appellant. I surmise that Veracel was required to make these representations and provide these warranties because part of the equity financing was directly or indirectly used to pay for Veracel's Tax Attributes.

[40] The Appellant contends that the reason for including Veracel in the equity financing was not limited to the use of its Tax Attributes. The Appellant suggests that Veracel's participation was also necessary to achieve a successful equity financing. I find this position unconvincing for several reasons.

[41] The documentary evidence reveals to me that the New Investors required the assurance that they would obtain what they bargained for, namely, an equity stake

[17] Exhibit A-1, Tab 44.

in Birchcliff's oil and gas business. I am comforted in my conclusion by the fact that the evidence shows that it was Birchcliff's business that was presented as the investment opportunity for potential investors. The promotional materials were prepared by Birchcliff and presented by Birchcliff's officers and executives.[18] David Tonken testified that investors were interested in investing in Birchcliff's business, not in Veracel.[19] He further testified that any questions the investors had regarding Veracel related solely to its Tax Attributes, and that Veracel's "participation was the tax pools".[20] When questioned about the value Veracel added to the equity financing, Jim Surbey could not point to anything other than the Tax Attributes.[21]

[42] It was suggested in the Appellant's oral arguments that Birchcliff benefited from Veracel's involvement in the equity financing because it would gain access to the equity without expending resources or effort in raising the equity itself, and without the risk of a failed offering.[22] I am not convinced that streaming the equity financing through Veracel simplified the financing process for Birchcliff. The evidence shows that Birchcliff remained significantly involved in this process, both in marketing the opportunity to potential investors and in preparing documents such as the Subscription Agreements.[23] Furthermore, from the evidence, I believe that Birchcliff's management already had a plan to raise equity without Veracel's involvement before being approached by David Tonken. Birchcliff was experienced in, and familiar with, the subscription receipt financing technique, as it had previously participated in a similar subscription receipt offering when it had undertaken the Scout Amalgamation.[24] Furthermore, when Birchcliff arranged the Bridge Loan with Scotia Capital, Scotia Capital was confident that Birchcliff could successfully raise equity.[25] The risk of a failed offering is questionable in light of Scotia Capital's confidence in Birchcliff's ability to raise equity and Birchcliff's previous participation in the subscription receipt offering in the Scout transactions. In the Scout transactions, the subscription receipts were issued in the name of Birchcliff rather than in the name of Scout.[26]

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[18] Transcript of November 18, 2013, pages 82, 83 and 157.
[19] Transcript of November 18, 2013, pages 82 and 83.
[20] Transcript of November 18, 2013, page 157.
[21] Transcript of November 20, 2013, page 96.
[22] Transcript of November 20, 2013, page 194.
[23] Transcript of November 19, 2013, page 96.
[24] Transcript of November 20, 2013, pages 3 and 4.
[25] Exhibit A-1, Tab 16.
[26] Transcript of November 20, 2013, page 7.

[43] The Appellant's position that Veracel intended to pursue a "restart" transaction is simply not believable. I infer from the evidence that Birchcliff planned to raise new share capital to finance the Devon Properties purchase. Had Birchcliff not been approached by David Tonken to enter into the "loss monetization" transactions at issue in this appeal, Birchcliff would have issued the subscription receipts directly to the New Investors. I also conclude, on the basis of the evidence, that the Original Veracel Shareholders desired only to monetize Veracel's Tax Attributes for their own benefit. There was no intention on their part to engage in a restart transaction.

[44] In light of the above, I conclude that the subscription receipt financing was "seeded" into Veracel for the purpose of avoiding the acquisition of control restrictions, and this, if successful, would have allowed Birchcliff to gain access to Veracel's Tax Attributes. I must now determine whether this plan worked or failed.

VI. Analysis

A. Sham

[45] The Respondent argues that the creation and the issuance of the Class B shares were a sham because the New Investors would not enjoy the rights and privileges attached to those shares. The Respondent also contends that the shares were never properly issued. According to the Respondent's reply, the plan of arrangement called for the issuance of Class B shares for the purpose of representing that the New Investors were shareholders of Veracel before the amalgamation. In other words, they were Class B shareholders only on paper.

[46] At the very end of the Respondent's cross-examination of him, David Tonken made a comment which weighed heavily in the Respondent's argument on sham. The Respondent pursued a line of questions on why the Class B shares had been created and why they purported to have been issued to the New Investors. Of interest are the following questions and answers:

> Q So . . . then . . . pursuant to the plan of arrangement, there's a new class of shareholders coming into existence pursuant . . . to what I understand the plan . . . to purport to say, and that's the Class B shareholders, correct?
>
> A Correct.
>
> Q And did the directors or pre-existing shareholders of Veracel intend that control of Veracel was to be altered by the creation and issuance of those shares?

A No.

Q No? Okay. . . .[27]

[47] This last answer is used by the Respondent to support the contention that the documents relating to the Class B shares were a sham. In closing arguments, the Respondent argued:

> If we could move to the sham argument on page 41 and this sham argument . . . is that effectively they didn't create any shares. Here they did not intend to create any Class B shares with real controlling rights.
>
> Under the acquisition of control issue, it's -- they were just unsuccessful in doing so, but here where there is no intent to create or issue shares with any effective rights to control the corporation, but such shares are nonetheless created to give the appearance that their holders have control. The purported creation of the new class of controlling shares is a sham.
>
> In this case [it] was intended by the pre-existing shareholders and directors of Veracel that the Class B shareholders would have no rights to exert any control over Veracel.
>
> Do you know where we got this? We got this from Mr. Tonken. He said, I think it was the last question, the last two questions of his cross-examination. He was asked whether the directors or pre-existing shareholders of Veracel intended that control of Veracel was to be altered by the creation and issuance of the Class B shares. He said, no.
>
> 34 million new voting shares are going to be created and you don't intend that they're going to alter control of Veracel?[28]

[48] In my opinion, the Respondent has not placed David Tonken's answer in its proper context. It is apparent to me that David Tonken understood the question to be asking whether the directors of Veracel intended that the creation and issuance of the Class B shares give rise to an acquisition of control of Veracel. Needless to say, that was not in the cards. The Appellant's position is that a large group of unrelated investors committed, after solicitation, to an investment in Veracel for reasons that appealed individually to each of them. In that context, David Tonken was justified in saying that it was never intended that the New Investors be viewed as a "group of persons" who, as such, would act in concert with respect to the control of Veracel. David Tonken's answer does not signify that it was intended

[27] Transcript of November 18, 2013, page 176.
[28] Transcript of November 21, 2013, pages 65 and 66.

that the New Investors would not enjoy the attributes of ownership of those shares, although they would only do so for a brief moment.

[49] There appears to be no dispute between the parties as to the meaning of sham. The parties' lengthy oral and written submissions make reference to the classic definition of a sham referred to in the often-cited case of *Snook v. London & West Riding Investments, Ltd.*[29] In *Snook*, Lord Diplock stated that "sham":

> . . . means acts done or documents executed by the parties to the "sham" which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create. One thing I think, however, is clear in legal principle, morality and the authorities . . . that for acts or documents to be a "sham", with whatever legal consequences follow from this, all the parties thereto must have a common intention that the acts or documents are not to create the legal rights and obligations which they give the appearance of creating. No unexpressed intentions of a "shammer" affect the rights of a party whom he deceived. . . .[30]

[50] Canadian courts adopted the *Snook* definition of sham in 1972.[31] This definition of sham was reaffirmed and followed by the Supreme Court of Canada in *Stubart Investments Ltd. v. The Queen*.[32] In *Stubart*, Justice Estey defined a sham as "a transaction conducted with an element of deceit so as to create an illusion calculated to lead the tax collector away from the taxpayer or the true nature of the transaction; or, simple deception whereby the taxpayer creates a facade of reality quite different from the disguised reality".[33]

[51] Two more recent decisions of Justice Noël of the Federal Court of Appeal discuss sham. In *Antle v. Canada*,[34] he said, in *obiter*: "The required intent or state of mind is not equivalent to *mens rea* and need not go so far as to give rise to what is known at common law as the tort of deceit . . . . It suffices that parties to a transaction present it as being different from what they know it to be."[35] In *2529-1915 Québec Inc. v. Canada*,[36] he said:

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[29] [1967] 1 All ER 518.
[30] *Snook*, at page 528.
[31] *M.N.R. v. Cameron*, [1974] S.C.R. 1062.
[32] [1984] 1 S.C.R. 536.
[33] *Stubart*, at pages 545 and 546.
[34] 2010 FCA 280.
[35] *Antle*, at paragraph 20.
[36] 2008 FCA 398.

> 59 It follows from the above definitions that the existence of a sham under Canadian law requires an element of deceit which generally manifests itself by a misrepresentation by the parties of the actual transaction taking place between them. When confronted with this situation, courts will consider the real transaction and disregard the one that was represented as being the real one.

[52] As the Appellant points out, the essence of the Respondent's theory of sham is that a large number of independent investors orchestrated mass deception. I find nothing in the evidence to support the view that the New Investors were engaged in deceit. I surmise that the Respondent takes offence at the Class B shares having been issued for a very brief moment as a critical step in a preordained series of transactions so that there would be no opportunity for the New Investors to exercise their rights of share ownership. In practice, this often happens when transactions are completed pursuant to the terms of a plan of arrangement. The parties to a transaction require assurance that the transaction will be completed in a certain way. They do not want to commit to an earlier transaction without assurance that the subsequent transactions will also be completed. For example, this is a common feature of plans of arrangement used in the context of debt workouts. Debt holders do not want their debts to be compromised or settled without assurance that they will receive the consideration promised to them.

[53] In the case at bar, the New Investors were promised that they would receive Class B shares of Veracel for their subscription receipts and that these Class B shares would become shares of the Appellant following the amalgamation of Birchcliff and Veracel. This is what happened. The brevity of the share ownership does not negate the fact that the New Investors became shareholders of Veracel.

[54] Furthermore, I respectfully disagree with the Respondent's suggestion that the shares were never issued. The documentary evidence clearly shows that the Class B shares were to be issued as consideration for the acquisition of the subscription receipts by the investors. Susan Mak, the assistant manager of client services at Olympia, the subscription receipt agent for Veracel, testified that Olympia received the funds realized from the sale of the subscription receipts. She confirmed that Olympia received the certificate for 34,000,000 Class B shares of Veracel in trust for the New Investors. She further confirmed that Olympia received instructions to exchange the certificate representing 34,000,000 Class B shares of Veracel for 34,000,000 common shares of the Appellant following the amalgamation. Her cross-examination did not reveal any inconsistencies or contradictions with her evidence in chief.

[55] Considering the evidence as a whole, I am satisfied that the Class B shares were effectively issued and their existence cannot be ignored under the legal doctrine of sham.

B. Were the Class B shareholders a "group of persons" that acquired control of Veracel?

[56] The Respondent argues that the Class B shareholders acquired control of Veracel as a "group of persons" by virtue of the fact that they acted in concert as a group by entering into the Subscription Agreement and giving Jeff Tonken and Jim Surbey an irrevocable proxy to approve the plan of arrangement. I respectfully disagree. A finding in favour of the Respondent would have significant consequences for, and interfere with, common business practices.

[57] Proxies have become a common feature of modern corporate law. Institutional shareholders are often solicited by management to give proxies, for example, to approve a slate of candidates for election to the board. It is reasonable to infer that shareholders agree to give such proxies because it simplifies their life and because the slate conforms to their individual interests. Another example is the decision by corporations to hire professional proxy solicitation firms for the purpose of soliciting approval of transactions; this is designed to ward off the advances of activist shareholders.

[58] Plans of arrangement are also a common feature of modern corporate law. In a public context, they are used for all but the most straightforward transactions. For example, if a share reorganization is planned in order to offer a choice to existing shareholders (different classes of shares, shares exchangeable for shares of a parent, etc.), a plan is used to ensure that the transactions are completed in the proper order and that the shareholders end up with what they bargained for. Plans of arrangement are also regularly used to implement so-called "public butterfly transactions". The most notable example was the split-up of Canadian Pacific Limited holdings to eliminate the holding company discount in 2001. If shareholders are to be treated as a "group of persons" simply because they grant to the same person a proxy to vote their shares or agree to carry out the butterfly transaction pursuant to a plan of arrangement, this would mean that most of those types of transactions would become fully taxable.[37]

[37] An acquisition of control cannot arise under the "butterfly" carve-outs.

[59] A court-sanctioned plan of arrangement is often used to implement a debt workout for the purpose of the *Companies' Creditors Arrangement Act*. Debt holders require assurance that all of the steps leading to the recapitalization of their debt will be carried out. Does this make them a "group of persons"? In view of the principles developed in the case law discussed below, I do not believe so.

[60] In *Silicon Graphics Ltd. v. Canada*,[38] the Federal Court of Appeal held that there must be a common connection or community of interest uniting shareholders of a particular corporation before they can be considered as a "group of persons" with respect to the control of a particular corporation. In this regard, the Court of Appeal said:

> 36 Based on these cases, I agree with the appellant's submission that simple ownership of a mathematical majority of shares by a random aggregation of shareholders in a widely held corporation with some common identifying feature (e.g. place of residence) but without a common connection does not constitute *de jure* control as that term has been defined in the case law. I also agree with the appellant's submission that in order for more than one person to be in a position to exercise control it is necessary that there be a sufficient common connection between the individual shareholders. The common connection might include, *inter alia*, a voting agreement, an agreement to act in concert, or business or family relationships.
>
> 37 In the present case, no evidence was adduced that would suggest the non-resident shareholders will vote as a block in the election of the directors of Alias or in other important matters relating to control of that company. The residence of shareholders alone provides no indication as to whether or not they are in agreement on the major issues relating to control of a company. The fact that there are in excess of 50% of the shareholders of Alias residing in the United States where there is no evidence that they have any common connection or indeed even know each other's identity provides no indication as to whether or not they could or would agree on any issue relating to control of the company.

[61] In the case at hand, there is no evidence to show that the New Investors knew each other or had a plan to control the corporation together. I infer that the New Investors entered into the Subscription Agreement and granted a proxy to Jeff Tonken or Jim Surbey to vote their shares in favour of the plan, if required, because it appealed to their individual self-interest. I surmise that they did so without discussing the matter with the other investors. Therefore, I agree with the Appellant's submission that the grant of the proxy in these circumstances is insufficient to demonstrate a common connection between the New Investors, and

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[38] 2002 FCA 260.

I find that the New Investors did not constitute a "group of persons" that acquired control of Veracel.

VII. General Anti-Avoidance Rule

[62] I will now consider whether the GAAR applies to disallow the deduction of non-capital losses by the Appellant. In *Canada Trustco Mortgage Co. v. Canada*,[39] the Supreme Court of Canada established a three-step framework for determining whether the GAAR applies to a transaction or series of transactions. This framework was reasserted by the Supreme Court in *Lipson v. Canada*[40] and *Copthorne Holdings Ltd. v. Canada*.[41]

[63] Within this framework, the first step is to inquire into the existence of a "tax benefit" within the meaning of subsection 245(1). For there to be a tax benefit, a transaction or a series of transactions of which the transaction is a part must result in "a reduction, avoidance or deferral of tax or other amount payable" under the Act or other relevant source of tax law, or "an increase in a refund of tax or other amount" under the Act or other relevant source of tax law.

[64] Under the second step of the framework established in *Canada Trustco*, the transaction giving rise to the tax benefit must be an "avoidance transaction" within the meaning of subsection 245(3).

[65] The third step of the framework is to determine whether the avoidance transaction was abusive pursuant to subsection 245(4). An avoidance transaction will be found to be abusive if "it cannot be reasonably concluded that a tax benefit would be consistent with the object, spirit or purpose of the provisions relied upon by the taxpayer".[42]

[66] The Respondent considers the following to be avoidance transactions that form part of a preordained series of transactions (the "Veracel Transactions"):

(a) the transfer of all assets of Veracel to a newly incorporated company;
(b) the sale of subscription receipts by Veracel rather than Birchcliff;
(c) the exchange of the subscription receipts for Class B shares; and
(d) the amalgamation of Veracel and Birchcliff.

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[39] 2005 SCC 54.
[40] 2009 SCC 1.
[41] 2011 SCC 63.
[42] *Canada Trustco*, paragraph 66.

[67] The Respondent argues that the tax benefit is the preservation and use of the Tax Attributes by the Appellant without the restrictions imposed under the Loss Streaming Restrictions.

[68] The Supreme Court in *Copthorne* affirmed that the existence of a tax benefit can be determined by comparing the taxpayer's situation with an alternative arrangement that would have been carried out but for the existence of the tax benefit.[43]

[69] In this case, Birchcliff could have issued the subscription receipts directly to the New Investors to raise the equity financing. Instead, Veracel issued the subscription receipts to the New Investors. The subscription receipts were exchanged for Class B shares of Veracel, and Veracel and Birchcliff were then amalgamated. Because Veracel had issued the subscription receipts to the New Investors, there was no acquisition of control of Veracel upon the amalgamation of Veracel and Birchcliff, and the Tax Attributes were not subject to the Loss Streaming Restrictions. Therefore, I accept the Respondent's position that the tax benefit in this case is the preservation and use of the Tax Attributes.

[70] The second step in the GAAR framework is to determine whether the transaction giving rise to the tax benefit is an avoidance transaction. Pursuant to subsection 245(3) of the Act, an avoidance transaction is a transaction that results in a tax benefit and is not undertaken primarily for a *bona fide* non-tax purpose.[44] The determination under subsection 245(3) requires an objective assessment of the relative importance of the driving forces of the transaction.[45]

[71] Considering the evidence as a whole, I am satisfied that the sale of subscription receipts by Veracel rather than Birchcliff constituted an "avoidance transaction". In this regard, I conclude that the Veracel Transactions form part of the same series of transactions. As noted in my factual findings, I conclude that Birchcliff agreed to participate in the Veracel Transactions, including the shifting of Birchcliff's required equity financing to Veracel, for the primary purpose of allowing the Appellant to gain access to Veracel's Tax Attributes without restriction.

[72] The Appellant alleges that the primary purpose behind the Veracel Transactions, including the sale of subscription receipts by Veracel rather than

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[43] *Copthorne*, paragraph 35.
[44] *Copthorne*, paragraph 39.
[45] *Canada Trustco*, paragraph 28.

Birchcliff, was to raise equity financing for the acquisition of the Devon Properties.

[73] Although the overarching purpose behind the Veracel Transactions and the sale of subscription receipts by Veracel was to raise equity financing for the Devon Properties acquisition, this does not provide a *bona fide* non-tax reason for having Veracel rather than Birchcliff issue the subscription receipts to the New Investors. As noted earlier, I reject the Appellant's version, according to which Veracel intended to "restart" in the oil and gas field, and I infer that Birchcliff would have issued the subscription receipts directly to the New Investors had the parties not believed that the Loss Streaming Restrictions could be avoided by shifting the equity financing to Veracel for the purpose of benefiting from the exception in clause 256(7)(*b*)(iii)(B). I agree with the Respondent that the primary purpose for including Veracel in the equity financing was to preserve and utilize the Tax Attributes.

[74] This appeal thus turns on the outcome of the third step of the framework established in *Canada Trustco*, which is the determination of whether the avoidance transactions are abusive under subsection 245(4).[46] Within this framework, the abuse inquiry involves, first, interpreting the provisions of the Act giving rise to the tax benefit to determine their object, spirit and purpose and, second, determining whether the impugned transactions fall within or frustrate the purpose of those provisions.[47] As described in *Copthorne*:

> 69 In order to determine whether a transaction is an abuse or misuse of the Act, a court must first determine the "object, spirit or purpose of the provisions . . . that are relied on for the tax benefit, having regard to the scheme of the Act, the relevant provisions and permissible extrinsic aids" (*Trustco*, at para. 55). The object, spirit or purpose of the provisions has been referred to as the "legislative rationale that underlies specific or interrelated provisions of the Act" (V. Krishna, *The Fundamentals of Income Tax Law* (2009), at p. 818).
>
> 70 The object, spirit or purpose can be identified by applying the same interpretive approach employed by this Court in all questions of statutory interpretation — a "unified textual, contextual and purposive approach" (*Trustco*, at para. 47; *Lipson v. Canada*, 2009 SCC 1, [2009] 1 S.C.R. 3, at para. 26). While the approach is the same as in all statutory interpretation, the analysis seeks to determine a different aspect of the statute than in other cases. In a traditional statutory interpretation approach the court applies the textual, contextual and purposive analysis to determine what the words of the statute mean. In a GAAR

[46] *Canada Trustco*, at paragraph 36.
[47] *Canada Trustco*, at paragraph 44.

> analysis the textual, contextual and purposive analysis is employed to determine the object, spirit or purpose of a provision. Here the meaning of the words of the statute may be clear enough. The search is for the rationale that underlies the words that may not be captured by the bare meaning of the words themselves. However, determining the rationale of the relevant provisions of the Act should not be conflated with a value judgment of what is right or wrong nor with theories about what tax law ought to be or ought to do.
>
> [Emphasis added.]

[75] A transaction will be abusive if it circumvents the application of a provision such as a specific anti-avoidance rule or relies upon a provision in a manner that frustrates the object, spirit or purpose of the rule.[48]

[76] The existence of abusive tax avoidance must be clear. If it is not, the benefit of the doubt goes to the taxpayer. Moreover, the Minister bears the burden of establishing abusive tax avoidance.[49]

[77] *Canada Trustco* and *Copthorne* each reiterate the principle that tax planning is not per se abusive for the purposes of subsection 245(4). In *Canada Trustco*, the Supreme Court stated:

> 61 A proper approach to the wording of the provisions of the *Income Tax Act* together with the relevant factual context of a given case achieve balance between the need to address abusive tax avoidance while preserving certainty, predictability and fairness in tax law so that taxpayers may manage their affairs accordingly. Parliament intends taxpayers to take full advantage of the provisions of the Act that confer tax benefits. Parliament did not intend the GAAR to undermine this basic tenet of tax law.

[78] Similarly, in *Copthorne*, the Supreme Court said that "[t]axpayers are entitled to select courses of action or enter into transactions that will minimize their tax liability".[50] As a result, a taxpayer who chooses a course of action that

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[48] *Canada Trustco*, at paragraph 45.

[49] *Canada Trustco*, at paragraph 66. This is often referred to as the "burden of persuasion". The source of this burden is the concept of "procedural fairness". The taxpayer should know what case the taxpayer must meet. Interestingly, this has not been interpreted as barring appellants on appeal from bringing forth arguments that were not presented in the Tax Court, as demonstrated in *Global Equity Fund Ltd. v. The Queen*, 2011 TCC 507, provided that in such a case the Respondent has not been prejudiced by the appellant's belatedly raising the new legal argument. In that case, Justice Woods allowed the appeal because the Crown did not persuade her that the GAAR applied. On appeal, the Crown raised different arguments with respect to the object, purpose and spirit of the provisions that were violated by the appellant's tax plan. The Federal Court of Appeal allowed the appeal on those grounds at paragraphs 66 to 68 of *Canada v. Global Equity Fund Ltd.*, 2012 FCA 272. The determination of the object, spirit and purpose of a provision is, after all, a question of law.

[50] *Copthorne*, at paragraph 65.

minimizes his or her tax liability will not necessarily have engaged in abusive tax avoidance for the purposes of subsection 245(4).

[79] I must now undertake the two-stage analysis for the purpose of determining whether the sale of the subscription receipts by Veracel rather than Birchcliff constituted abusive tax avoidance.

[80] The Respondent contends that the Veracel Transactions circumvented the application of subsection 111(5) of the Act, or frustrated or defeated the object, spirit or purpose of that provision. In that regard, the Respondent argues that subsection 111(5) is part of a general policy against loss trading embedded within the Act and that it would offend the object, spirit and purpose of that general policy and the Loss Streaming Restrictions to allow the Appellant to utilize Veracel's Tax Attributes.

[81] The Respondent also contends that the issue of Class B shares to the New Investors, which made them Veracel shareholders for a brief moment, constituted an abusive reliance on the exception set out in clause 256(7)(*b*)(iii)(B), contrary to the object, spirit and purpose of that carve-out from the general rule laid out in the preamble to that provision.

[82] The Appellant, on the other hand, argues that subsection 111(5) adopts a shareholder-level common law test to determine when non-capital losses are restricted, and that the GAAR cannot apply to a common law test. *De jure* control, as defined under general principles, must be acquired by a person or "group of persons" before the Loss Streaming Restrictions can apply.

[83] The Appellant also invokes a number of policy considerations in favour of its position, namely:

(a) The elimination of tax attributes is inequitable.
(b) Parliament chose a bright line "acquisition of control" test with regard to the impairment of corporate tax attributes.
(c) Anti-avoidance rules that deem an acquisition of control do not apply to the transactions in this case.
(d) Parliament amended the rules regarding amalgamation to give effect to a 2013 budget announcement.

[84] The Appellant argues that the words and context of paragraph 256(7)(*b*) suggest that Parliament did not intend that there be an examination of the

shareholdings of the predecessor corporations to the amalgamated entity, other than immediately prior to the amalgamation, for the purpose of determining whether the Majority Voting Interest Test was satisfied. As a result, because the New Investors became Class B shareholders of Veracel prior to the amalgamation, albeit for a brief moment, the Majority Voting Interest Test was satisfied as required by the carve-out from that specific deemed acquisition of control rule.

[85] For the purpose of deciding this matter, I am not required to determine whether there is a general policy embedded in the provisions of the Act that prohibits loss trading between unrelated parties. In my opinion, the outcome of this appeal turns on a narrower issue, namely, whether the sale of the subscription receipts by Veracel circumvented the application of subparagraph 256(7)(*b*)(iii) or whether, with regard to the sale, the exception set out in clause 256(7)(*b*)(iii)(B) was relied on in a manner that frustrated the object, spirit and purpose of that provision. Therefore, I will leave the question of whether the Act embodies a general prohibition against loss trading to be determined in a case that does not involve a question of the application of a specific deeming rule.[51]

[86] I begin the first step of the abuse inquiry with a textual review of the relevant parts of paragraph 256(7)(*b*), which reads as follows:

> 256(7) . . .
>
> > (*b*) where at any time 2 or more corporations (each of which is referred to in this paragraph as a "predecessor corporation") have amalgamated to form one corporate entity (in this paragraph referred to as the "new corporation"),
> >
> > > (i) control of a corporation is deemed not to have been acquired by any person or group of persons solely because of the amalgamation unless it is deemed by subparagraph 256(7)(*b*)(ii) or 256(7)(*b*)(iii) to have been so acquired,
> > >
> > > (ii) a person or group of persons that controls the new corporation immediately after the amalgamation and did not control a predecessor corporation immediately before the amalgamation is deemed to have acquired immediately before the amalgamation control of the predecessor corporation and of each corporation it controlled immediately before the amalgamation (unless the person or group of persons would not have acquired control of the predecessor corporation if the person or group of

[51] I observed that the Appellant did not canvass in its written submissions the issue of the application of the specific deeming rule. Mindful of the heightened requirement of procedural fairness arising from the fact that it was not I who heard the appeal, I gave both parties the opportunity to file further written submissions. They both filed additional written submissions on this specific point.

> persons had acquired all the shares of the predecessor corporation immediately before the amalgamation), and
>
> (iii) control of a predecessor corporation and of each corporation it controlled immediately before the amalgamation is deemed to have been acquired immediately before the amalgamation by a person or group of persons
>
> (A) unless the predecessor corporation was related (otherwise than because of a right referred to in paragraph 251(5)(*b*)) immediately before the amalgamation to each other predecessor corporation,
>
> (B) unless, if one person had immediately after the amalgamation acquired all the shares of the new corporation's capital stock that the shareholders of the predecessor corporation, or of another predecessor corporation that controlled the predecessor corporation, acquired on the amalgamation in consideration for their shares of the predecessor corporation or of the other predecessor corporation, as the case may be, the person would have acquired control of the new corporation as a result of the acquisition of those shares, or
>
> (C) unless this subparagraph would, but for this clause, deem control of each predecessor corporation to have been acquired on the amalgamation where the amalgamation is an amalgamation of
>
> (I) two corporations, or
>
> (II) two corporations (in this subclause referred to as the "parents") and one or more other corporations (each of which is in this subclause referred to as a "subsidiary") that would, if all the shares of each subsidiary's capital stock that were held immediately before the amalgamation by the parents had been held by one person, have been controlled by that person;
>
> . . .

[87] The words of subparagraph 256(7)(*b*)(i) are clear. If predecessors A and B are amalgamated, an acquisition of control does not arise simply by virtue of their amalgamation unless control is deemed to have been acquired under subparagraph 256(7)(*b*)(ii) or (iii). Something more is required.

[88] The wording of subparagraph 256(7)(*b*)(ii) is somewhat more complex, because both a general rule and an exception are embedded in the provision. The general rule is best explained by reference to an example. Let us assume that predecessors A and B are amalgamated. Predecessor A has a controlling shareholder. Predecessor B is widely held. Predecessor A is worth twice as much

as predecessor B such that the controlling shareholder of predecessor A ends up with *de jure* control of the amalgamated corporation. In this example, control of predecessor B will be deemed to have been acquired by the controlling shareholder of predecessor A immediately prior to the amalgamation of both corporations.

[89] The exception to the general rule stated in subparagraph 256(7)(*b*)(ii) can be best explained by a slight variation to the above example. Both predecessor A and predecessor B have controlling shareholders who are related by virtue of the fact that they have a common parent corporation. If the controlling shareholder of predecessor A ends up with control of the amalgamated entity, the general rule does not apply because the controlling shareholder of predecessor A would be deemed not to have acquired control of predecessor B had he or she acquired all the shares of predecessor B before the amalgamation. The exception is required in order to facilitate related-party corporate reorganizations.

[90] Subparagraph 256(7)(*b*)(iii) is of particular importance to the case at hand. It is an understatement to say that this provision is a difficult read. The complexity arises because the general rule set out in the preamble of subparagraph 256(7)(*b*)(iii) is followed by three separate exceptions set out in each of clauses 256(7)(*b*)(iii)(A), (B) and (C). The general rule is that control of a predecessor corporation is deemed to have been acquired immediately before an amalgamation, unless one of the exceptions applies.

[91] The easiest exception to understand is set out in clause 256(7)(*b*)(iii)(A). Once again, an example best illustrates the meaning of the words contained in that provision. Let us assume that predecessors A and B are related by virtue of the fact that they have a common parent corporation. Consistent with a number of other exceptions found in subsection 256(7), an acquisition of control does not arise upon an amalgamation of related corporations; this is in order to facilitate related-party corporate reorganizations.

[92] The exception in clause 256(7)(*b*)(iii)(B) is based on the Majority Voting Interest Test. Once again, an example best illustrates this exception. If predecessors A and B are amalgamated and both are widely held and unrelated, control of predecessor A will be deemed to have been acquired unless the shareholders of predecessor A end up with a majority of the voting shares of the amalgamated entity. The wording of the provision requires that we test for *de jure* control on the basis of the following hypothesis. The provision requires first that we suppose all the shares of the amalgamated entity received by the shareholders of a particular predecessor corporation, in our example predecessor A, were

acquired by a sole hypothetical person. If that person would have acquired control of the amalgamated entity by virtue of the fact that the shareholders of predecessor A received in the aggregate a majority of the voting shares of the amalgamated entity, then control of predecessor B, whose shareholders received less than a Majority Voting Interest, is deemed to have been acquired immediately before the amalgamation.

[93] Clause 256(7)(*b*)(iii)(C) deals with the case where two corporations amalgamate and the shareholders of each predecessor receive exactly 50% of the voting shares of the amalgamated entity. In the absence of this exception, control of both corporations would be deemed to have been acquired. In this narrow case of 50-50 voting shareholdings, the deemed acquisition of control rule does not apply.

[94] The Appellant relies on a purely textual interpretation of clause 256(7)(*b*)(iii)(B) to take the position that the deemed acquisition of control rule set out in the preamble of that provision does not apply to Veracel because the Veracel shareholders, which include the Class B shareholders, received a majority of the voting shares of the Appellant on the amalgamation of Birchcliff and Veracel.

[95] Needless to say, under a GAAR analysis, a textual, contextual and purposive analysis is required to determine whether reliance on this exception violates the object and spirit of the provision in an abusive manner.

[96] This is where I believe the Appellant's appeal fails. A contextual analysis requires an examination of other relevant provisions, which are those that are "grouped together" or "work together to give effect to a plausible and coherent plan".[52] The immediate context of paragraph 256(7)(*b*) is subsection 256(7), which describes the circumstances where control of a corporation is deemed not to have been acquired and the circumstances where control is deemed to have been acquired. In the former case, generally speaking, there is a continuity of shareholder interest that Parliament views as sufficient to trump a technical acquisition of *de jure* control. In such a case, while *de jure* control is strictly speaking acquired by a person or "group of persons", Parliament deems *de jure* control not to have been acquired. For example, Parliament will allow an exchange of majority voting shares between related parties to facilitate corporate reorganizations. In the instant case, the Majority Voting Interest Test in clause 256(7)(*b*)(iii)(B) is intended to reflect a continuity of shareholder interest that

[52] *Copthorne*, paragraph 91.

would justify an exception to the deemed acquisition of control upon amalgamation.

[97] I observe that a similar test was employed in the reverse takeover rule set out in paragraph 256(7)(*c*) as it applied in the 2006 taxation year.[53] That provision reads as follows:

> 256(7) . . .
>
> > (*c*) subject to paragraph 256(7)(*a*), where 2 or more persons (in this paragraph referred to as the "transferors") dispose of shares of the capital stock of a particular corporation in exchange for shares of the capital stock of another corporation (in this paragraph referred to as the "acquiring corporation"), control of the acquiring corporation and of each corporation controlled by it immediately before the exchange is deemed to have been acquired at the time of the exchange by a person or group of persons unless
> >
> > > (i) the particular corporation and the acquiring corporation were related (otherwise than because of a right referred to in paragraph 251(5)(*b*)) to each other immediately before the exchange, or
> > >
> > > (ii) if all the shares of the acquiring corporation's capital stock that were acquired by the transferors on the exchange were acquired at the time of the exchange by one person, the person would not control the acquiring corporation;
> >
> > . . .

[98] Under that provision, if a corporation acquires another corporation in a share-for-share exchange, control of the acquiring corporation is deemed to have been acquired unless one of the two exceptions set out in subparagraph 256(7)(*c*)(i) or (ii) applies.

[99] The technical notes to paragraph 256(7)(*c*) reveal that the purpose of the rule is to prevent the "reverse takeover" technique from being used to circumvent the result that would be arrived at had a profitable corporation ("Profitco"), being the

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[53] In 1997, the federal government introduced subparagraph 256(7)(*b*)(iii) as an amendment to former paragraph 256(7)(*b*), and paragraph 256(7)(*c*) as a new provision of the Act. Subparagraph 256(7)(*b*)(iii) broadened the application of the deemed acquisition of control rules in the context of amalgamations, and paragraph 256(7)(*c*) introduced a rule to deem an acquisition of control to have occurred in a reverse takeover scenario. The explanatory notes accompanying the amendments suggest that the "hypothetical shareholder" provisions in clause 256(7)(*b*)(iii)(B) and subparagraph 256(7)(*c*)(ii) were enacted because, prior to the amendments, certain corporations were able to escape the application of the deemed acquisition of control rules on the basis that they were widely held, with no controlling shareholder(s), such that the combined entity ended up not being controlled by a person or a "group of persons". Thus, it appears that these provisions were enacted to assist with the operation of the deemed acquisition of control rules.

larger of the two corporations and widely held, simply acquired a loss corporation ("Lossco"). The examples given in the technical notes read as follows:

> New paragraph 256(7)(*c*) of the Act deals with reverse takeover transactions which are illustrated by the following examples.
>
> *EXAMPLE A:*
>
> *An individual, Mr. X, owns all the shares of a corporation (Lossco) which have a total fair market value of $100,000. A profitable public corporation (Pubco) that is not controlled by any person or group of persons wishes to gain access to Lossco's non-capital loss carryforward. If Pubco were to acquire the shares of Lossco from Mr. X, various stop-loss rules in the Act would limit the deductibility of those losses. Instead, the shareholders of Pubco transfer their shares of Pubco to Lossco in exchange for shares of Lossco worth $10,000,000. Mr. X relinquishes control of Lossco as a result of the exchange.*
>
> *EXAMPLE B:*
>
> *Assume the same facts as in example A except that, instead of transferring their shares of Pubco to Lossco in a share-for-share exchange, the shareholders of Pubco receive shares of Lossco in consideration for the disposition of their shares of Pubco on a triangular amalgamation or merger of Pubco and a wholly owned subsidiary of Lossco.*
>
> In each of these examples, there is no acquisition of control of Lossco under the existing rules unless there is a group of shareholders that controls Lossco after the takeover. However, if new paragraph 256(7)(*c*) were applied to each of these examples, control of Lossco would be considered to have been acquired by a person or group of persons because the shares of Lossco issued to the shareholders of Pubco in each case are such that, if they had been acquired by one person, that person would have acquired control of Lossco. This paragraph applies to mergers that occur after April 26, 1995 except in certain specified circumstances.[54]

[100] In the absence of this rule, an acquisition of control of Lossco could be avoided by causing Lossco to acquire Profitco in a "reverse takeover" transaction. The rule triggers a deemed acquisition of control unless Lossco and Profitco are related, or the Profitco shareholders collectively do not end up holding a Majority Voting Interest in Lossco after completion of the share-for-share exchange.

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[54] Canada, Department of Finance, *Explanatory Notes Relating to Income Tax* (Ottawa: Department of Finance, 1997), at pages 536 and 537.

[101] I acknowledge that the rule actually refers to the shareholder interest of the Profitco shareholders in Lossco. If they, as transferors, receive shares that together represent a Majority Voting Interest in Lossco, then control of Lossco is deemed to have been acquired. The rule does not apply if the original Lossco shareholders own in the aggregate shares that represent a Majority Voting Interest in Lossco after completion of the transaction. This is analogous to the test applied in the context of an amalgamation. As noted earlier, if the Lossco shareholders do not in the aggregate own shares representing a Majority Voting Interest in the amalgamated entity, control of Lossco is deemed to have been acquired immediately prior to the amalgamation. These rules indicate to me that Parliament intended that there be a significant continuity of the Lossco shareholder interest in the combined enterprise for a deemed acquisition of control not to arise in these circumstances. In the instant case, the evidence shows there is no continuity of interest of the Original Veracel Shareholders as shareholders of the Appellant.

[102] In my opinion, in mandating the Majority Voting Interest Test as a means of determining the circumstances where the deeming rule should apply, Parliament did not expect that taxpayers would circumvent the rule by implementing strategies that skew the voting interest of the shareholders of the predecessor Lossco in the amalgamated entity or artificially make persons shareholders in a predecessor Lossco solely to ensure mere technical compliance with the test. As noted earlier, I have found that this is what the parties did when they "seeded" the required equity financing into Veracel, causing the New Investors to become Class B shareholders of Veracel for only a fleeting moment in order to guarantee strict compliance with the words of the provision.

[103] *Canada Trustco* states that "abusive tax avoidance may be found where the relationships and transactions as expressed in the relevant documentation lack a proper basis relative to the object, spirit or purpose of the provisions that are purported to confer the tax benefit, or where they are wholly dissimilar to the relationships or transactions that are contemplated by the provisions".[55] I find such to be the case in this matter.

[104] In a loss trading context, in the absence of clause 256(7)(*b*)(iii)(B), Lossco shareholders seeking to monetize their losses after Lossco has abandoned the failing business would end up with less than a majority of the voting shares of the amalgamated entity.[56] Their interest in the amalgamated entity would reflect the

[55] *Canada Trustco*, paragraph 60.

[56] In that context, absent the parties' desire to circumvent the Loss Streaming Restrictions, one would expect voting rights to be aligned with the parties' economic interest in the entity.

market value of the losses. Profitco shareholders would end up with a Majority Voting Interest[57] in the amalgamated entity.

[105] In my opinion, the Majority Voting Interest Test indicates that Parliament did not want amalgamations and reverse takeovers being used as techniques to avoid an acquisition of control in situations where the original Lossco shareholders do not collectively receive shares representing a Majority Voting Interest in the combined enterprise.

[106] Therefore, it is apparent to me that Parliament adopted the Majority Voting Interest Test to prevent Lossco from being subsumed by Profitco without an acquisition of control of Lossco. On a textual, contextual and purposive analysis of subparagraph 256(7)(*b*)(iii), artificial compliance[58] with the Majority Voting Interest Test which lacks a proper basis relative to the object, spirit or purpose of that test amounts to an abuse of the provision.

[107] A brief comment on *Copthorne*[59] is warranted here. Copthorne Holdings Ltd. ("Copthorne") was a Canadian company that was the parent of VHHC Holdings Ltd. ("VHHC"). By a series of transactions that stretched out over a few years, Copthorne sold the shares of VHHC to a related non-resident corporation. As a result, Copthorne and VHHC became sister corporations. Copthorne and VHHC were ultimately amalgamated "horizontally" to form the successor, also named Copthorne.

[108] Copthorne argued that, because the amalgamation was "horizontal", the paid-up capital of its shares included the amount of the paid-up capital of the shares of the two predecessor corporations. Had the two predecessor corporations remained parent and sister, the paid-up capital of VHHC would have been eliminated on a "vertical" amalgamation.

[109] The Supreme Court, in affirming the Tax Court's decision, held that, in the context of that case, the horizontal amalgamation of Copthorne and VHHC was subject to the application of the GAAR. The paid-up capital of VHHC was eliminated in the calculation of Copthorne's paid-up capital.

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[57] As defined earlier, note 3 above.

[58] In the instant case, the evidence shows that the New Investors assumed little risk as Class B shareholders, as they were shareholders only for the briefest moment in time. They were assured by the court-sanctioned plan of arrangement that they would end up with shares of Amalco. The facts indicate that this was done to ensure textual compliance with clause 256(7)(*b*)(iii)(B).

[59] 2011 SCC 63.

[110] In my opinion, the "abusive" nature of the transactions considered in *Copthorne* is less apparent than the abuse found to exist with regard to the transactions in the instant case. I note that the series of transactions giving rise to the benefit in *Copthorne* was carried out over a long period of time. It was also unclear that the series was completely planned when the first steps were taken. This did not prevent the Supreme Court from looking at the situation at the starting point of the series of transactions, when Copthorne was the parent corporation of VHHC.

[111] In contrast, in the instant case, the New Investors were not shareholders of Veracel at the commencement of the series of transactions. They were made transient shareholders of Veracel for the sole purpose of artificially complying with the Majority Voting Interest Test mandated in clause 256(7)(*b*)(iii)(B). In addition, the Veracel Transactions were painstakingly planned before they were implemented. They were carried out in rapid sequential order. The New Investors became shareholders of Veracel literally for the briefest time. The financing was "seeded" into Veracel to circumvent the application of the deeming rule in subparagraph 256(7)(*b*)(iii) by an attempt to qualify the transactions under the exception found in clause 256(7)(*b*)(iii)(B) in a manner which does harm to the object, spirit and purpose of that exception. While tax planning does not necessarily bring into play the GAAR, this is a case where the proverbial elastic was stretched beyond its breaking point.

[112] Subsection 245(2) empowers the Minister to determine the tax consequences that are reasonable in the circumstances in order to deny a tax benefit. As noted, the Veracel Transactions were planned so as to fit within the exception provided for in clause 256(7)(*b*)(iii)(B). As a result, in my opinion the issue of the Class B shares by Veracel should be ignored, resulting in an acquisition of control of Veracel upon the amalgamation of Veracel and Birchcliff. In this context, the reasonable tax consequence that flows from the application of the GAAR is that the Loss Streaming Restrictions apply to prevent the Appellant from using Veracel's Tax Attributes.

VIII. Conclusion

[113] For all these reasons, the appeal is dismissed and the Minister's reassessment of the Appellant's 2006 taxation year is confirmed. Costs are awarded to the Respondent.

Signed at Ottawa, Canada, this 1st day of October 2015.

"Robert J. Hogan"

Hogan J.

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