Docket: 2002-1316(IT)G

BETWEEN:

COPTHORNE HOLDINGS LTD.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on November 30 and December 1, 2006
at Toronto, Ontario

Before: The Honourable Justice Diane Campbell

Appearances:

Counsel for the Appellant:	Richard W. Pound, Q.C. and Pierre-Louis Le Saunier
Counsel for the Respondent:	Eric Noble Franco Calabrese and Martin Beaudry

---

JUDGMENT

The appeal from the assessment made under the General Anti-Avoidance Rule, section 245 of the *Income Tax Act*, is allowed to delete penalties and the assessment is referred back to the Minister of National Revenue for reconsideration and reassessment in accordance with the attached Reasons for Judgment.

There will be an award of two sets of counsel costs to the Respondent.

Signed at Summerside, Prince Edward Island, this 28th day of August 2007.

"Diane Campbell"

Campbell J.

Citation: 2007TCC481
Date: 20070828
Docket: 2002-1316(IT)G

BETWEEN:

COPTHORNE HOLDINGS LTD.,

Appellant,

And

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Campbell J.

[1] The assessment in this appeal arose when the Minister of National Revenue (the "Minister") applied the *General Anti-Avoidance Rule* (the "GAAR"), section 245 of the *Income Tax Act* (the "*Act*"), to transactions that facilitated the preservation of paid-up capital ("PUC") in respect to certain shares.

[2] The Minister assessed Copthorne Holding Ltd. (a predecessor of the Appellant) on account of tax payable by a non-resident, L.F. Investments. This tax arose in respect to a purported failure to withhold and remit that tax on an amount deemed to be a dividend paid to a non-resident shareholder. Penalties were also assessed pursuant to subsection 227(8) of the *Act*.

[3] The parties entered into a Joint Statement of Facts and Law ("JSF"), which I have attached as Appendix "A" to these reasons. In addition to the Schedule "B" diagrams attached to the parties' joint statement, I have included my own detailed series of diagrams of transactions as Appendix "B" to my reasons. I intend to reference my own series of diagrams in my analysis of the transactions by diagram number.

[4] The facts and transactions involved in this appeal are lengthy and complex but the parties have largely agreed upon the essential facts by way of their JSF. As a result, a brief overview of the transactions, relevant to this appeal, will be sufficient.

The Facts

Events prior to the 1993 Share Sale

[5] Copthorne Holdings Ltd. ("Copthorne I") was incorporated in Ontario in 1981 in order to acquire the Harbour Castle Hotel in Toronto. The one common share was issued to Big City Project Corporation ("Big City"), a Netherlands Corporation indirectly controlled by Li Ka-Shing. Both corporations are members of a group of companies controlled directly or indirectly by the Li family. In 1981, Copthorne I had PUC of $1. Copthorne I sold the Harbour Castle Hotel (the "Hotel Sale") in 1989 for a substantial capital gain.

[6] Following the Hotel Sale, Copthorne I incorporated a wholly owned subsidiary under the laws of Barbados called Copthorne Overseas Investment Ltd. ("Coil"). Coil carried on a successful bond-trading business through its Singapore branch.

[7] In 1987, VHHC Investments Inc. ("VHHC Investments") was incorporated in Ontario. Victor Li, son of Li Ka-Shing, owned all of the Class A voting common shares of VHHC Investments with PUC of $100, together with 18.75% of the Class B non-voting common shares. The remaining Class B shares were owned by Asfield B.V. ("Asfield"), a Netherlands corporation that was indirectly owned by a trust whose principal beneficiary was Victor Li.

[8] Between 1987 and 1991, Victor Li, Asfield and L.F. Holdings, a Barbados corporation controlled by Li Ka-Shing, invested capital in VHHC Investments. At the end of 1991, VHHC Investments had PUC of $96,736,845.

[9] During this period, VHHC Investments used $67,401,279 of the invested capital, received from Victor Li, Asfield and L.F. Holdings, to invest in shares of VHHC Holdings Ltd. ("VHHC Holdings"), a lower tiered subsidiary of VHHC Investments. As a result, at the end of 1991, VHHC Holdings had PUC of $67,401,279.

[10] Also by the end of 1991, VHHC Holdings owned 100% of another lower tiered subsidiary, VHSUB Holdings ("VHSUB"). VHSUB had a substantial and

accrued capital loss, resulting from its investment in another Canadian corporation Husky Oil Ltd. ("HOL"). [JSF paras 3, 4(i) to 4(v)]

[11] In summary, following these December 1991 transactions, VHHC Investments had used $67,401,279 of the capital invested by Victor Li, Asfield and L.F. Holdings Investments to purchase 67,401,279 common shares of VHHC Holdings with a PUC of $67,401,279. VHHC Holdings then used these share subscription funds to invest, directly or indirectly, through its subsidiary VHSUB, in HOL. As a result of declining oil and gas prices by the end of 1991, the value of HOL's shares had fallen dramatically. As a result, VHHC Holdings now owned shares of VHSUB which had a substantial capital loss.

[12] In 1992, VHHC Investments sold its 67,401,279 common shares of VHHC Holdings to Copthorne I for $1,000. The sole purpose of this transaction was to shift the inherent capital loss of the shares of VHHC Holdings in VHSUB to Copthorne I. A portion of the capital loss could then be used by Copthorne I to shelter the capital gain it had realized on the Hotel Sale in 1989. The PUC of the shares of VHHC Holdings remained at $67,401,279 and was passed on to the purchaser, Copthorne I. [Diagrams 5(i) to 5(v)]

The 1993 Share Sale

[13] In 1993, the Li family decided to amalgamate Copthorne I, VHHC Holdings and two other Canadian corporations so that:

(1) the losses incurred by one or more corporations could be used to shelter income earned by others, and

(2) the corporate structure of the Li Family Canadian Holdings would be simplified.

[14] It is likely that prior consideration was given to amalgamation but it did not occur until 1993 because the focus was on the loss transfer utilization transactions that occurred in 1992. If VHHC Holdings and Copthorne I had amalgamated prior to the 1992 transactions, the loss, triggered by the amalgamation could not have been carried back to offset the capital gain realized by Copthorne I on the Hotel Sale in 1989. It therefore became necessary to shift the capital loss to the Appellant prior to an amalgamation.

[15] Because VHHC Holdings became a subsidiary of Copthorne I, after the sale by VHHC Investments, the PUC in VHHC Holdings would be eliminated, under corporate law, upon a vertical amalgamation of VHHC Holdings with Copthorne I. To preserve the PUC of $67,401,279 in the shares of VHHC Holdings, Copthorne I sold those shares for $1,000 to Big City in 1993 (the "1993 Share Sale") prior to the amalgamation. The Minister's position is that this 1993 Share Sale is an avoidance transaction.

[16] On January 1, 1994, Copthorne I, VHHC Holdings and two other Canadian Corporations, owned by the Li family, were amalgamated (the "First Amalgamation") to form Copthorne Holdings Ltd. (Copthorne II). Prior to amalgamation, Big City owned one common share in Copthorne I, together with 67,401,279 common shares in VHHC Holdings, acquired pursuant to the 1993 Share Sale. After amalgamation these shares were converted to 20,001,000 common shares of Copthorne II with an aggregate paid up capital of 67,401,280 (i.e. $67,401,279 plus $1). [Diagrams 6(i) to 6(iii)]

The Redemption

[17] In 1994, the Department of Finance released revised amendments to the foreign accrual property income ("FAPI"), including the proposed introduction of what is now paragraph 95(2)(1) of the *Act*. The proposed changes would have adversely affected Coil by making all of Coil's income FAPI.

[18] As a result, the Li family decided to dispose of its investment in Coil and repatriate the proceeds of such disposition for investment outside of Canada. The Li family decided to further simplify their Canadian corporate structure and consolidate their principal Canadian investments (Copthorne II and HOL) under a single offshore company.

[19] As part of this plan, L.F. Investments was incorporated in Barbados in November 1994. In December 1994, Victor Li and Asfield sold their common shares, and L.F. Holdings sold its preferred shares, in VHHC Investments, to L.F. Investments. [Diagrams 8(i) and 8(ii)]

[20] In addition, Big City sold its common shares in Copthorne II to L.F. Investments. Consequently, L.F. Investments owned the common shares of Copthorne II with its PUC of $67,401,280 and the common and preferred shares of

VHHC Investments with its PUC of $96,736,845 for an aggregate PUC of $164,138,125[1]. [Diagrams 8(iii) to 8(iv)]

[21] In January 1995, Copthorne II, VHHC Investments and two other Canadian corporations, owned by Li Ka-Shing, were amalgamated (the "Second Amalgamation") to form Copthorne Holdings Ltd. ("Copthorne III") [Diagrams 9(i) to 9(iii)]. Immediately following, Copthorne III redeemed 142,035,895 of the Class D preference shares (the "Redemption") held by L.F. Investments. No amount was withheld by Copthorne III in respect of this Redemption because Copthorne III had an aggregate PUC of $164,138,025 after the Second Amalgamation. [Diagram 11] Therefore Copthorne III did not withhold and remit any tax on behalf of the non-resident, L.F. Investments, pursuant to subsection 215(1) of the *Act*.

[22] On January 1, 2002 Copthorne III amalgamated with five other companies and continued as Copthorne Holdings Ltd., the Appellant in this appeal.

The Minister's Assessment

[23] The Minister applied GAAR and issued an assessment for unremitted withholding tax, a penalty and interest, in respect to the Appellant's failure to withhold and remit Part XIII tax on the basis that:

(a) L.F. Investments received a "tax benefit" within the meaning of subsection 245(1) of the *Act*;

(b) The tax benefit was the avoidance of the withholding tax payable by L.F. Investments;

(c) The tax benefit arose from the "inappropriate increase" in the PUC of the Class D preference shares of Copthorne III which resulted from a series of

[1] Of this amount, $164,138,025 was allocated to Class D preference shares of Copthorne III upon the Second Amalgamation. It is important to point out that of the $164,138,025 of PUC, associated with these Class D Preferred Shares, $67,401,279 is derived from the same $96,736,845 of PUC associated with the invested capital of Victor Li, Asfield and L.F. Holdings in VHHC Investments. [Diagrams 10(i) and 10(ii)]

transactions that included an "avoidance transaction" within the meaning of subsection 245(3) of the *Act*;

(d) The avoidance transaction was the 1993 Share Sale;

(e) The avoidance transaction resulted in an abuse of the *Act* read as a whole within the meaning of subsection 245(4);

(f) The tax consequences, reasonable in the circumstances to deny the tax benefit, would be to reduce the PUC of all of the Class D preference shares by $67,401,280 so that a taxable dividend in the amount of $58,325,223, calculated with reference to the revised PUC of each of the shares, would be deemed to have been paid by Copthorne III to L.F. Investments pursuant to subsection 84(3) of the *Act*;

(g) Copthorne III was therefore required to deduct or withhold the amount of $8,748,783.40 (i.e. 15% of the taxable dividend deemed to have been paid, which was the applicable rate under the *Canada-Barbados Income Tax Convention*); and

(h) Having failed to deduct or withhold, Copthorne III was liable to a penalty of 10% of the amount that should have been deducted or withheld, or $874,878.34.

The Issues

[24] The central issue in the present appeal is whether section 245 applied to the Redemption. In deciding whether section 245 applies, there are four important sub-issues:

(a) Whether a tax benefit was received within the meaning of subsection 245(1) of the *Act*;

(b) Whether such a tax benefit resulted, directly or indirectly, from a series of transactions that included the sales of shares of VHHC Holdings by Copthorne I to Big City on July 7, 1993 (the 1993 Share Sale);

(c) Whether the 1993 Share Sale was an avoidance transaction within the meaning of subsection 245(3); and

(d) Whether it may reasonably be considered that the 1993 Share Sale, or series of transactions resulted, directly or indirectly, in a misuse of the provisions of the *Act* or an abuse having regard to the provisions of the *Act*, other than section 245, read as a whole, within the meaning of subsection 245(4) of the *Act*.

Analysis

[25] The transactions in this appeal are numerous and at first glance lengthy and complex. If one looks at these transactions in conjunction with the governing provisions contained in the *Act*, it is not immediately apparent why any of the corporate undertakings should have attracted the application of GAAR. However, as the saying goes "that would not be seeing the forest for the trees". When I step back and look at the big picture of what occurred here, the calculation of PUC resulted in the very blatant advantage of a "double counting" in the amount of $67,401,279. None of the provisions in the *Act* ever intended that an artificial inflation of PUC be preserved for a subsequent return of such an increase to shareholders on a tax-free basis. I am dealing with a total PUC of $164,138,025 belonging to Copthorne III, and associated with Class D preference shares. The origin of this amount is made up of $96,736,745 PUC originally belonging to VHHC Investments and $67,401,279 PUC belonging to Copthorne II. However the $67,401,279 is easily traced to the initial investment made by VHHC Investments in VHHC Holdings. This PUC was preserved by the 1993 Share Sale and maintained throughout the First and Second Amalgamations. This means that the $67,401,279 PUC is part and parcel of or is derived from the $96,736,845 PUC. To permit transactions that produce an aggregate of these two amounts creates a double counting of PUC in the amount of $67,401,279. This simply produces an incorrect result and permits shareholders an unfair advantage, something that was never intended in the application of these provisions.

[26] The approach to be taken and the principles to be applied to cases where an assessment has been made under section 245 were recently established in two unanimous decisions of the Supreme Court of Canada, *Canada Trustco Mortgage Co. v. Canada*, [2005] 2 S.C.R. 601, 2005 DTC 5523 and *Mathew v. Canada*, [2005] 2 S.C.R. 643, 2005 DTC 5538 ("*Kaulius*"). In *Canada Trustco, supra,* at paragraph 66 the Supreme Court summarized the requirements that must be met in order for the GAAR to apply:

The approach to s. 245 of the *Income Tax Act* may be summarized as follows:

1. Three requirements must be established to permit application of the GAAR:

   (1) A *tax benefit resulting from a transaction* or part of a series of transactions (s. 245(1) and (2));

   (2) that the transaction is an *avoidance transaction* in the sense that it cannot be said to have been reasonably undertaken or arranged primarily for a *bona fide* purpose other than to obtain a tax benefit; and

   (3) that there was *abusive tax avoidance* in the sense that 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.

2. The burden is on the taxpayer to refute (1) and (2), and on the Minister to establish (3).

3. If the existence of abusive tax avoidance is unclear, the benefit of the doubt goes to the taxpayer.

4. The courts proceed by conducting a unified textual, contextual and purposive analysis of the provisions giving rise to the tax benefit in order to determine why they were put in place and why the benefit was conferred. The goal is to arrive at a purposive interpretation that is harmonious with the provisions of the Act that confer the tax benefit, read in the context of the whole Act.

5. Whether the transactions were motivated by any economic, commercial, family or other non-tax purpose may form part of the factual context that the courts may consider in the analysis of abusive tax avoidance allegations under s. 245(4). However, any finding in this respect would form only one part of the underlying facts of a case, and would be insufficient by itself to establish abusive tax avoidance. The central issue is the proper interpretation of the relevant provisions in light of their context and purpose.

[27] In the present appeal, the impugned tax benefit results from the Redemption, which forms part of the "Second Series of Transactions" (JSF, paragraph 62). The alleged avoidance transaction, the 1993 Share Sale, is contained in the First Series of Transactions (JSF, paragraph 61). Because it is clear from the facts in this

appeal and because the parties have acknowledged in their JSF that there are clearly two series of transactions, before addressing any of the other issues in this appeal it will be first necessary to determine whether the impugned tax benefit is part of a series of transactions that included the alleged avoidance transaction.

[28] Subsections 245(2) and 245(3) of the *Act* use the expression "series of transactions". In determining the meaning of this expression, the Supreme Court in *Canada Trustco* adopted the majority's comments in *OSFC Holdings Ltd. v. The Queen*, 2001 DTC 5471, and, at paragraph 25 stated:

> The meaning of the expression "series of transactions under s.245(2) and (3) is not clear on its face. We agree with the majority of the Federal Court of Appeal in *OSFC* and endorse the test for a series of transactions as adopted by the House of Lords that a series of transactions involves a number of transactions that are **"pre-ordained in order to produce a given result" with "no practical likelihood that the pre-planned events would not take place in the order ordained"**: *Craven v. White,* [1989] A.C. 398, at p. 514, *per* Lord Oliver; see also *W.T. Ramsay Ltd. v. Inland Revenue Commissioners*, [1981] 1 All E.R. 865. [emphasis added]

[29] In *OSFC Holdings*, *supra,* Rothstein, J.A. (as he was then), at paragraph 24, concluded the following in respect to the common law test or pre-ordination test:

> …Pre-ordination means that when the first transaction of the series is implemented, all essential features of the subsequent transaction or transactions are determined by persons who have the firm intention and ability to implement them. That is, there must be no practical likelihood that the subsequent transaction or transactions will not take place.

[30] The decision in *OSFC Holdings* was confirmed by the Federal Court of Appeal in *The Queen v. Canadian Utilities Limited et al.*, 2004 DTC 6475 ("*Canutilities*"), at p. 6483:

> In Canada, a common law series only requires that, when the initial transaction is completed, the subsequent transaction or transactions needed to avoid tax have been determined by those persons who have the firm intention and ability to implement them and that all of those transactions do in fact occur.

[31] The Respondent did not argue that the First Series of Transactions and the Second Series of Transactions were connected by application of the common law test. At the time of the 1993 Share Sale, the essential features of the Redemption had not been determined and Copthorne I had not formed the intention to implement the Redemption. The evidence only indicates that PUC was preserved

because it was viewed as an attribute that held some value (Transcript pages 33-35, 37-39). Therefore, when the 1993 Share Sale occurred, the Redemption was not pre-ordained within the meaning of the *OSFC Holdings* common law test and as such the Redemption, under that test alone, does not form part of the series of transactions that includes the 1993 Share Sale. However, this alone is not conclusive because it is necessary to consider whether the Redemption is included in the First Series of Transactions pursuant to subsection 248(10), which extends the meaning of the common law series.

[32] Subsection 248(10) states:

> (10) For the purposes of this Act, where there is a reference to a series of transactions or events, the series shall be deemed to **include any related transactions or events completed in contemplation of the series.** [emphasis added]

[33] The question is whether, pursuant to subsection 248(10), the Redemption in January 1995 is connected to this First Series of Transactions occurring in 1993. A determination of this question requires a consideration of the phrase "related transactions or events completed in contemplation of the series".

[34] The Federal Court in *OSFC Holdings* did not indicate that subsection 248(10) requires that the related transactions be pre-ordained or that the related transactions should be completed at a particular point in time. At paragraph 36, the Court stated:

> …As long as the transaction has some connection with the common law series, it will, if it was completed in contemplation of the common law series, be included in the series by reason of the deeming effect of subsection 248(10). Whether the related transaction is completed in contemplation of the common law series requires an assessment of whether the parties to the transaction knew of the common law series, such that it could be said that they took it into account when deciding to complete the transaction. If so, the transaction can be said to be completed in contemplation of the common law series. [emphasis added]

[35] In *Canada Trustco*, the Supreme Court commented on the application of subsection 248(10) at paragraph 26:

> Section 248(10) extends the meaning of "series of transactions" to include "related transactions or events completed in contemplation of the series". The Federal Court of Appeal held, at para. 36 of *OSFC*, that this occurs where the parties to the transaction "knew of the ... series, such that it could be said that

> they took it into account when deciding to complete the transaction". **We would elaborate that "in contemplation" is read not in the sense of actual knowledge but in the broader sense of "because of" or "in relation to" the series**. The phrase can be applied to events either before or after the basic avoidance transaction found under s. 245(3). As has been noted:
>
> > It is highly unlikely that Parliament could have intended to include in the statutory definition of "series of transactions" related transactions completed in contemplation of a subsequent series of transactions, but not related transactions in the contemplation of which taxpayers completed a prior series of transactions.
> >
> > (D. G. Duff, "Judicial Application of the General Anti-Avoidance Rule in Canada: *OSFC Holdings Ltd. v. The Queen*", 57 I.B.F.D. Bulletin 278, at p. 287) [emphasis added]

[36] Since the Supreme Court in *Canada Trustco* confirmed that the time line is inconsequential in connecting the transaction to the common law series, it therefore does not matter whether the related transaction occurred before or after the series. It is also clear from the quoted passages that the Supreme Court has broadened the meaning of the word "contemplation". The Court clarified that actual knowledge of the common law series is not required but instead the phrase "in contemplation of" is to be given the broader meaning of "because of" or "in relation to" the series.

[37] The Respondent's position is that the First Series of Transactions, which included the 1993 Share Sale, constitutes the common law series and that the Second Series of Transactions, which included the Redemption, are related transactions completed in contemplation of the common law series. The Appellant argued that "applying a low threshold of causality would expand the scope of the provision so as to catch virtually every transaction which is done after the common law series". (Appellant's Notes of Argument, paragraph 34). The Appellant's position is that a low threshold standard between transactions would lead to an anomalous and inappropriate result.

[38] The Appellant asserts that "a transaction should only be considered to be "in contemplation" of a common law series if the fact, that the common law series had been undertaken (or is expected to be undertaken), is a significant factor in deciding to undertake the transactions" (Appellant's Notes of Argument, paragraph 43). The Appellant points to the introduction of new FAPI rules in February 1994, together with the proposed amendments released in June 1994, that would result in

Coil's income being considered FAPI, as being the basis for the argument that the Redemption in 1995 was an independent event, distinct from the 1993 Share Sale.

[39] While I agree that the Supreme Court never intended to catch transactions that are only remotely connected to the common law series, I conclude that there is a strong nexus between the transactions in this appeal.

[40] Unlike the situation in *MIL (Investments) S.A. v. The Queen*, 2006 DTC 3307 ("*MIL*"), where there was evidence that the Appellant took steps to try to prevent the sale of shares, being the transaction sought to be related to the series, the Redemption, in the present appeal, was exactly the type of transaction necessary to make a tax benefit a reality based on the preservation of the PUC. Although there is no evidence that the Redemption was planned at the time of the First Series of Transactions, when the Redemption occurred in January 1995, it was clearly done in contemplation of the First Series of Transactions.

[41] Certainly one of the reasons for the Redemption was to extract the surplus from Coil because of the changes in the FAPI provisions. However this alone is not determinative. In *Canutilities, supra,* the fact, that a transaction had an independent purpose and existence, quite apart from the series, did not mean that it was excluded if it had been pre-ordained to achieve a composite result. At paragraph 65, the Federal Court of Appeal stated:

> Where the parties intend and have the ability to ensure that a number of transactions produce a given composite result that engages a provision of the Act, the concept of a common law series means that the court must give effect to the composite result, even though it was produced by a number of transactions, rather than just one. **If the parties intend that a transaction with an independent purpose and existence will assist in achieving this composite result and have the ability to ensure that the independent transaction is carried out and the transaction is in fact carried out, the independent transaction will be considered part of the series**. [emphasis added]

[42] Although this passage deals with connecting a transaction under the common law test, the reasoning is equally applicable under a subsection 248(10) analysis. In the present appeal, although changes to FAPI were the impetus for engaging in the Redemption, this does not alter the fact that the Redemption was done with the actual knowledge of and in contemplation of the 1993 Share Sale. The evidence was that the Appellant preserved the PUC because it was viewed as an attribute of value. Without the Redemption or some other similar transaction, there would be no way of tapping into the value created by its preservation. The

Redemption became the mechanism for returning this preserved PUC to one of the Li group of companies. The fact that the Li group had no precise knowledge in 1993 of the mechanism, which would eventually be used to access the preserved PUC, is not determinative. The First Series of Transactions is related to the Second Series of Transactions because the Second Series is completed in contemplation of the First Series, within the meaning of subsection 248(10), in the sense that the Appellant had knowledge of the prior preservation of PUC and took this into account when completing the Redemption. I believe that, when the Supreme Court in *Canada Trustco* broadened the meaning of "in contemplation of", it was precisely this sort of factual situation which it intended to address.

Tax Benefit

[43] For the purposes of GAAR, tax benefit is defined in subsection 245(1) as:

> …a reduction, avoidance or deferral of tax or other amount payable under this Act or an increase in a refund of tax or other amount under this Act;

[44] The Respondent's position is that the tax benefit derives from the application of subsection 215(6) of the *Act* in respect to the Appellant's failure to withhold and remit Part XIII tax on a dividend, deemed to have been paid to L.F. Investments, for which L.F. Investments is liable under subsection 212(2). Although the redemption amount is equal to the PUC of the shares, the tax benefit arises from the preservation of PUC at the time of the First Series of Transactions and its subsequent distribution to a non-resident shareholder.

[45] The Supreme Court in *Canada Trustco*, indicated that, in some instances, in order to establish the existence of a tax benefit, it will be necessary to compare the resulting consequences of an alternative arrangement. In this appeal, the Li group of companies could have completed the First Series of Transactions, which included the First Amalgamation, without selling and transferring the shares of VHHC Holdings to Big City. If this 1993 Share Sale had not occurred, the $67,401,279 of PUC in VHHC Holdings would have been eliminated and it would have been unavailable to be distributed tax-free at the time of the 1995 Redemption.

[46] Subsection 245(2) addresses a tax benefit that results from a "series of transactions". In order for subsection 245(2) to apply to a transaction, it is sufficient that the reduction, avoidance or deferral of tax, results, directly or indirectly, from a series of transactions of which the avoidance transaction is a

part. The fact that neither the 1993 Share Sale, nor the preservation of PUC, resulted in a direct reduction, avoidance or deferral of tax in 1993 is not ultimately the determinative factor. In this appeal, the tax benefit resulted from a series of transactions, within the meaning of subsection 245(10), which commenced with the preservation of PUC and ended with the Redemption of the Copthorne III Class D preferred shares. If the 1993 Share Sale had not occurred, $96,736,845 of PUC only would have been available to be distributed tax-free as a return of capital to the shareholders of Copthorne III. Instead, total PUC of $164,138,025 was available of which $142,035,895 was actually distributed. Therefore the tax benefit, within the meaning of section 245, is this additional amount which was available for distribution because of the preservation of PUC within that First Series of Transactions. However the real core of the problem here is that the PUC of $67,401,279 is actually only an artificial increment which resulted in a double counting of a portion of the $96,736,845. The tax benefit occurred when the artificial increase was returned to shareholders on a tax-free basis.

Avoidance Transaction

[47] The second requirement which must be addressed in a GAAR analysis is whether the series of transactions, or any transaction within the series, was an avoidance transaction. This is essentially a factual determination. A tax benefit must result as part of a series of transactions that includes an avoidance transaction. The question then becomes whether the transaction(s) may reasonably be considered to have been undertaken or arranged primarily for a *bona fide* purpose other than to obtain a tax benefit.

[48] Subsection 245(3) defines avoidance transaction as:

> An avoidance transaction means any transaction
>
> (a) that, but for this section, would result, directly or indirectly, in a tax benefit, unless the transaction may reasonably be considered to have been undertaken or arranged primarily for *bona fide* purposes other than to obtain the tax benefit; or
>
> (b) that is part of a series of transactions, which series, but for this section, would result, directly or indirectly, in a tax benefit, unless the transaction may reasonably be considered to have been undertaken or arranged primarily for *bona fide* purposes other than to obtain the tax benefit.

[49] The alleged avoidance transaction in this appeal is the July 7, 1993 Sale of Shares of VHHC Holdings by Copthorne I to Big City (the 1993 Share Sale). The

common shares of VHHC Holdings were sold for $1,000, which was the estimated fair market value of these shares (JSF, paragraph 37). The 1993 Share Sale is the only avoidance transaction upon which the Respondent relies in supporting the GAAR assessment (Respondent's Written Argument, paragraph 34).

[50] The Respondent argues that the 1993 Share Sale was not arranged primarily for *bona fide* purposes other than to obtain this tax benefit because the only purpose for the Share Sale was to preserve approximately $67 million PUC which would facilitate a future tax-free distribution. This PUC would otherwise have disappeared on the First Amalgamation.

[51] The Appellant's position is that the primary purpose of the First Amalgamation and the 1993 Share Sale was the reorganization of the Li family's corporate holdings. The Appellant submits that such a reorganization is akin to an investment objective and, as such, a *bona fide* non-tax purpose. The Appellant also argued that the Redemption is irrelevant to a determination of whether the 1993 Share Sale and First Amalgamation have *bona fide* non-tax purposes because the First Series of Transactions have to be considered alone in ascertaining whether the primary purpose was to achieve a tax benefit.

[52] Guidance in the determination of whether a transaction is an avoidance transaction, within the meaning of subsection 245(3), was provided by the Supreme Court in *Canada Trustco* at paragraphs 27 to 35. I have reviewed at length the principles to be distilled from *Canada Trustco* in *MacKay et al. v. The Queen*, 2007 DTC 425, 2007 TCC 94. Generally the test under subsection 245(3) requires an objective assessment of the relative importance of the driving forces of the transaction (*Canada Trustco*, paragraph 28). In conducting this inquiry the courts must examine the relationships between the parties and the actual transactions that were executed between them. The facts surrounding the transactions will be central in determining whether there was an avoidance transaction (*Canada Trustco*, paragraph 30).

[53] In applying the *Canada Trustco* test and conducting an objective assessment of the driving forces of the transaction, evidence regarding the purpose for the 1993 Share Sale, the First Amalgamation and the Redemption will be relevant. Subsection 245(3) requires that the primary purpose of the impugned transaction, the 1993 Share Sale, be determined. Relevant, although not determinative, to this inquiry will be the overall purpose of the First Series of Transactions.

[54] The Appellant argues that even if one transaction is arranged primarily to obtain a tax benefit "it remains that each and every transaction in a series could be viewed as being an integral part of a series of transactions that has a *bona fide* purpose which is more important than the tax purpose of a transaction taken individually" (Appellant's Notes of Argument, paragraph 68). While the overall purpose of the First Series of Transactions, including the First Amalgamation, could be viewed as having a legitimate non-tax purpose, the 1993 Share Sale was not an integral component to achieving the commercial purpose of simplifying the Li family corporate holdings. In fact, when the First Series of Transactions are viewed in their entirety with the subsequent Redemption, the inescapable conclusion is that the 1993 Share Sale was implemented to preserve approximately $67 million in PUC for the ultimate purpose of facilitating a tax-free distribution within the Li corporate group, in the event of a transfer of the relevant shares or a further corporate reorganization or amalgamation. If this had not been done, the PUC would have disappeared on the First Amalgamation. Therefore, I conclude that the 1993 Share Sale was undertaken primarily to preserve what amounted to a double counting of PUC in VHHC Holdings which resulted in a tax benefit. As such it is an avoidance transaction within the meaning of subsection 245(3).

Misuse or Abuse

[55] The final issue in this appeal is whether the transactions constitute an abuse or misuse within the meaning of subsection 245(4). The Supreme Court of Canada in both *Canada Trustco* and *Kaulius*, *supra*, directs that the proper approach to the interpretation of subsection 245(4) is a unified textual, contextual and purposive analysis of the sections of the *Act* from which the tax benefit arose.

[56] The relevant passages, which provide this direction, are contained within paragraphs 44 and 45 of *Canada Trustco*:

> 44 The heart of the analysis under s. 245(4) lies in a contextual and purposive interpretation of the provisions of the Act that are relied on by the taxpayer, and the application of the properly interpreted provisions to the facts of a given case. The first task is to interpret the provisions giving rise to the tax benefit to determine their object, spirit and purpose. The next task is to determine whether the transaction falls within or frustrates that purpose. The overall inquiry thus involves a mixed question of fact and law. The textual, contextual and purposive interpretation of specific provisions of the *Income Tax Act* is essentially a question of law but the application of these provisions to the facts of a case is necessarily fact-intensive.

> 45 This analysis will lead to a finding of abusive tax avoidance when a taxpayer relies on specific provisions of the *Income Tax Act* in order to achieve an outcome that those provisions seek to prevent. As well, abusive tax avoidance will occur when a transaction defeats the underlying rationale of the provisions that are relied upon. An abuse may also result from an arrangement that circumvents the application of certain provisions, such as specific anti-avoidance rules, in a manner that frustrates or defeats the object, spirit or purpose of those provisions. By contrast, abuse is not established where it is reasonable to conclude that an avoidance transaction under s. 245(3) was within the object, spirit or purpose of the provisions that confer the tax benefit.

[57] The provisions that are in issue in this appeal are subsection 89(1), which defines PUC, subsection 84(3), the dividend deeming section and paragraph 87(3)(a), which involves the computation of PUC on amalgamation. I believe that the series of transactions in this appeal resulted in a misuse of these provisions in that they were used to artificially increase the PUC on amalgamation with the subsequent return of this artificial increase to shareholders on a tax-free basis, the very result that these provisions were intended to prevent.

The Text of the Provisions:

[58] Pursuant to subsection 89(1), although PUC is an income tax concept, the initial calculation of the amount of the PUC of a class of shares is based on relevant corporate law principles rather than tax law. It is referred to generally as the "stated capital" of a class of shares, subject to adjustments for tax purposes, calculated according to specific provisions of the *Act*. One of these adjustments may occur on corporate amalgamations, resulting in PUC being less than the reported stated capital.

[59] On a redemption of shares, subsection 84(3) provides for a deemed dividend to the extent that the amount paid on redemption exceeds the PUC of the shares. This ensures that the PUC can be returned to the shareholder on a tax-free basis but that any excess will be deemed to be and treated as a dividend.

[60] Paragraph 87(3)(a) provides the mechanism for the computation of PUC on an amalgamation. It requires a PUC reduction when the PUC of the new corporation exceeds the aggregate of the PUC of the predecessor corporations.

The Context of the Provisions

[61] The Supreme Court in *Kaulius* at paragraph 47 commented on the proper approach to be taken in determining the context:

> 47 The basic rules of statutory interpretation require that the larger legislative context be considered in determining the meaning of statutory provisions. This is confirmed by s. 245(4), which requires that the question of abusive tax avoidance be determined having regard to the provisions of the Act, read as a whole.

[62] The question is whether other provisions of the *Act* provide guidance in determining if Parliament intended that PUC could be preserved in a multi-level amalgamation.

[63] The initial starting position is that subsection 89(1) provides that the PUC of a share will be equal to its stated capital, in accordance with corporate legislative provisions, both federally and provincially. Since adjustments must be made to PUC for tax purposes, when certain corporate transactions would otherwise confer advantages upon shareholders, Parliament enacted certain provisions and it is subsection 87(3) that specifically applies to this appeal. The immediate context of subsection 87(3) is the preceding subsection 87(2), which provides for the continuity of Canadian corporations, from an income tax perspective, upon qualifying mergers. It is a detailed provision dealing with the continuity of surplus accounts, reserves, costs and other financial aspects of the predecessor corporations. Such a provision for continuity is consistent with the intention for continuity of PUC, as contemplated in subsection 87(3). In addition, paragraph 87(9)(b) contains a similar rule to decrease PUC where, on a merger, it is increased by an amount that exceeds the total PUC in respect to shares of the predecessor corporations exchanged for parent shares. The scheme therefore of section 87 is to generally preserve the continuity of PUC on amalgamations provided the PUC of the corporations that are amalgamated is not higher than that of those corporations that are being amalgamated.

[64] Subparagraph 178(2)(a)(iii) of the *Ontario Business Corporations Act* supports my analysis concerning increases to PUC. It provides for the cancellation of shares held by one amalgamating corporation in another, without any repayment of capital. In order for an amalgamation to become legally effective, section 178 requires that the articles of incorporation be submitted in the prescribed form including a statement from the directors of the corporation providing:

> (a) there are reasonable grounds for believing that,

> (i) each amalgamating corporation is and the amalgamated corporation will be able to pay its liabilities as they become due, and
>
> (ii) the realizable value of the amalgamated corporation's assets will not be less than the aggregate of its liabilities and stated capital of all classes; (Emphasis added)

This corporate law principle limits the effectiveness of transactions where a corporation sells shares of its subsidiary corporation to the corporations' parent company. This principle limits the effectiveness of such transactions that achieve an increase in the stated capital of the amalgamated corporation, which increases the PUC.

[65] Like the other subsections within section 84, subsection 84(3) ensures that PUC can be returned to a shareholder tax-free but any excess of PUC will be treated as a deemed dividend.

The Purpose of the Provisions and Parliament's Intent

[66] Prior to the amendment to the definition of PUC in 1976, PUC was computed according to corporate law without any reference to the provisions of the *Act*. In corporate law, stated capital represents the money that a shareholder has committed to the corporation and is akin to a corporation's permanent capital base. Even though the starting point for the calculation of PUC is the stated capital, adjustments are made in keeping with the general purpose of the *Act* to tax income and not capital. Such general purposes are apparent in many provisions in the *Act*, notably section 84.

[67] The aim of subsection 84(3) is to tax corporate distributions to shareholders as dividend income, unless those distributions represent a return of capital. This purpose is especially apparent when subsection 84(3) is viewed in the context of section 84 in its entirety.

[68] The history and policy reasons behind the enactment of section 84 were described in 1979 by Gould and Laiken (Dividend vs. Capital Gains under Share Redemptions, Canadian Tax Journal [March – April 1979], Vol. 27, No. 2, p. 162):

> … Also introduced in 1950 was the concept of a deemed dividend to prevent the conversion to capital of corporate surplus which would otherwise be distributed as a dividend. This concept is now contained in section 84 of the *Income Tax Act*

> (the "*Act*"). In 1963, a provision for the use of ministerial discretion was passed as the last in a series of measures to prevent dividend stripping. This provision became subsection 247(1) of the *Act*.

[69] Although subsection 247(1), referred to in the above passage, has now been repealed, it is relevant in conducting a purposive analysis of section 84. When this subsection was introduced in 1963, the Minister of Finance, in his Budget Speech, stated:

> Another type of tax avoidance about which the government is particularly concerned is the proliferation of methods of moving undistributed income from a corporation into the hands of its shareholders without the payment of tax. This abuse, and it is an expensive abuse to the public treasury, has become increasingly prevalent in recent years.

[70] Prior to its repeal, subsection 247(1) was amended in 1985 in response to the introduction of the capital gains exemption. In the Technical Notes accompanying Bill C-84 (November 1985), the Department of Finance stated:

> It is intended that subsection 247(1) apply in circumstances where, as part of a corporate reorganisation of a public or private corporation, the paid up capital of shareholders is increased inappropriately but in circumstances where no specific avoidance provision of the Act applies. (emphasis added)

[71] Subsection 247(1) was repealed when GAAR was introduced in 1988. Although subsection 247(1) has no application in the present appeal, it is noteworthy that the purpose of this provision was complementary to section 84 in situations where specific anti-avoidance rules did not apply. Subsection 87(3) is an example of one such specific anti-avoidance rule. It was enacted in respect to amalgamations occurring after March 31, 1977 and applies where the PUC of the new corporation exceeds the total PUC of the predecessor corporations. Before the enactment of this subsection, the same situation gave rise to a paid up capital deficiency ("PUCD") under paragraph 87(2) (s.1). With the repeal of PUCD, it was necessary to prevent the inflation of distributable capital on amalgamation by an artificial adjustment in PUC.

[72] Because PUC is paramount in determining tax consequences, it is essential to have provisions in the *Act* relating to PUC in the context of amalgamations. Subsection 87(3) insures that the PUC of a new corporation is limited to the aggregate of the PUC of the predecessor corporations, which prevents the artificial inflation of PUC on amalgamation. Implicit in subsection 87(3) is that the shares,

and therefore the PUC of the shares of a predecessor corporation held in another predecessor corporation, are to be eliminated.

[73] The Supreme Court in *Canada Trustco* indicates that the second step, in a subsection 245(4) analysis, requires a determination of whether the transaction or transactions fall within or frustrate the object, spirit and purpose of the relevant provisions. Since the Supreme Court decision, this Court has addressed the question of surplus stripping and GAAR in a number of cases. Both the provisions and the circumstances in the present appeal differ from those in *Desmarais v. Canada*, **[**2006] 3 C.T.C. 2304, 2006 TCC 44 and *Evans v. The Queen*, 2005 DTC 1762, 2005 TCC 684. While the *Act* contains many provisions which seek to prevent surplus stripping, the analysis under subsection 245(4) must be firmly rooted in a unified textual, contextual and purposive interpretation of the relevant provisions. As such, reliance on a general policy against surplus stripping is inappropriate to establish abusive tax avoidance. In *Lipson v. Canada*, 2007 DTC 5172, 2007 FCA 113, the Federal Court of Appeal confirmed that the overall purpose of the series of transactions must be considered in understanding an abuse analysis. Justice Noël at paragraph 45 stated:

> 45. It follows in my view that where a tax benefit results from a series of transactions, the series becomes relevant in ascertaining whether any transaction within the series gives rise to an abuse of the provisions relied upon to achieve the tax benefit. Counsel for the appellant pointed out that no reference is made to a series of transactions in subsection 245(4). That is so. However subsection 245(4) must also be read in context and where the tax benefit results from a series of transactions under subsection 245(3), the series cannot be ignored in conducting the abuse analysis.

[74] At first glance in this appeal, it is not immediately obvious that any of the transactions in this appeal constitute abusive tax avoidance. The provisions of the *Act* appear to have operated precisely as they were intended to, producing the results that would be expected. After the 1993 Share Sale, the First Amalgamation was completed in accordance with subsection 87(3), in that the PUC was preserved and the PUC of the new corporation was equal to the aggregate PUC of the predecessor corporations. The Redemption of the Class D Preference shares of Copthorne III was later effected pursuant to subsection 84(3). Similarly, the Redemption does not appear to offend the provisions or result in an abuse. However, when the Redemption is viewed together with the 1993 Share Sale of VHHC Holdings to Big City, the abusive element becomes apparent. When VHHC Investments is later amalgamated with Copthorne II, the underlying principles respecting the calculation of PUC are offended because approximately $67 million

of PUC is essentially double counted in the PUC of the newly amalgamated corporation. It is this double counting that circumvents the proper application of the relevant provisions in a manner that frustrates and defeats the object, spirit and purpose of those provisions, which individually, together and when read in conjunction with other provisions in the *Act*, are meant to operate to prevent the artificial increase of PUC on amalgamation and its subsequent return to shareholders on a tax-free basis. Of the total PUC of $164,138,025 associated with Class D Preference shares, $96,736,845 belonged to VHHC Investments and $67,401,280 belonged to Copthorne II. However, the $67,401,279 can be traced back to the investment made by VHHC Investments in the common shares of VHHC Holdings, a lower tiered subsidiary. The $67,401,279 amount originated with the $96,736,845 amount invested by Victor Li, Asfield and L.F. Holdings. VHHC Holdings was sold to Copthorne I and the PUC of $67,401,279 in VHHC Holdings was preserved through the 1993 Share Sale by Copthorne I to Big City. This same PUC was maintained throughout the First and Second Amalgamations. Therefore $67,401,279 of PUC associated with the Class D preference Shares of Copthorne III is derived from the same $96,736,845 of PUC associated with the shares of VHHC Investments. This is the origin of the double counting of $67,401,279 of PUC and the aggregate of $67,401,279 and 96,736,845 results in this artificial increase. Instead $142,035,895 was distributed as a tax-free return of capital when only $96,736,845 of PUC was actually ever available for distribution. Consequently, the overall result that the relevant provisions were meant to address has been circumvented. In doing so, the purpose and underlying rationale of these statutory provisions (as well as corporate principles) have been frustrated and their object, spirit and purpose defeated. The resulting artificial preservation and inflation in PUC allowed the stripping of surplus without appropriate withholding tax. When the many transactions here are distilled down to the essential core, it is clearly an abuse of the *Act* to which section 245 should apply.

Penalty

[75] The assessment in this appeal included a ten per cent penalty under subsection 227(8) for the Appellants' failure to deduct or withhold tax. Paragraph 227(8)(a) reads:

> (8) Penalty – Subject to subsection (8.5), every person who in a calendar year has failed to deduct or withhold any amount as required by subsection 153(1) or section 215 is liable to a penalty of
>
> (a) 10% of the amount that should have been deducted or withheld; or […]

[76] The first determination that must be addressed is whether subsection 227(8) is a strict liability or absolute liability penalty provision. In *Safety Boss Ltd v. Canada*, 2000 DTC 1767, [2000] T.C.J. No. 18, Chief Justice Bowman addressed the issue of whether subsection 227(8) was an absolute liability provision. Although he found it unnecessary to decide this issue, he was of the view that *Canada (Attorney General) v. Consolidated Canadian Contractors Inc. (C.A.)*, [1999] 1 F.C. 209 (F.C.A.) ("*Consolidated Canadian Contractors*") did not support the argument that subsection 227(8) was an absolute liability provision and therefore the application of the penalty could be subject to a defence of due diligence. In *Ogden Palladium Services (Canada) Inc. v. Canada*, [2001] 2 C.T.C. 2404, affirmed [2003] 1 C.T.C. 206 (F.C.A.), the Court also relied on *Consolidated Canadian Contractors* and stated that a defence of due diligence was available under subsection 227(8).

[77] It is only because of the application of GAAR that the liability to pay the withholding tax arises. The question therefore is whether the Appellant becomes liable to pay a penalty under subsection 227(8) when it was not technically required to withhold tax under the relevant provisions of the *Act*. I do not think that a GAAR assessment can give rise to penalties for non-compliance with the technical sections of the *Act*. First, the GAAR is not a penalty provision. If a transaction, or series of transactions, runs afowl of GAAR, the remedy specified in subsection 245(2) is that tax consequences will be determined that are reasonable in the circumstances in order to deny a tax benefit that would otherwise result from the transaction. Subsection 245(2) does not indicate that a successful GAAR assessment will cure the deficiency in the scheme of the *Act* but merely that the tax benefit resulting from the technical application of the section will be denied.

[78] Second, there is nothing in the GAAR provisions that would allow a taxpayer to self assess on the basis that GAAR applies. Subsection 245(7) provides that:

> Notwithstanding any other provision of this Act, the tax consequences to any person, following the application of this section, shall only be determined through a notice of assessment, reassessment, additional assessment or determination pursuant to subsection 152(1.11) involving the application of this section.

This provision indicates that a taxpayer cannot self-assess on the basis that GAAR applies. The Appellant argued that:

> … Taxpayers self assess on the basis of compliance with the technical provisions of the Act. The application of GAAR can only be initiated by the CRA. Unless subsection 227(8) is an absolute liability provision (which, as discussed below, it is not), a penalty should not be imposed as a consequence of the successful application of GAAR by the Minister, since a taxpayer can never file or pay anything on the basis that GAAR applies, without the Minister first initiating the application of GAAR. (Appellant's Notes of Argument, paragraph 126).

I agree with the Appellant's comments and conclude that a successful GAAR assessment prevents the Minister from applying penalties under subsection 227(8), where, according to the technical application of subsection 215(1), there was no tax payable by a non-resident.

The Reasonable Tax Consequences

[79] The Appellant also objected to the Minister's calculation of the tax benefit and submits that it was not reasonable in the circumstances (Notice of Appeal, paragraph 54). The revised PUC of the redeemed shares was computed by the Minister as follows:

Number of shares redeemed / Number of shares issued x Revised PUC = Revised PUC of Redeemed Shares

$142,035,895 / $164,138,025 x $96,736,845 = $83,710,672

This method meant that the difference of $58,325,223, between $142,035,895 of PUC (for the Class D preference shares of Copthorne III that were redeemed) and the $83,710,672 is a taxable dividend received by L.F. Investments, upon which Part XIII tax would have been exigible. The end result under Article X of the Canada-Barbados Tax Convention limits the tax on the dividend to 15% or $8,748,783.

[80] The Appellant did not provide an alternative basis for this calculation, nor did the Appellant indicate why the Minister's method was not acceptable. It is reasonable to reduce the amount of PUC of the redeemed shares by the proportionate amount that PUC was overstated for those redeemed shares. Had all of the Class D preference shares been redeemed, with a revised PUC of $96,736,845, the amount of the deemed dividend would have been $67,401,280. The Minister's calculation of the deemed dividend according to the proportion of shares actually received, which is equal to the tax benefit, is therefore reasonable.

[81] The appeal is therefore allowed to delete penalties that have been applied. In respect to the GAAR assessment, a taxable dividend of $58,325,223 will be deemed to have been paid by Copthorne III to L.F. Investments, pursuant to subsection 84(3), resulting in the amount of $8,748,783 to be remitted by Copthorne III as withholding tax on this deemed dividend. Because the Respondent has been successful for the most part, there will be an award of two sets of counsel fees in respect to costs.

Signed at Summerside, Prince Edward Island, this 28th day of August 2007.

"Diane Campbell"

Campbell J.

2002-1316(IT)G

TAX COURT OF CANADA

In Re the *Income Tax Act*

BETWEEN:

COPTHORNE HOLDINGS LTD.

Appellant

and

HER MAJESTY THE QUEEN

Respondent

JOINT STATEMENT OF FACTS AND LAW

The parties agree to the following statements of fact and legal conclusions for the purposes of this appeal. Neither party will adduce evidence contrary to the statements of fact, or advance arguments inconsistent with the legal propositions, contained herein:

1. By Notice of Assessment dated February 1, 2000, the Minister of National Revenue (the "Minister") assessed Copthorne Holding Ltd. (a predecessor of the Appellant) for the amount of $8,748,783.40 under subsections 215(1) and 245 of the *Income Tax Act* (the "*Act*") on account of the tax payable by a non-resident, as well as a 10% penalty in the amount of $874,878.34 under subsection 227(8) of the *Act* for failing to deduct or withhold that tax (and arrears interest) following a

determination made by the Minister under the General Anti-Avoidance Rule contained in subsection 245(2) of the *Act*.).

2. Copthorne Holdings Ltd. ("Copthorne I") was a corporation that was incorporated under the laws of Ontario in 1981. The one issued and outstanding common share of Copthorne I (the paid-up capital of which was $1.00) was owned by Big City Project Corporation B.V. ("Big City"), a Netherlands corporation.

3. At all material times, Big City was indirectly controlled by Li Ka-Shing, a businessman resident in Hong Kong.

4. Copthorne I was formed to acquire the Harbour Castle Hotel in Toronto, which it sold in 1989 for a substantial gain (the "Hotel Sale").

5. Following the sale, Copthorne I incorporated a wholly-owned subsidiary under the laws of Barbados called Copthorne Overseas Investment Ltd. ("COIL"). Copthorne I used the proceeds from the sale of the hotel (and other funds) to subscribe for common shares of COIL.

6. COIL established an active bond-trading business that it carried on through a branch in Singapore and in which it deployed the funds contributed by Copthorne I.

7. VHHC Investments is a corporation that was incorporated under the laws of Ontario in 1987.

8. Victor Li, a Canadian citizen and son of Li Ka-Shing, owned all of the issued and outstanding Class A voting common shares of VHHC Investments, with a paid-up capital of $100, which he had acquired for $100. VHHC Investments also had authorized a class of non-voting common shares, designated as Class B non-voting common shares, which were owned as to 18.75% by Victor Li and 81.25% by Asfield B.V., a Netherlands corporation the shares of which were owned, indirectly, by a trust of which Victor Li was the principal beneficiary. In 1987, Victor Li acquired 7,500,000 Class B non-voting common shares and Asfield B.V. acquired 32,500,000 Class B non-voting common shares, in each case for cash consideration of $1.00 per share.

9. Initially, VHHC Investments owned all of the common shares of a corporation that was incorporated under the laws of Ontario in 1987 called VHHC Holdings Ltd. ("VHHC Holdings").

10. Husky Oil Ltd. ("HOL") is a corporation that was incorporated under the laws of Canada. At all material times, HOL and its subsidiaries carried on the business of oil and gas production, refining and distribution.

11. In 1987, VHHC Holdings acquired 19,718,314 common shares of HOL in the course of a going-private transaction. After the going-private transaction was completed, the shareholders of HOL were: Nova Corporation or one of its subsidiaries ("Nova") as to 43%, Union Faith Canada Holdings Ltd. (a wholly-owned subsidiary of Hutchison

Whampoa Limited, a Hong Kong public company) as to 43%, VHHC Holdings as to 9% and CIBC as to 5 %.

12. HOL subsequently required a further infusion of equity to fund operations and the shareholders agreed to make further contributions of capital to HOL in amounts proportionate to their interests. Victor Li and Asfield B.V. contributed a further $14,740,000 for additional Class B non-voting common shares of VHHC Investments and VHHC Holdings acquired a further 7,094,994 common shares of HOL.

13. Accordingly, during 1987 and 1988, Victor Li and Asfield B.V. invested a total of $54,740,000 in 54,740,000 Class B non-voting common shares of VHHC Investments. (In 1989, $11,719,534 of this was returned on a reduction of stated capital, leaving the 54,740,000 Class B common shares with a paid-up capital $43,020,466).

14. VHHC Investments in turn invested $13,685,000 of the share subscription funds received from Victor Li and Asfield B.V. in 13,685,000 common shares of VHHC Holdings and advanced the balance to VHHC Holdings by way of loan.

15. VHHC Holdings used the subscription funds and borrowed funds referred to above (together with other borrowed funds) to acquire common shares of HOL.

16. The aggregate adjusted cost base of VHHC Holdings' 26,813,308

common shares of HOL was approximately $136.6 million.

17. By the end of 1991, the fair market value of the common shares of HOL had fallen dramatically mainly as a result of depressed prices in the oil and gas industry.

18. HOL required additional equity investment from its shareholders; however, Nova was not prepared to invest further and decided to dispose of its interest.

19. In December of 1991, Nova's common and preferred share interest in HOL was acquired by corporations controlled by Li Ka-Shing and Hutchison and additional capital was contributed to HOL by its shareholders. A number of transactions occurred in this connection, including the following:

    (a) L.F. Holdings Ltd. ("L.F. Holdings"), a Barbados corporation the shares of which were owned by Li Ka-Shing, subscribed for 53,716,279 non-voting redeemable preferred shares of VHHC Investments for $53,716,279.

    (b) VHHC Investments used some of these funds to (i) subscribe for 33,716,279 additional common shares of VHHC Holdings for $33,716,279 and (ii) subscribe for 20,000,000 preferred shares of VHSUB Holdings Inc., a newly-incorporated Canadian subsidiary of VHHC Holdings ("VHSUB Holdings"), for $20,000,000.

    (c) VHHC Holdings used the $33,716,279 of subscription funds received from VHHC Investments to:

        (i) subscribe for 14,500,000 common shares of VHSUB Holdings, for $14,500,000; and

        (ii) advance $19,216,279 to HOL by way of shareholder subordinated loan.

(d) VHSUB Holdings used the subscription proceeds of $20,000,000 referred to in paragraph (b) above and the $14,500,000 referred to in paragraph (c)(i) above to invest in additional common shares of HOL.

(e) VHHC Holdings transferred its 26,813,308 common shares of HOL, which then had a value of $1.9515 per share to VHSUB Holdings.

(f) VHHC Holdings realized a capital loss of roughly $84.3 million on that transfer which loss was denied under paragraphs 40(2)(e) and 85(4)(a) of the *Act*, as they then read, and was added to the adjusted cost base of the common shares of VHSUB Holdings owned by VHHC Holdings under paragraph 85 (4)(b).

(g) VHSUB Holdings subsequently redeemed the preference shares referred to in (b) above and VHHC Investments used the proceeds to subscribe for an additional 20,000,000 common shares of VHHC Holdings for $20,000,000.

20. Following the December 1991 transactions, VHHC Investments owned 67,401,279 common shares of VHHC Holdings which shares had an aggregate adjusted cost base of $67,401,279 (i.e., $13,685,000, $33,716,279 and $20,000,000) and an aggregate paid-up capital of the same amount.

21. VHHC Holdings had used the share subscription funds received from VHHC Investments in the amount of $67,401,279 to invest directly or indirectly in HOL. At the end of 1991, VHHC Holdings owned all of the issued and outstanding shares of VHSUB Holdings. These shares had a nominal fair market value but an adjusted cost base of approximately $84.3M, being the economic loss sustained by VHHC Holdings to that point on its investment in HOL.

22. After the consummation of the December 1991 HOL transactions, which were not foreseen at the time of the Hotel Sale, VHHC Holdings owned shares of VHSUB Holdings with a substantial accrued loss. During 1992, consideration was given to shifting some of that accrued loss (on the shares of VHSUB Holdings owned by VHHC Holdings) to Copthorne so that it could be realized by Copthorne and then carried back to shelter the capital gain realized on the Hotel Sale in 1989 (see paragraph 4). This would then make available Copthorne's non-capital losses, which had previously been carried back to shelter the capital gain from the Hotel Sale, to be carried forward and deducted in future taxation years against ordinary income. This had to be done in 1992, since the carryback period for a capital loss is limited to three years.

23. If VHHC Holdings and Copthorne had simply amalgamated, and the new amalgamated corporation had then sold the VHSUB Holdings shares to an unrelated purchaser, the desired result would not have been achieved since the capital loss realized by the new amalgamated corporation could not have been carried back to a predecessor. Therefore, a plan was developed that relied upon the stop-loss rules as they then existed in paragraph 40(2)(e) and paragraph 53(1)(f.1) to transfer some of the high cost base of the VHSUB Holding shares to Copthorne.

24. Since it was understood by the Li family that VHHC Holdings and Copthorne were not "controlled, directly or indirectly, by the same

person or group of persons" (VHHC Holdings was understood to be controlled by Victor Li and Copthorne was understood to be controlled by Li Ka-Shing), even though the two corporations were clearly "related" within the meaning of the *Act*, it was understood that a direct sale of the VHSUB Holdings shares by VHHC Holdings to Copthorne would not have achieved the desired result, but rather would have crystallized the loss in VHHC Holdings.

25. Also, at that time VHHC Holdings owned some preferred shares of Copthorne. If it owned those shares when it transferred the VHSUB Holdings shares to Copthorne, the loss on the VHSUB Holdings shares would not have been added to the adjusted cost base of the VHSUB Holdings shares to Copthorne under paragraph 53(1)(f.1) of the *Act*, but rather would have been added to the adjusted cost base of those Copthorne preferred shares to VHHC Holdings under former paragraph 85(4)(b) of the *Act*.

26. To address these issues, the following transactions were carried out:

    (a) VHHC Holdings sold the preferred shares of Copthorne to VHHC Investments for a note for $16,680,000 (being the redemption amount of the preferred shares, their adjusted cost base to VHHC Holdings and their estimated fair market value). VHHC Holdings then did not own any shares of Copthorne.

(b) In 1992 VHHC Investments sold the 67,401,279 common shares of VHHC Holdings to Copthorne I for 1 class "A" Special share of Copthorne valued at $1,000, being the estimated fair market value of the VHHC Holdings common shares at that time. This transaction resulted in Copthorne I directly controlling VHHC Holdings, so that both corporations were then clearly controlled, directly or indirectly, by the same person or group of persons.

(c) VHHC Holdings then sold 55,500,000 of its 66,826,213 VHSUB Holdings common shares to Copthorne I for $1,245.77 in cash, being their estimated fair market value at the time. The stop-loss rules in paragraph 40(2)(e) and paragraph 53(1)(f.1) of the *Act* applied to this transaction so that Copthorne I inherited the high adjusted cost base of those VHSUB Holdings shares.

(d) Finally, Copthorne I and VHHC Holdings sold their VHSUB Holdings shares to an unrelated purchaser for their fair market value, and claimed capital losses. Copthorne carried its capital loss back to 1989 to shelter the capital gain from the Hotel Sale.

27. The transfer of the shares of VHHC Holdings to Copthorne I in 1992 was not undertaken for any purpose related to the paid-up capital of

those shares, but with the sole objective of shifting the inherent capital loss on VHHC Holdings shares of VHSUB Holdings to Copthorne I so that Copthorne I could utilize a portion of it to shelter the capital gain it had realized on the Hotel Sale in 1989. The transfer of the VHHC Holdings shares to Copthorne I was intended to ensure that both corporations would then be under common *de facto* control so that the stop-loss rules would apply to the desired effect.

28. While the adjusted cost base of the common shares of VHHC Holdings acquired by Copthorne I was $1000, the paid-up capital of $67,401,279 was an attribute of those shares that passed to Copthorne I as purchaser.

29. In 1993, it was decided that Copthorne I and VHHC Holdings, as well as two other Canadian corporations owned by the Li Family, namely, Li's Investments Co. Ltd. ("Li's Investments") and Grand Realty Ltd. ("Grand Realty"), should be amalgamated so that:

(i) the losses that had been or were anticipated to be incurred by one or more such corporations could be used to shelter income that it was anticipated would be earned by one or more other such corporations; and

(ii) the corporate structure of the Li Family's Canadian holdings would be simplified.

30. Although it is hard to provide an exact date, the possibility of amalgamating was likely first considered in 1992, after VHHC Holdings had disposed of its investment in HOL in December of 1991, but this did not proceed because it was realized that this would have adversely affected the December 1992 loss

utilization transactions.

31. As noted above, the objective of the December 1992 transactions was to transfer an accrued unrealized capital loss that was in VHHC Holdings to Copthorne I and then trigger that loss so that Copthorne I could carry it back to offset a capital gain it had realized in 1989. If VHHC Holdings and Copthorne I had amalgamated in 1992, and the loss had then been triggered by the amalgamated company (Copthorne II), that loss could not have been carried back to offset the capital gain previously realized by Copthorne I. It was therefore necessary to utilize other transactions to shift the capital loss to Copthorne I, which transactions were implemented in December 1992. Those transactions included having Copthorne I acquire the shares of VHHC Holdings from VHHC Investments.

32. The earliest that VHHC Holdings and Copthorne I could have amalgamated without disrupting the loss utilization planning (and without triggering abbreviated taxation years) would have been January 1, 1993. However, because the Appellant's attention, in late 1992, was focused on implementing the loss utilization transactions rather than the amalgamation, the amalgamation did not occur on January 1, 1993, even though it was being considered.

33. Attention was again focused on the amalgamation in January of 1993. It then became apparent that as a consequence of VHHC Investments having transferred the shares of VHHC Holdings to Copthorne I in order to give effect to the December 1992 loss utilization transactions, the paid-up capital of the

VHHC Holdings shares would be lost in the amalgamation unless those shares could be transferred to some other entity with the related group prior to amalgamation.

34. In 1993 consideration was given, for the first time, to preserving the paid-up capital of the shares of VHHC Holdings then owned by Copthorne I in the amount of $67,401,279. The paid-up capital of the shares of VHHC Holdings was an attribute of those shares that was perceived in a general sense as potentially having some value either to the corporate group of which VHHC Holdings was then a member or to a purchaser in the event that the shares of VHHC Holdings were ever sold.

35. A decision was made, in mid January of 1993, to proceed with the amalgamation of Copthorne I and VHHC Holdings. The idea of including Li's Investments Co. Ltd. and Grand Realty Ltd. in the amalgamation had been considered in mid 1992, and was also under consideration in mid January of 1993. It was ultimately decided to include those two companies in the amalgamation, as they had extra shelter to contribute to the amalgamated entity and since this would also further simplify the Li Family's Canadian holdings.

36. It is the Appellant's position that there was no plan, in 1993, to return all or any portion of the paid-up capital on the shares of VHHC Holdings to the existing or any future shareholders. Further, none of the features of any future transaction by which the potential value perceived to be associated with paid-up capital might be realized were determined at the time, nor was there any intention at

that time to implement any such transaction.

37. Under corporate law, inter-corporate shareholdings would have been cancelled on an amalgamation of Copthorne I and VHHC Holdings. Copthorne I therefore sold its common shares of VHHC Holdings to Big City on July 7, 1993 for $1,000 (the "1993 Share Sale"), which amount was determined to be their estimated fair market value at that time. The Share Sale is the avoidance transaction as relied on by the Respondent.

38. Consideration was given to different options for implementing the amalgamation of Copthorne I and VHHC Holdings that resulted in the loss of paid-up capital associated with the VHHC Holdings on one hand, and no loss of the paid-up capital on the other.

39. Copthorne I, VHHC Holdings, Li's Investments and Grand Realty subsequently amalgamated effective January 1, 1994. The amalgamated corporation continued under the name Copthorne Holdings Ltd. ("Copthorne II"). The amalgamation was not implemented until January 1, 1994 to avoid creating two 1993 fiscal year ends.

40. On the amalgamation, the 1 common share of Copthorne I owned by Big City was converted into 20,000,000 common shares of Copthorne II, and the 67,401,279 common shares of VHHC Holdings owned by Big City were converted into 1,000 common shares of Copthorne II. This resulted in Big City owning 20,001,000 common shares of

Copthorne II with an aggregate paid-up capital of $67,401,280 (i.e., $67,401,279 plus $1).

41. The exchanges reproduced at schedule "A" to this Statement took place during the examination for discovery of the Respondent's nominee.

42. At the time the CRA auditor prepared his position paper for this assessment he had found no evidence or information that indicated that the Appellant intended to use the preserved paid-up capital in any specific manner, or that the transactions in late 1994 and early 1995 had ever been contemplated or were contemplated at the time the sale took place in July 1993. The auditor concluded, without evidence of any plan to utilize the preserved paid-up capital in any specific manner, that there was a view on the part of Copthorne and/or LF Investments that, at some point in the future, they would want to utilize the preserved capital.

43. In February 1994, the federal government delivered its budget which included substantial changes to the foreign accrual property income ("FAPI") rules. The Appellant was advised that those proposed changes would not have adversely affected COIL (or Copthorne II as the sole shareholder of COIL), because COIL had more than five full-time employees engaged in its bond trading business. Subsequently, in June 1994, revised amendments to the foreign affiliate rules were

released by the Department of Finance, including the proposed introduction of what is now paragraph 95(2)(l) of the *Act*. The effect of this provision would have been to make all of COIL's income FAPI.

44. It is the Appellant's position that the proposed FAPI rules were neither foreseen, contemplated or anticipated when the Share Sale and the amalgamation to form Copthorne II took place.

45. It is the Appellant's position that Copthorne II considered how best to deal with this unforeseen and unanticipated event and ultimately decided to dispose of its investment in COIL and repatriate the proceeds from such disposition for investment outside of Canada, and, at the same time, the decision was made to further simplify the Li's family Canadian corporate structure and consolidate their principal Canadian investments (Copthorne II and HOL) under a single offshore holding company.

46. The value of Copthorne II's investment in COIL was determined to be $367,417,889. Of this, it was determined that $60,073,035 could be used to repay loans that had been previously advanced to Copthorne I by related non-residents.

47. At that time, the amount of paid-up capital attributable to shares of Canadian corporations owned, directly or indirectly, by the Li Family, was as follows:

(a) Big City owned 20,001,000 common shares of Copthorne II with an aggregate paid-up capital of $67,401,280;

(b) Victor Li owned 100 Class A common shares of VHHC Investments with an aggregate paid-up capital of $100;

(c) Victor Li and Asfield B.V. owned 54,740,000 Class B common shares of VHHC Investments with an aggregate paid-up capital of $43,020,466; and

(d) L.F. Holdings owned 53,716,279 preferred shares of VHHC Investments with an aggregate paid-up capital of $53,716,279.

48. The following transactions (among others) were then implemented in late 1994:

(a) The Li Family incorporated a new British Virgin Islands corporation, Copthorne International Investment Ltd. ("CIIL"), to which COIL sold its bond-trading business as a going concern for $367,417,889.

(b) The sale price was paid by CIIL issuing to COIL five promissory notes in the principal amounts of $1,073,035, $29,000,000, $30,000,000, $142,035,895 and $165,308,959.

(c) The notes for $1,073,035, $29,000,000 and $30,000,000 were distributed by COIL to Copthorne II on a reduction of stated capital and endorsed over by Copthorne II in repayment of the outstanding debts to related non-residents totalling $60,073,075 referred to in paragraph 34 above.

(d) The note for $142,035,895 was also distributed by COIL to Copthorne II on a reduction of stated capital.

(e) On November 22, 1994, L.F. Holdings incorporated a new Barbados corporation called L.F. Investments (Barbados) Ltd. ("L.F. Investments").

(f) On December 14, 1994, Victor Li and Asfield B.V. sold their Class A and Class B common shares of VHHC Investments to L.F. Investments for their fair market value, which was nominal, and L.F. Holdings sold its 53,716,279 preferred

shares of VHHC Investments to L.F. Investments for common shares of L.F. Investments with a stated value of $29,500,000.

(g) On December 23, 1994, Big City sold the 20,001,000 common shares of Copthorne II to L.F. Investments for $150,000,000, which amount was their determined to be their fair market value at that time.

(h) As a result of the foregoing, L.F. Investments owned the common shares of Copthorne II with a paid-up capital of $67,401,280, and the common and preferred shares of VHHC Investments with an aggregate paid-up capital of $96,736,845.

(i) Effective January 1, 1995, Copthorne II, VHHC Investments and two other Canadian corporations the shares of which were owned by Li Ka-Shing, namely, Optima Holdings Limited and Giltedged Investments Limited, were, amalgamated. The amalgamated company continued under the name of Copthorne Holdings Ltd. ("Copthorne III").

(j) On the amalgamation, L.F. Investments' shares of Copthorne II and VHHC Investments were exchanged for the following shares of Copthorne III:

				Copthorne III	
Class	Number	PUC	Class	Number	PUC
Copthorne II					
Common	20,001,000	$ 67,401,280	Common	1,000	$1
			D Preferred	134,638,000	$134,638,000
			F Preferred	15,361,000	$99
VHHC Investments					
Class A	100	$100	D Preferred	10	$10
Class B	54,740,000	$ 43,020,466	D Preferred	15	$15
Preferred	53,716,279	$ 53,716,279	D Preferred	29,500,000	$29,500,000
		$164,138,125			$164,138,125

Thus, the total paid-up capital attributable to the Class D preference shares of Copthorne III immediately after the amalgamation was $164,138,025, which was also their aggregate redemption amount and fair market value.

(k) Immediately following the amalgamation, Copthorne III redeemed 142,035,895 of the Class D preference shares (the "Redemption") by endorsing over the CIIL note for $142,035,895 to L.F. Investments.

49. The transactions that are relevant to this appeal are set out in Schedule "B" to this Statement. In the case of any factual discrepancy between the text of this Statement and the information set out in the attached Schedule "B", the parties agree that the facts contained in the text of this Statement shall prevail.

50. Because the total paid-up capital of the Class D preference shares that were redeemed was equal to their aggregate redemption amount, the amount Copthorne III paid or credited to L.F. Investments on the Redemption was not an amount on which income tax was then payable under subsection 84(3) and paragraph 212(2) (a) of Part XIII of the *Act*.

51. Copthorne III therefore did not deduct or withhold any amount in respect of the Redemption on behalf of L.F. Investments and remit it to the Receiver General pursuant to subsection 215(1) of the *Act*.

52. On January 1, 2002, Copthorne III amalgamated with five other companies and continued as Copthorne Holdings Ltd., the Appellant herein.

53. During the course of the review of the Appellant's objection to the assessment by the Canada Revenue Agency (the "CRA") appeals office, which resulted in the confirmation of the assessment, no facts came to light in addition to those identified at the audit stage.

54. During examination for discovery for this appeal the CRA auditor said "surplus" was anything in a corporation that exceeds its paid-up capital, an accounting term for which is "retained earnings".

55. The CRA auditor considered that the words "preserve" and "increase" to be synonymous in relation to the paid-up capital in the circumstances of this appeal.

56. As a result of the July 1993 transaction:

    a. there was no reduction of any tax payable in 1993;
    b. there was no avoidance of any tax or other amount payable under the Act for 1993;
    c. there was no deferral of any tax that might otherwise have been payable in respect of 1993; and
    d. there was no increase of any refund or other amount payable to the Appellant or anyone else for the 1993 taxation year.

57. It is the Respondent's position that it cannot reasonably be considered that the Sale was undertaken primarily for *bona fide* purposes other than to obtain a tax benefit.

58. As general legal propositions it is agreed that:

    a. Corporations are permitted to return paid-up capital to their shareholders tax free; and

    b. Paid-up capital is an attribute of the relevant shares and is not a personal attribute of a particular shareholder.

59. At the examination for discovery, the CRA auditor was asked the following question: "Are you in a position to direct my attention to any provision of the Act or the Regulations that supports the assertion that the paid-up capital of a corporation is limited to the quote, "original investment", unquote?" The CRA auditor answered: "Can I point to a specific provision? No."

60. The "series" of transactions upon which the Respondent relies in support of the assessment appealed against began with the July 1993 share transfer and concluded with the redemption of the class D preferred shares and redemption of the promissory note in January 1995. The series includes the transactions described in paragraphs 31 and 32 of the Notice of Appeal (paragraphs 37 and 40 herein), and extends to the transactions described in paragraph 39 of the Notice of Appeal (paragraph 48 herein) by virtue of s. 248(10) of the *Act*.

61. The July 7, 1993 Share Sale and the amalgamation which occurred on January 1, 1994 were part of a series of transactions (the "First Series of Transactions").

62. The transactions described in paragraphs 39(a) through (k) of the Notice of Appeal were each part of a series of transactions (the "Second Series of Transactions").

DATED at Toronto, Ontario, November 28, 2006.

Richard W. Pound Q.C
Stikeman Elliott
Barristers & Solicitors
Suite 4000
1155 Rene-Levesque Blvd. W.
Montreal, Quebec
H3B 3V2
Tel: (514) 397-3037
Fax: (514) 397-3222

Counsel for the Appellant

DATED at Toronto, Ontario, November 28, 2006

John H. Sims, Q.C.
Deputy Attorney General of Canada
Solicitor for the Respondent

Per: Franco Calabrese
Department of Justice
Ontario Regional Office
Tax Law Services Section
The Exchange Tower
130 King Street West
Suite 3400, Box 36
Toronto, Ontario
M5X 1K6
Tel: (416) 954-9988
Fax: (416) 973-0810

Counsel for the Respondent

TO: The Registrar
Tax Court of Canada
180 Queen Street West
Suite 200
Toronto, Ontario
M5V 3L6

AND TO: Richard W. Pound Q.C
Stikeman Elliott
Barristers & Solicitors
Suite 4000
1155 Rene-Levesque Blvd. W.
Montreal, Quebec
H3B 3V2

Counsel for the Appellant

A. I can't recall today whether we asked that specific question.

222. MR. POUND: Can you undertake to find out whether you did ask that question?

MR. CALABRESE: Yes, we will.

U/T

223. MR. POUND: Thank you.

BY MR. POUND:

224. Q. As I understand the position...and if I have it wrong, please tell me...you have two possible scenarios here. One is that the sale which took place in July 1993 could have occurred or could not have occurred, did occur?

A. It did occur, yes.

225. Q. If it had not occurred, when a later amalgamation took place, the paid-up capital would have been lost?

A. Yes, if the January 1, 1994 amalgamation had occurred without the prior share sale, it is my understanding the PUC would have been extinguished or cancelled.

226. Q. So you have a scenario where a company can act in one of two ways. It can do a transaction which has the effect, as it turns out later, of preserving some paid-up capital, or it can

not do a transaction, in which case, as it turns out, when the later transaction occurs, the paid-up capital is lost?

A. The company would have a choice of doing one or the other, yes.

227. Q. As I understand the assessment and the position taken in your position paper, the CRA believes that the taxpayer should have chosen to act in a way to lose the paid-up capital rather than to preserve it?

A. We never took the view that the corporation should or should not have done something. They did make the share sale, and there was an amalgamation, the result of which ended up with the preservation of the PUC.

228. Q. Which you have characterized as inappropriate?

A. Yes.

229. Q. Would that be the same as being wrong?

A. No, it was not...as I said earlier, my use of the word "inappropriate" was meant to convey the CCRA's view that the tax result was not the proper tax result.

230. Q. What would a proper tax result have

been?

A. Well, had the sale not taken place, the PUC would have been cancelled, and from our perspective, the only reason that we could see for the July 1993 share sale was to preserve the PUC.

231. Q. You have undertaken to...you have indicated some documents that support that view, and you have undertaken to see if there are any other elements of evidence to support it?

A. To support?

232. Q. That view, that there should have been a different result.

A. Yes.

MR. CALABRESE: Sorry, I just wanted to clarify which undertaking we are referring to. We have undertaken to determine whether Mr. Weevers asked for an explanation for this share transaction...

233. MR. POUND: He identified the two letters in Exhibit 1, tabs 9 and 10, and I said is there anything else. He then referred me to Mr....the letter at tab 10, and then I said is there anything else...

MR. CALABRESE: Those are the documents...

234. MR. POUND: So, in this case, we are talking about...we are having trouble figuring out where "inappropriate" doesn't seem to be necessarily what I understood it to be, which is that there was some opprobrium attached to it.

BY MR. POUND:

235. Q. You are now saying it is not the result that should have obtained in the view of CRA?

A. Correct.

236. Q. I have been trying to say, well, all right, we acknowledge that the transactions occurred, there was a sale, there was an amalgamation, and you are saying, but if the sale hadn't occurred, and the amalgamation had later taken place, this paid-up capital would have been lost, and you think that is what should have happened? It is a little bit like our former Prime Minister Trudeau said, you know, "Listen, if my grandmother had wheels, she would have been a bus". There was a sale?

A. Yes.

237. Q. We acknowledge that. There was an amalgamation?

A. Yes.

238. Q. You say, when the smoke clears, there has been an inappropriate...whatever that means...preservation of some paid-up capital, and you don't think that should have happened. You think, as I understand it, that they should never have made that sale, they should have done the amalgamation, in which case the paid-up capital would have been lost?

A. That is correct.

239. Q. That is what you think should have happened, and I am trying to find out why you think that should have happened.

A. Because we couldn't see any non-tax reason for the share sale that led us to conclude the only purpose for the July 1993 share sale was to gain some sort of tax advantage or tax benefit.

240. Q. Well, can you explain to me the basis for your view that the preservation of paid-up capital gives rise to a, in quotation marks, "tax benefit" under section 245?

A. Because paid-up capital can be returned to shareholders on a tax-free basis, tax benefits can be obtained when paid-up capital is increased for tax reasons only.

313. Q. The total for the paid-up capital on those shares that Big City got was the 67.4 million?

A. Yes.

314. Q. That is what happened. Just following paragraph 4 on page 4, you have another note in which you say:

"...If the July 7, 1993 sale of shares to Big City had not occurred, the shares of VHHCH would have been cancelled on the amalgamation..."

A. That is what the note says.

315. Q. But the sale had occurred?

A. Agreed, the sale had occurred.

316. Q. The shares were not cancelled?

A. They were not.

317. Q. Now, we may have touched on this a little earlier, but do I take it that the Respondent's position is that, for some reason, the sale should not have taken place?

A. I believe I explained earlier that it was our view that, had the share sale not taken place, the PUC would have been extinguished, and we were unable to ascertain any bona fide business purpose for the sale of the shares. In other words, the only reason we saw for the July 1993 sale of

shares was for tax reasons.

318. Q. So that is the same...you are giving me the same answer?

A. So whether...I have difficulty because I understand that the Courts have said the CCRA is not supposed to dictate to people how they do transactions, so I am hesitant to say that Copthorne should or should not have done something. I don't think we would view it in using that kind of language. But had the share sale not taken place, it would have been cancelled.

319. Q. So that is an observation...

A. In our view, the proper tax result, had the share sale not taken place, would have been the cancellation of the PUC.

320. Q. I am not sure that we have any dispute with that, but it had taken place?

A. Agreed.

321. Q. Could you just look at, very quickly, paragraphs 5 to 12? I put it to you, I don't think anything in those paragraphs bears on this appeal, but if something does, perhaps you should point it out.

A. They are included to summarize the shareholdings of Copthorne II and VHHC Investments.

Schedule "B"

DIAGRAM #1
(1989)

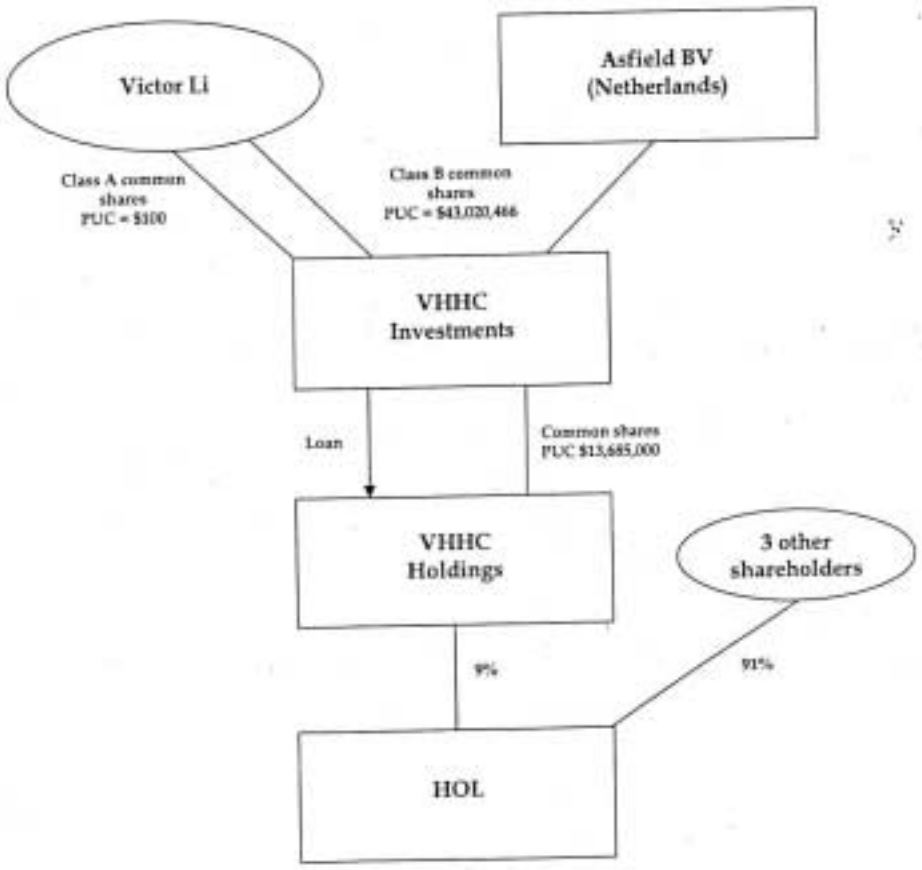
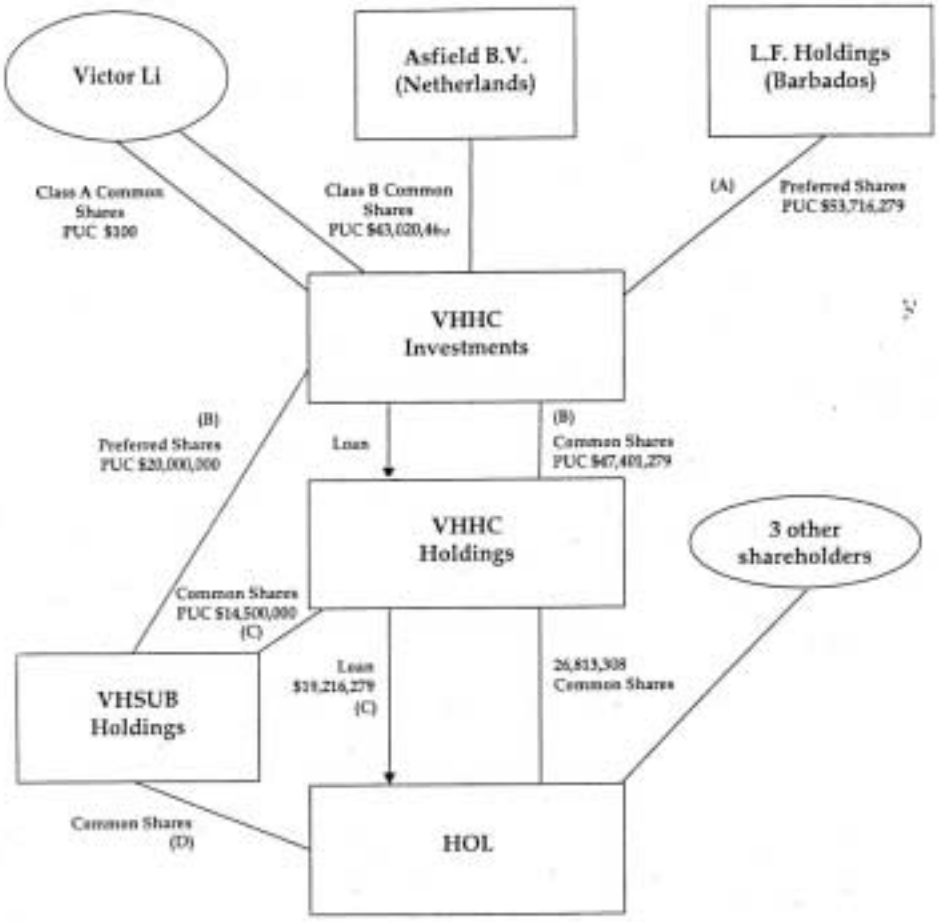


DIAGRAM #2
(1991)



Notes:

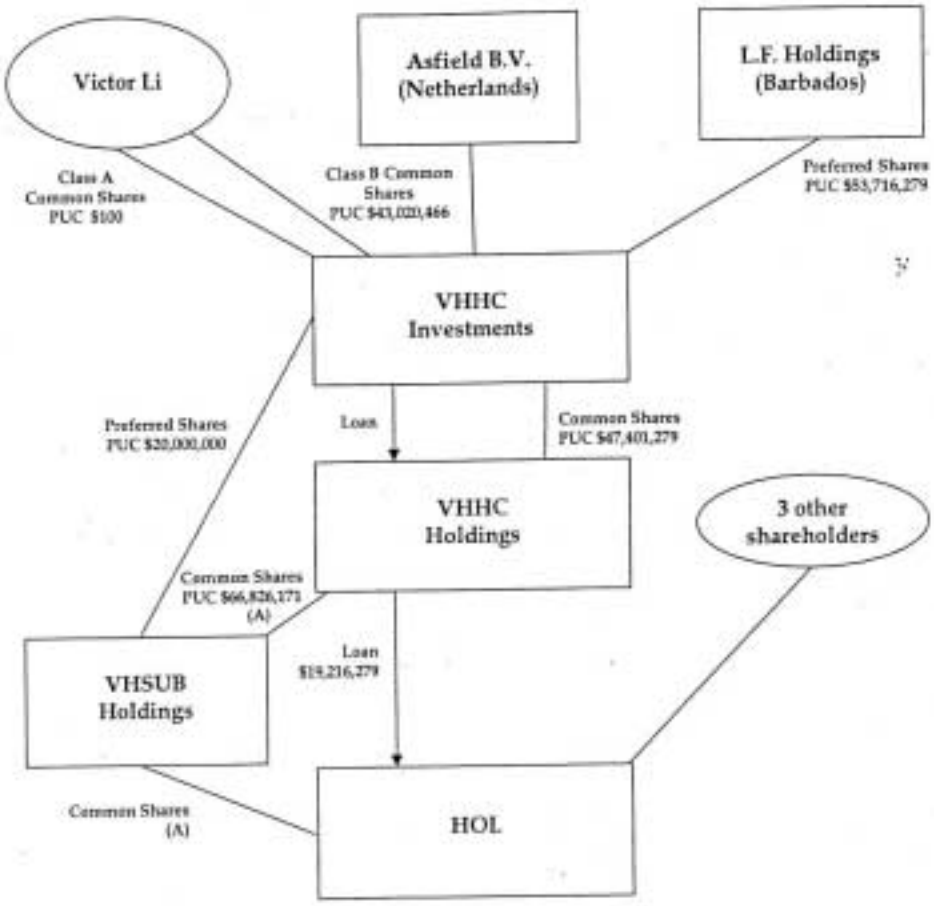
(A) L.F. Holdings subscribes for 53,716,279 non-voting redeemable preferred shares of VHHC Investments for $53,716,279. See par. 19(a) of Joint Statement of Facts ("JSF").

(B) VHHC Investments subscribes for (i) 33,716,279 additional common shares of VHHC Holdings for $33,716,279 (increases PUC to $47,401,279) and (ii) for 20,000,000 preferred shares of VHSUB Holdings for $20,000,000. See par. 19(b) of JSF.

(C) VHHC Holdings uses funds received from VHHC Investments ($33,716,279) to subscribe for common shares of VHSUB ($14,500,000) and make a loan to HOL ($19,216,279). See par. 19(c) of JSF.

(D) VHSUB Holdings uses funds ($34,500,000) to subscribe for common shares of HOL. See par. 19(d) of JSF.

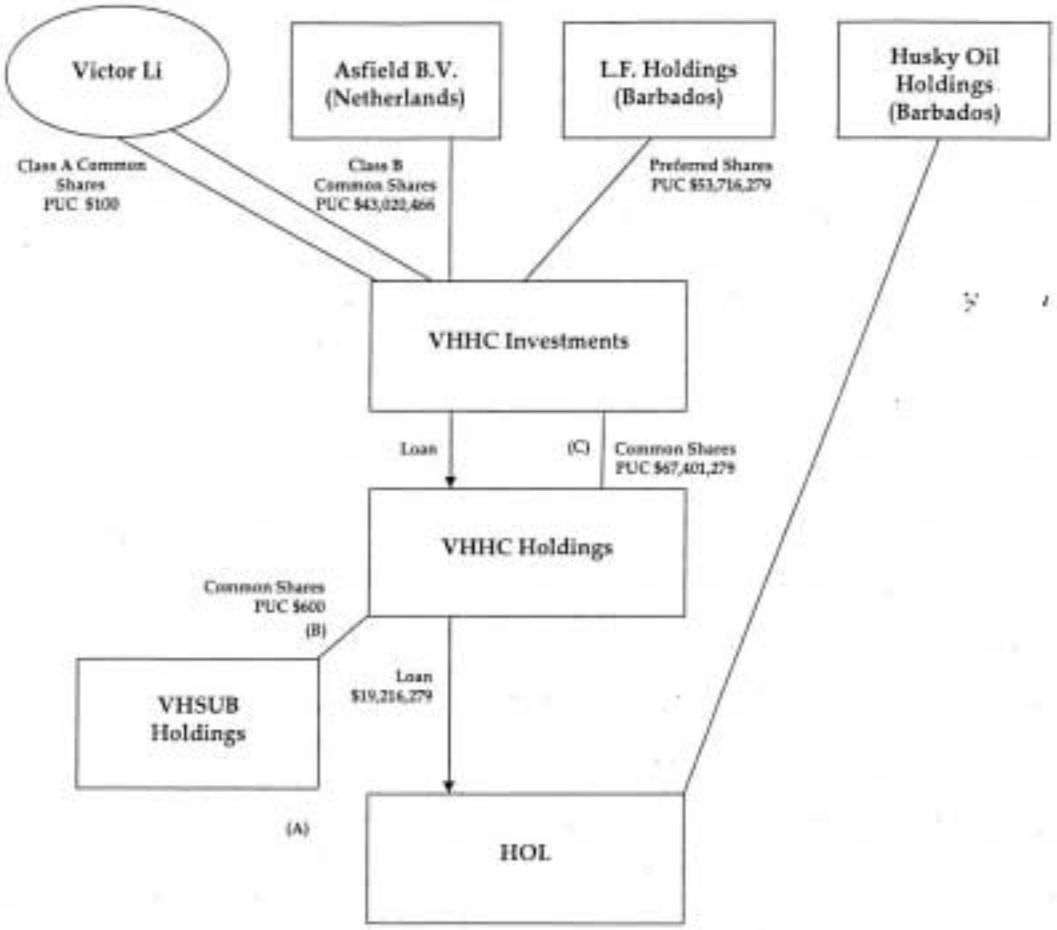
DIAGRAM #3
(1991)



Notes:

(A) VHHC Holdings transfers its 26,813,308 common shares of HOL valued at $52,326,171 to VHSUB Holdings in exchange for additional common shares of VHSUB Holdings. The transaction increases the PUC of the common shares of VHSUB Holdings to $66,826,171. See par. 19(e) of JSF.

DIAGRAM #4
(1991)



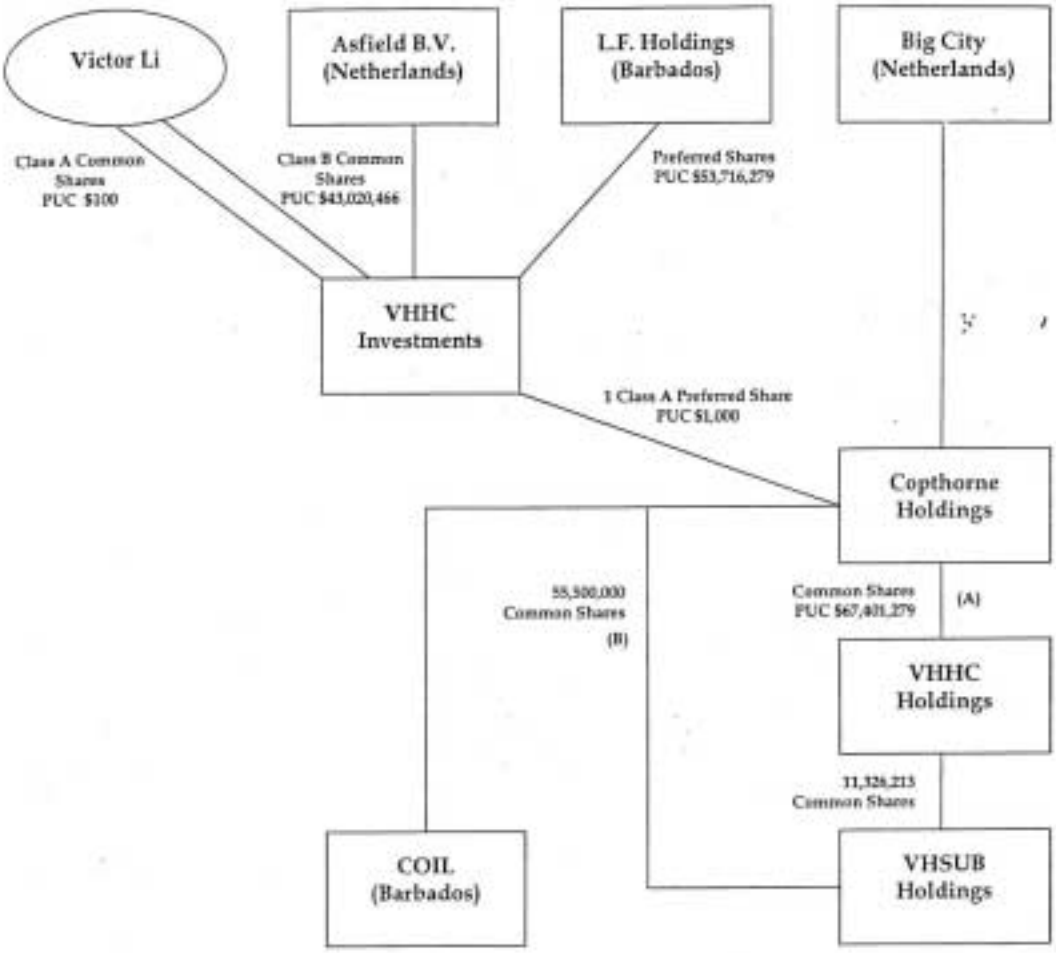
Notes :

(A) VHSUB Holdings sells all its shares of HOL for approximately $86,825,000 to Husky Oil Holdings Ltd., a newly-formed Barbados company that, at the same time, acquires all of the other issued shares of HOL.

(B) VHSUB Holdings uses $20,000,000 of the sale proceeds from (A) to redeem all the preferred shares owned by VHHC Investments for an amount of $20,000,000. See par. 19(g) of JSF.

(C) VHHC Investments uses the $20,000,000 amount received in (B) to subscribe for additional common shares of VHHC Holdings, hence increasing their PUC to $67,401,279. See par. 19(g) of JSF.

DIAGRAM #5
(1992)

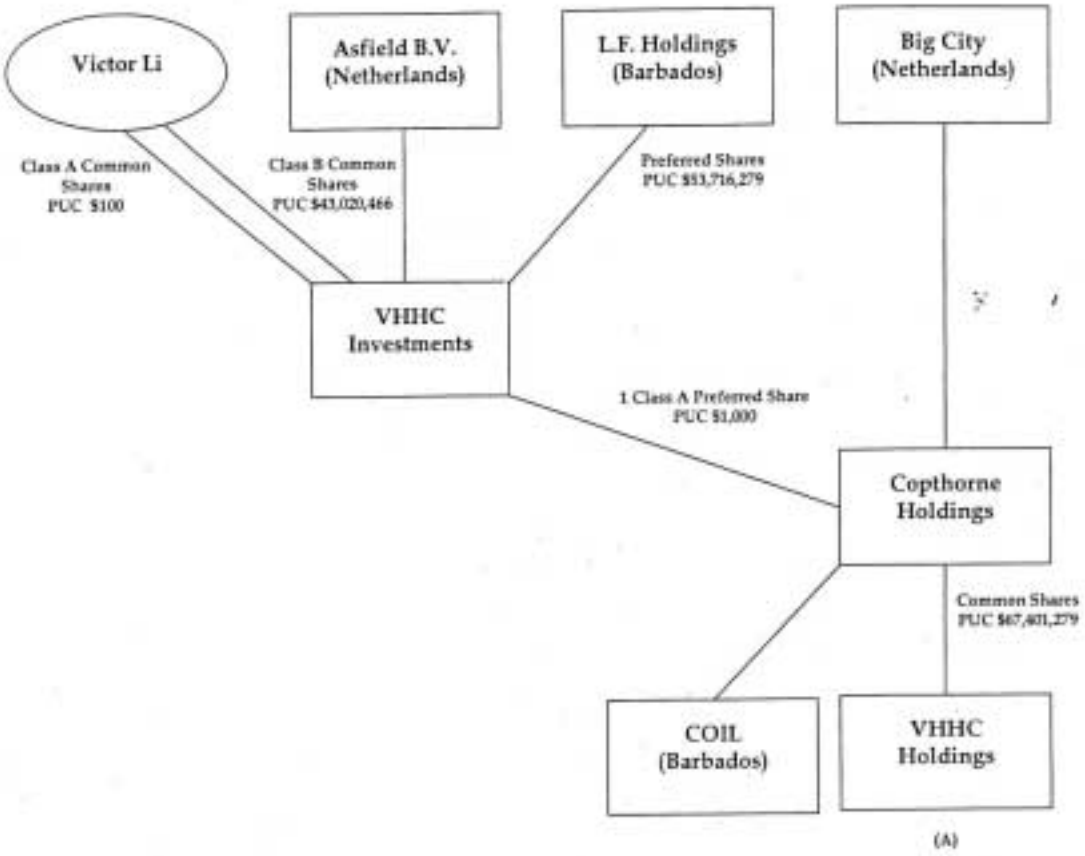


Notes:

(A) VHHC Investments sells all of its shares of VHHC Holdings to Copthorne Holdings for 1 class A special share of Copthorne Holdings valued at $1,000. See par. 26(b) of JSF.

(B) VHHC Holdings sells 55,500,000 of its 66,826,213 common shares of VHSUB Holdings to Copthorne Holdings. See par. 26(c) of JSF.

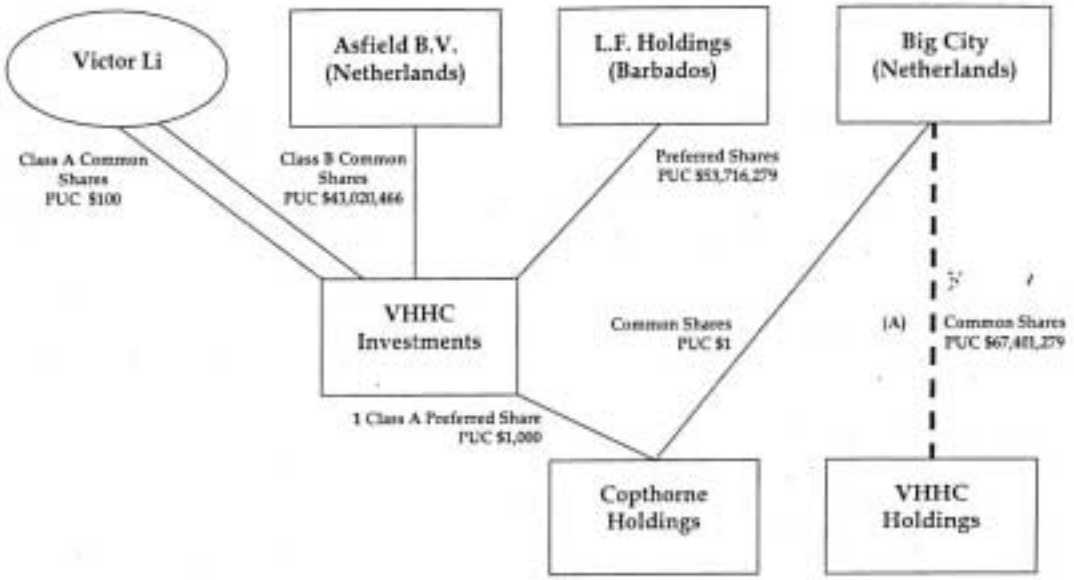
DIAGRAM #6
(1992)



Notes:

(A) Copthorne Holdings and VHHC Holdings sell all their common shares of VHSUB Holdings to an unrelated purchaser for their fair market value. See par. 26(d) of JSF.

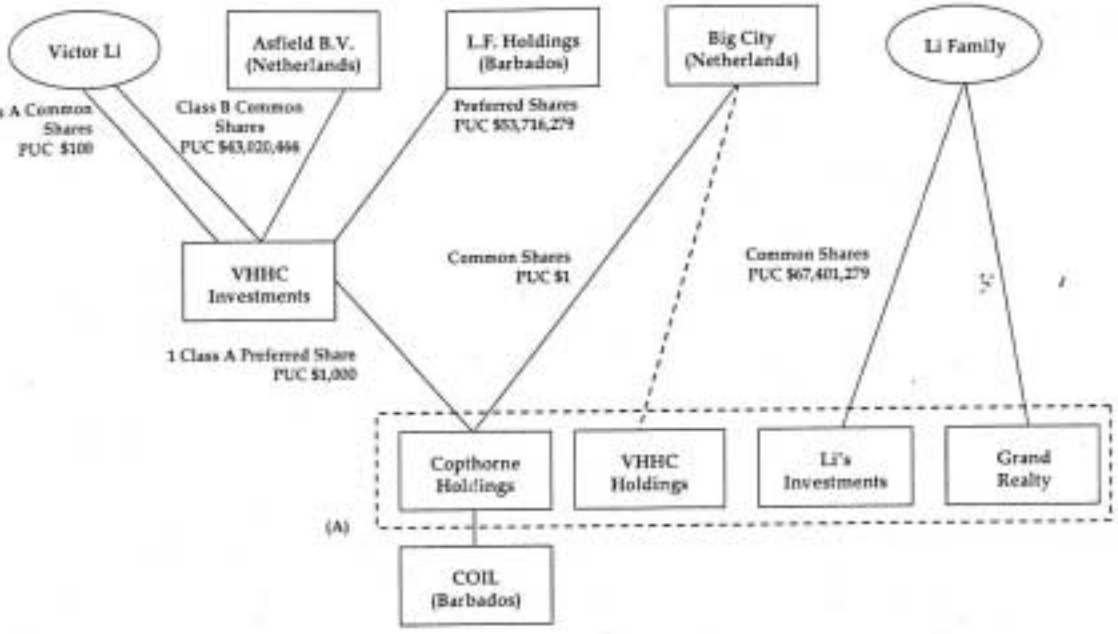
DIAGRAM #7
(JULY 1993)



Notes:

(A) Copthorne Holdings sells all of its common shares of VHHC Holdings to Big City at fair market value ($1,000). See par. 39 of JSF.

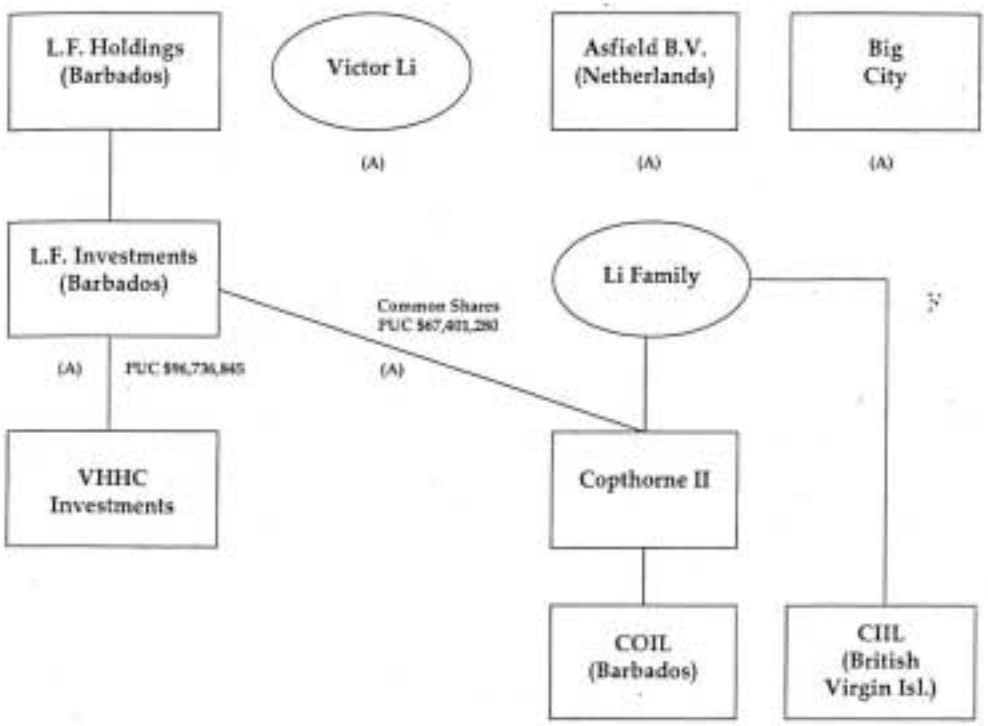
DIAGRAM #8
(JANUARY 1, 1994 - AMALGAMATION)



Notes:

(A) Amalgamation of Copthorne Holdings, VHHC Holdings, Li's Investments and Grand Realty to form "Copthorne II". See par. 40 of JSF.

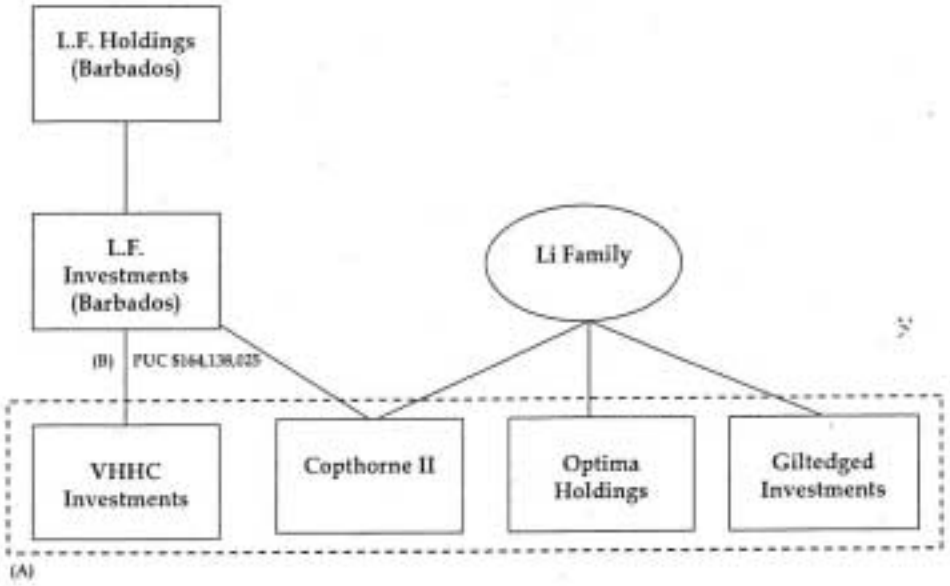
DIAGRAM #9
(DECEMBER 1994)



Notes:

(A) L.F. Investments acquires (i) all the shares of VHHC Investments owned by Victor Li, Asfield B.V. and L.F. Holdings with a total PUC of $96,736,845) and (ii) the shares of Copthorne II owned by Big City with a total PUC of $67,401,280. See par. 45(f) of JSF.

DIAGRAM #10
(JANUARY 1, 1995 - AMALGAMATION)



Notes:

(A) Amalgamation of VHHC Investments, Copthorne II, Optima Holdings and Giltedged Investments to form "Copthorne III". See par. 45(i) of JSF.

(B) Total PUC of shares of Copthorne III owned by L.F. Investments is $164,138,025.

2002-1316(IT)G

TAX COURT OF CANADA

BETWEEN:

COPTHORNE HOLDINGS LTD.

Appellant

and

HER MAJESTY THE QUEEN

Respondent

JOINT STATEMENT OF FACTS AND LAW

John H. Sims, Q.C.
Deputy Attorney General of Canada
Per: Franco Calabrese
Department of Justice
Ontario Regional Office
Tax Law Services Section
The Exchange Tower
130 King Street West
Suite 3400, Box 36
Toronto, Ontario
M5X 1K6

Tel: (416) 954-9988
Fax: (416) 973-0810
File: 3-493208

Counsel for the Respondent

Appendix “B”

Diagram #1: The Original Players (1987)

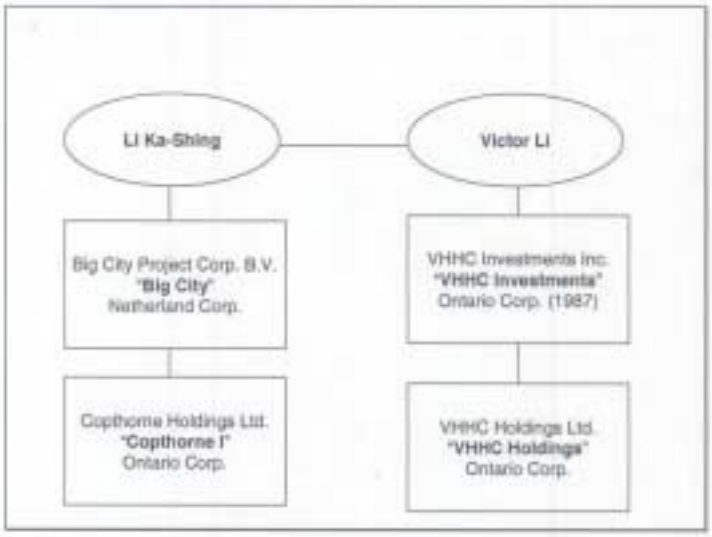


Diagram #2: Holdings of Husky Oil Limited (“HOL”) in 1987

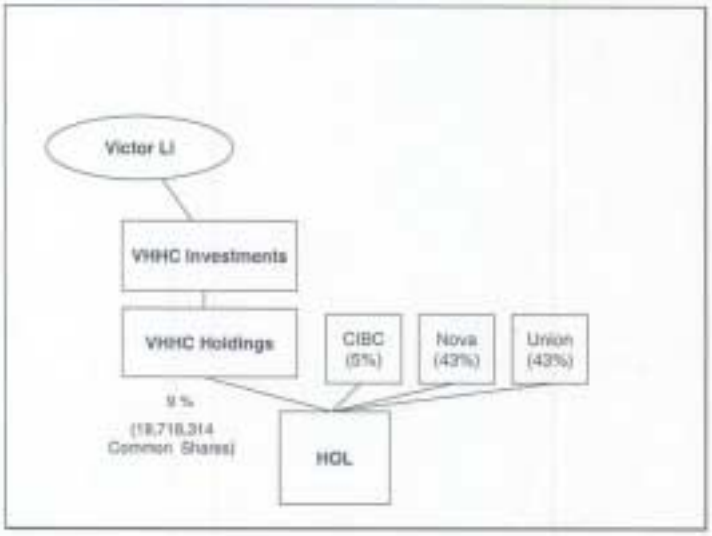
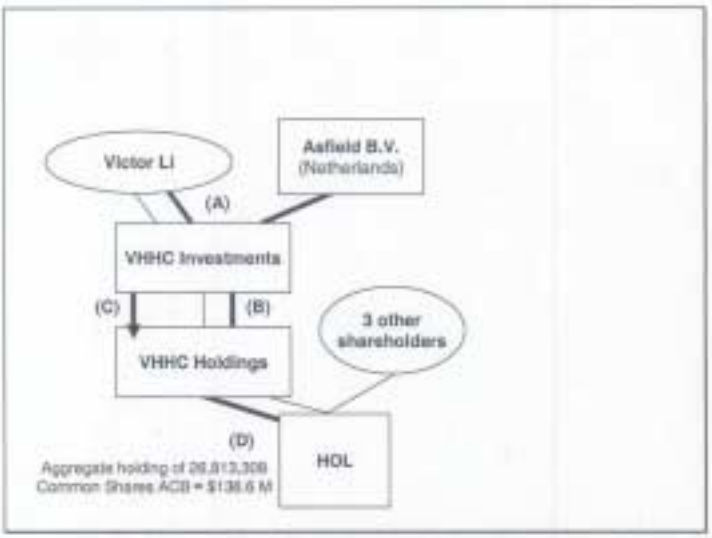
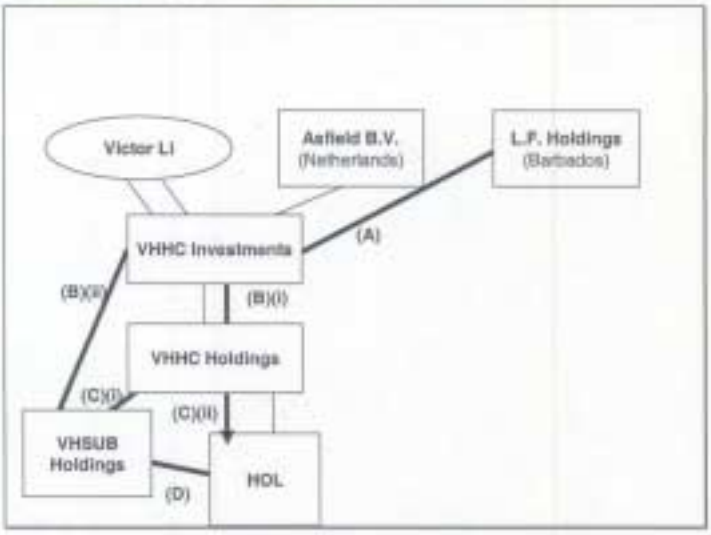


Diagram #3: 1989 Transactions



(A) Asfield B.V. & Victor Li invested $54,740,000 in 54,740,000 Class B Non-Voting Shares. In 1989, $11,719,534 was returned as a reduction in stated capital, leaving PUC $43,020,466.
(B) VHHC Investments invested $13,685,000 in 13,685,000 common shares of VHHC Holdings.
(C) The remaining balance from A was advanced to VHHC Holdings by way of a loan.
(D) VHHC Holdings acquired an additional 7,094,994 common shares of HOL with subscription funds and borrowed funds (together with other borrowed funds).

Diagram #4(i): December 1991 Transactions



(A) L.F. Holdings acquired 53,716,279 non-voting redeemable preferred shares of VHHC Investments for $53,716,279.
(B)(i) VHHC Investments subscribed for 33,716,279 common shares of VHHC Holdings (increasing PUC by $33,716,279).
(B)(ii) VHHC Investments subscribed for 20,000,000 preferred shares of VHSUB Holdings (PUC $20,000,000).
(C)(i) VHHC Holdings subscribed for 14,500,000 commons shares of VHSUB Holdings (using $14,500,000 from B(i)).
(C)(ii) VHHC Holdings loaned $19,216,279 (remainder of funds from B(i)) to HOL.
(D) VHSUB used $20,000,000 (from B(ii))+ $14,500,000 (from C(i)) to invest in common shares of HOL.

Diagram 4(ii): Summary of Holdings & PUC after December 1991 Transactions

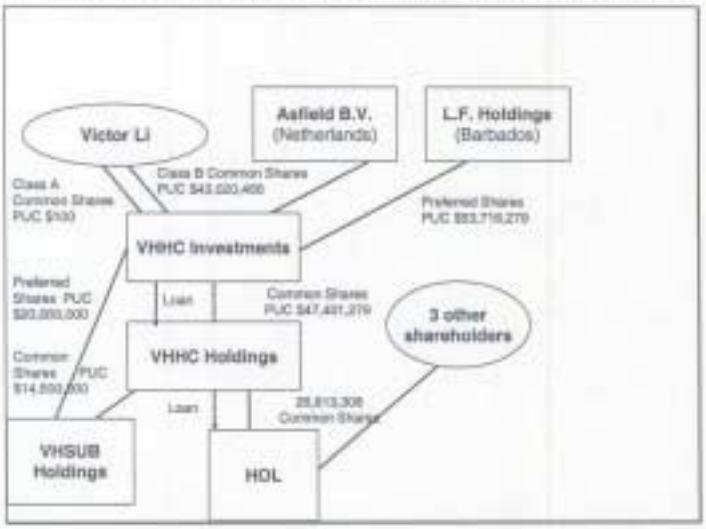
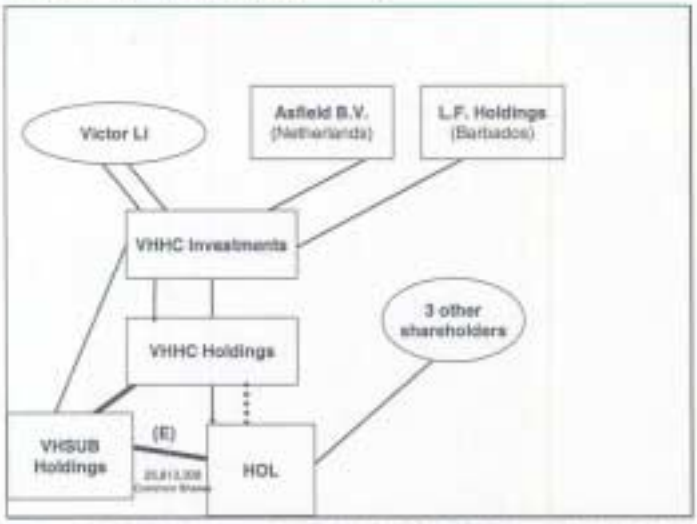
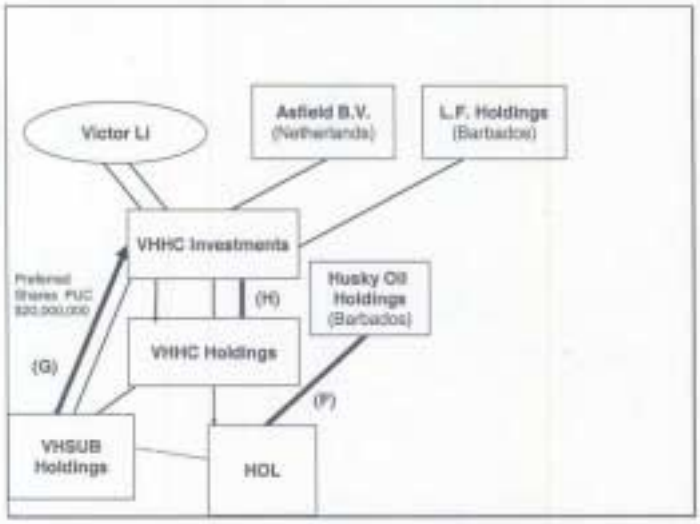


Diagram 4(iii): Transfer of HOL Shares



(E) VHHC Holdings transferred 26,813,308 common shares of HOL @ $1.9515/share to VHSUB Holdings in exchange for additional common shares of VHSUB Holdings (increases PUC of VHSUB Holdings to $66,826,171).
VHHC Holdings realized a capital loss of $84.3 million because of decline in value of HOL common shares. This loss was denied under s. 40(2)(e) and 85(4)(a) and added to ACB of Common Shares of VHSUB Holdings.

Diagram #4(iv): Sale of HOL Shares



(F) VHSUB Holdings sold all of its shares of HOL for approximately $86,825,000 to Husky Oil Holdings Ltd., a newly-formed Barbados company that, at the same time, acquires all of the other issued shares of HOL from the other three shareholders.
(G) VHSUB Holdings redeemed 20,000,000 preferred shares held by VHHC Investments, using the proceeds from the sale of the HOL common shares.
(H) VHHC Investments subscribed for an additional 20,000,000 Common Shares of VHHC Holdings.

Diagram #4(v): Summary of Holdings and PUC

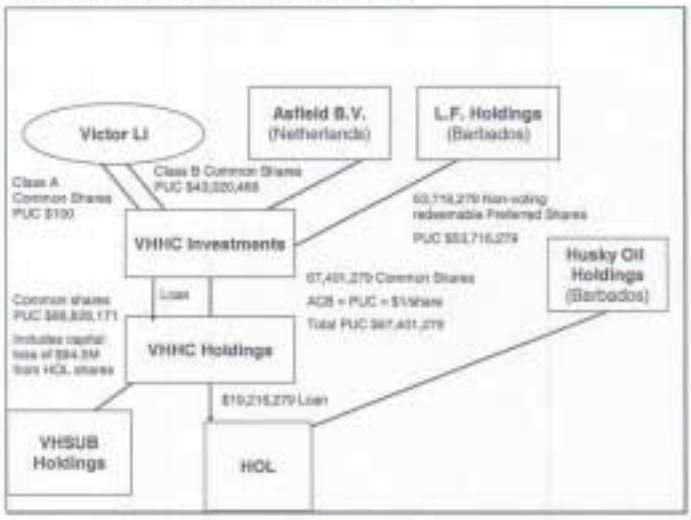


Diagram #5(i): Li Ka-Shing, Big City, & Copthorne I

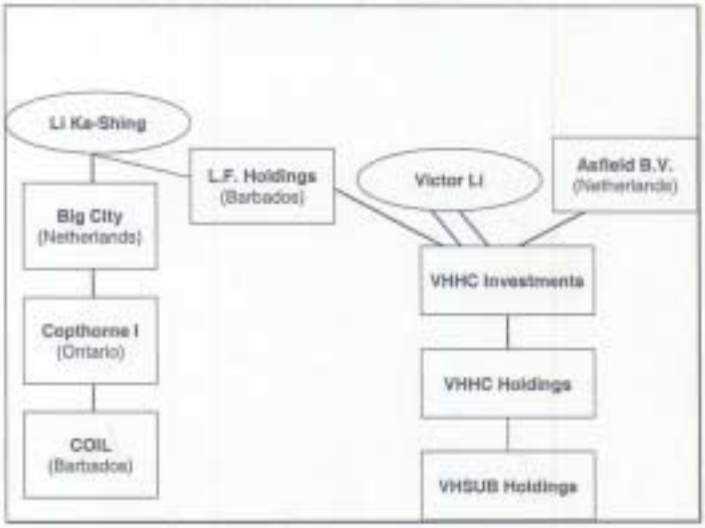


Diagram #5(ii): Sale VHHC Holdings to Copthorne I

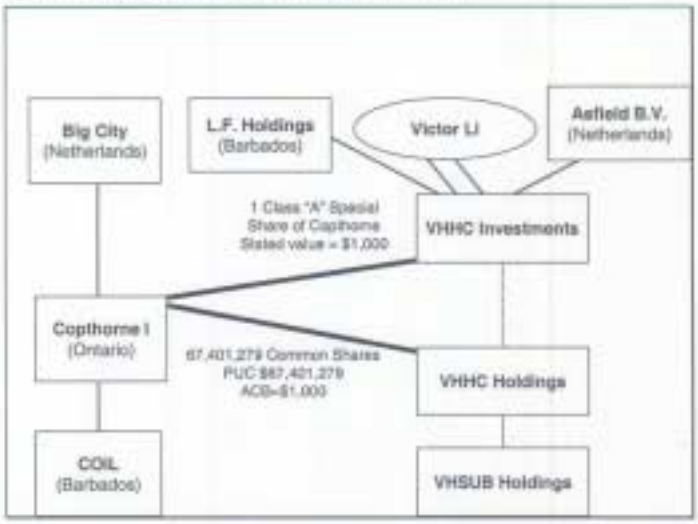
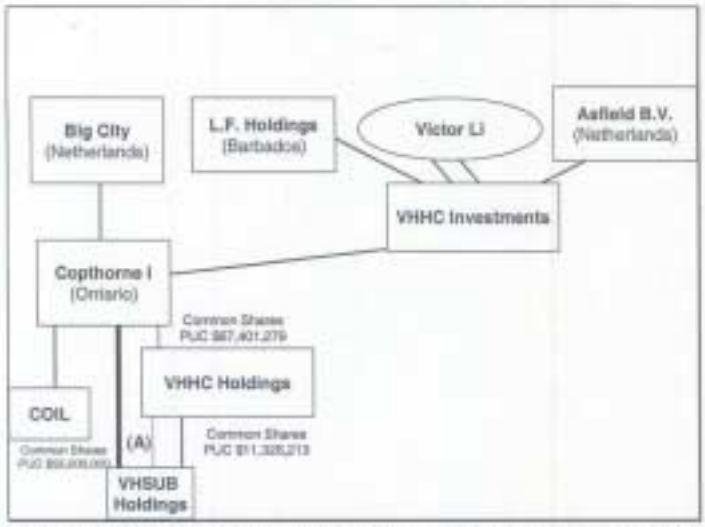
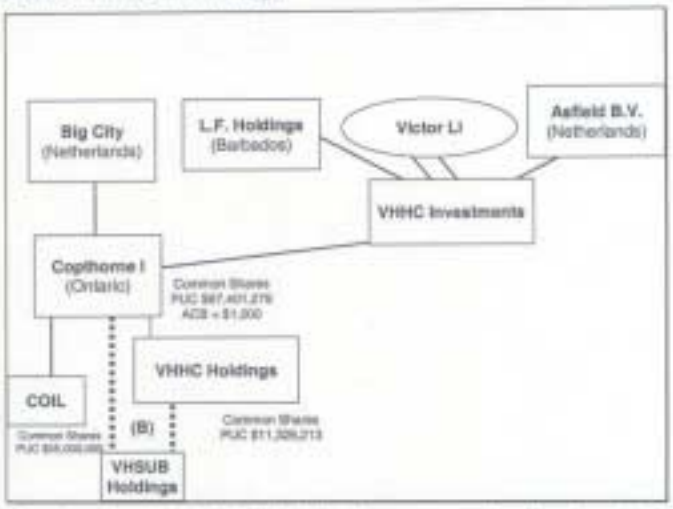


Diagram #5(iii): Sale VHSUB Holdings Shares to Copthorne



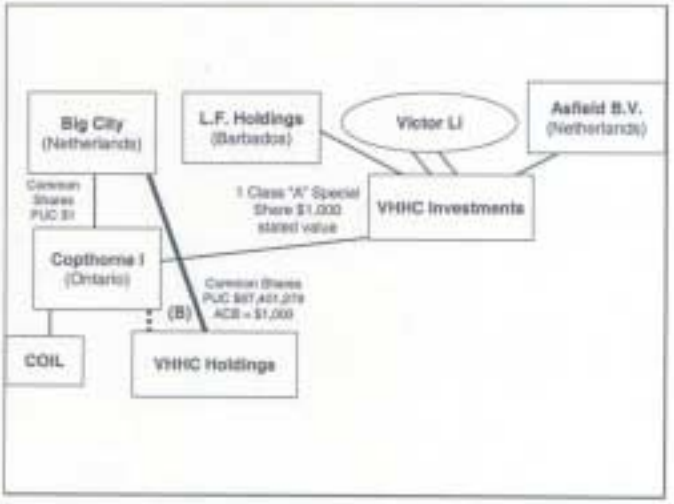
(A) VHHC Holdings sold 55,500,00 of its 66,826,213 common shares of VHSUB Holdings to Copthorne I. The Appellant argues that the transfer was not undertaken for any purpose related to the PUC of shares but rather the sole objective of this transaction was to shift the inherent loss on VHHC Holdings' shares of VHSUB to offset 1989 capital gain from the sale of the Harbour Castle Hotel.

Diagram #5(iv): Sale VHSUB Holdings



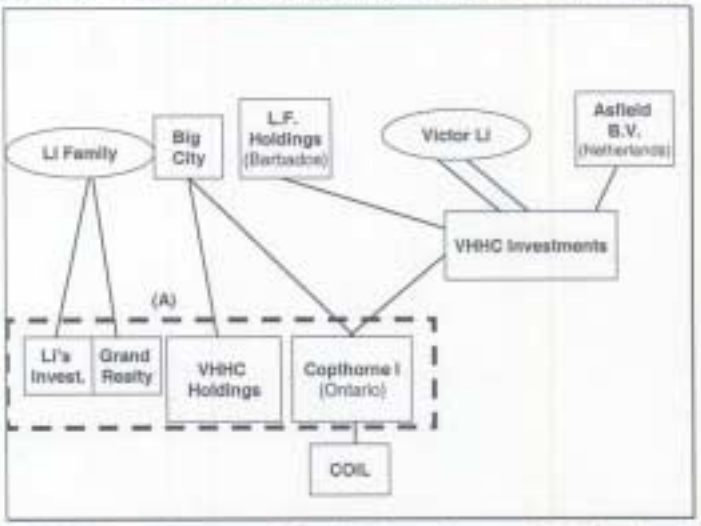
(B)VHHC Holdings and Copthorne I sold their VHSUB Holdings shares to an unrelated purchaser for FMV. They subsequently claimed capital losses. [JSF - 26(d)].

Diagram #5(v): Sale VHHC Holdings shares to Big City



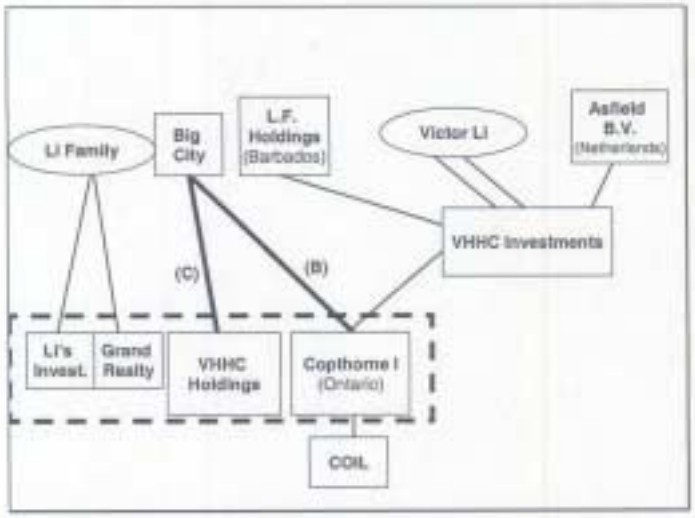
(B) Copthorne I sold all of its $67,401,279 common shares of VHHC Holdings to Big City for $1,000.

Diagram #6(i): Amalgamation and Creation of Copthorne II (January 1, 1994)



(A) Copthorne I, VHHC Holdings, Li's Investments and Grand Realty amalgamate to form "Copthorne II".

Diagram #6(ii): Exchange of Shares for Shares of Copthorne II



(B) 1 Common Share of Copthorne I converted into 20,000,000 common shares of Copthorne II.
(C) 67,401,279 common shares of VHHC Holdings converted into 1,000 common shares of Copthorne II.

Diagram #6(iii): Summary of Holdings & PUC after Amalgamation

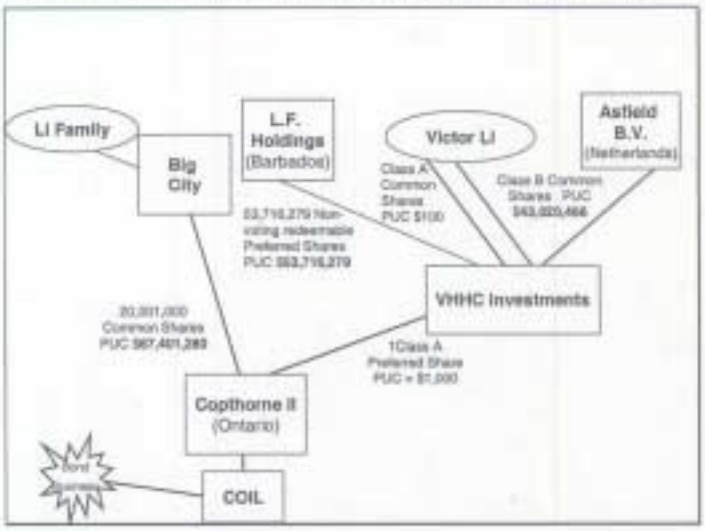
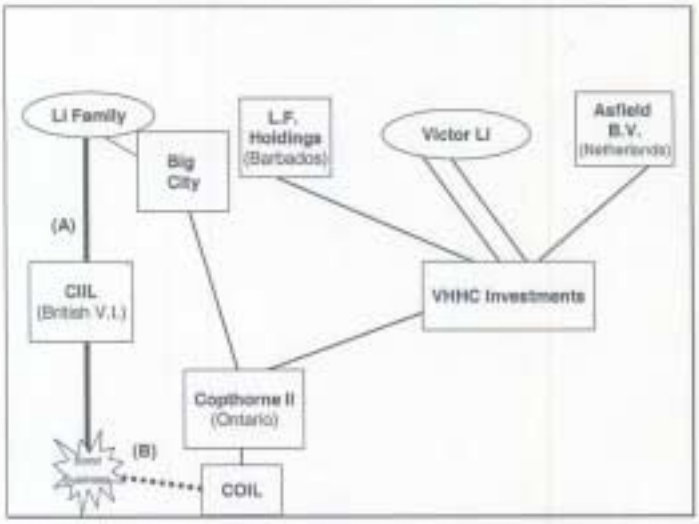
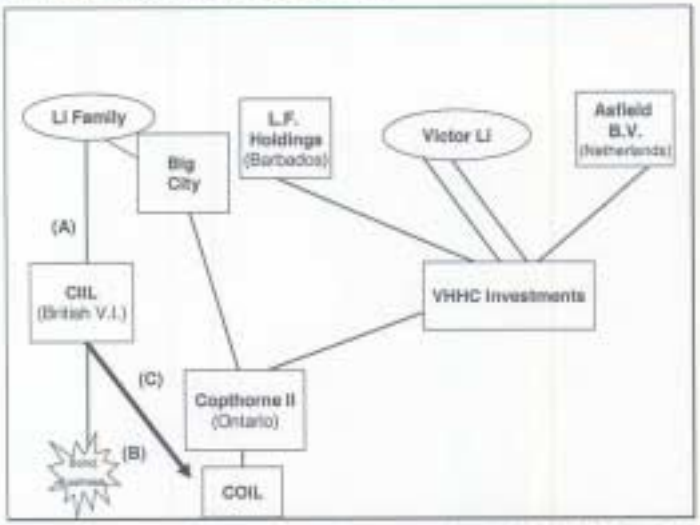


Diagram #7(i): Sale of Bond Business to CIIL



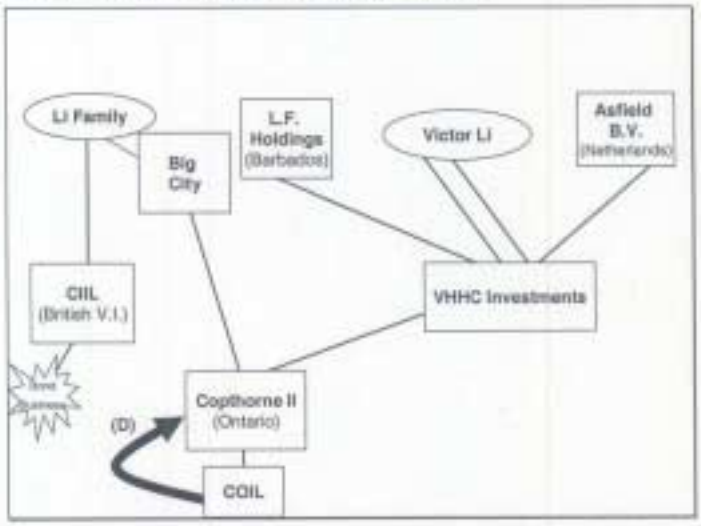
(A) The Li Family incorporated a new British Virgin Islands company, Copthorne International Investment Ltd. ("CIIL").
(B) COIL sold bond trading business to CIIL as a going concern for $367,417,889.

Diagram #7(ii): Sale of Bond Business to CIIL



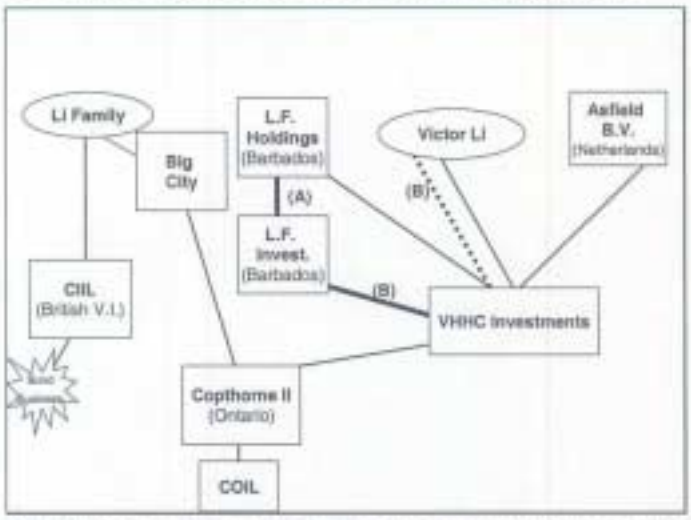
(C) Sale price ($367,417,889) was paid to COIL with 5 promissory notes (Note 1 $1,073,035; Note 2 $29,000,000; Note 3 $30,000,000; Note 4 $142,035,895; Note 5 $165,308,959).

Diagram #7(iii): Transfer of Proceeds to Copthorne II



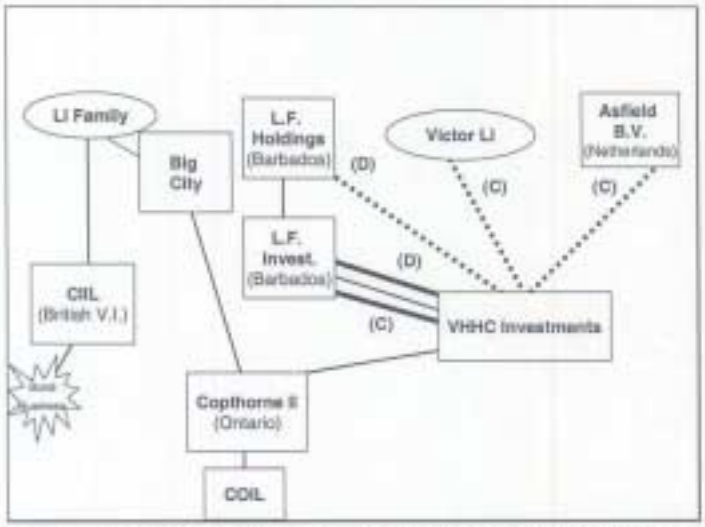
(D) Notes 1, 2, 3 ($1,073,035, $29,000,000, $30,000,000) distributed to Copthorne II for a reduction of paid-up capital. Funds were then used for repayment of $60,073,035 related non-resident debt.
Note 4 ($142,035,895) also distributed to Copthorne II for a reduction of paid-up capital.

Diagram #8(i): November 22 to December 14, 1994 Transactions



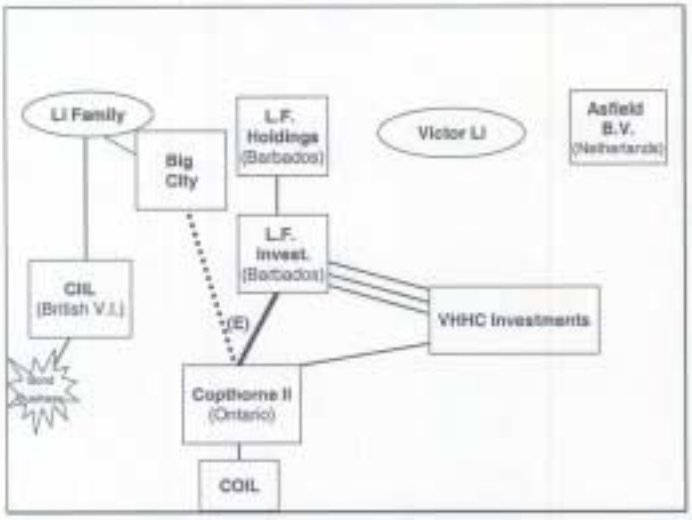
(A) On November 22, 1994, L.F. Holdings incorporated a new Barbados company, L.F. Investments (Barbados) Ltd.
(B) Victor Li sold 100 Class A common shares (PUC $100) of VHHC Investments to L.F. Investments for nominal fair market value.

Diagram #8(ii): December 14, 1994 Transactions



(C) Victor Li and Asfield B.V. sold 54,740,000 Class B common shares (PUC $43,020,466) of VHHC Investments to L.F. Investments for nominal fair market value.
(D) L.F. Holdings sold 53,716,279 Pref. shares (PUC $53,716,279) of VHHC Investments with a stated value of $29,000,000.

Diagram #8(iii): December 14, 1994 Transactions



(E) Big City sold **20,001,000** common shares of Copthorne II (PUC = $67,401,280) to L.F. Invest. for $150,000,000 (FMV).

Diagram #8(iv): Structure and PUC after Transactions

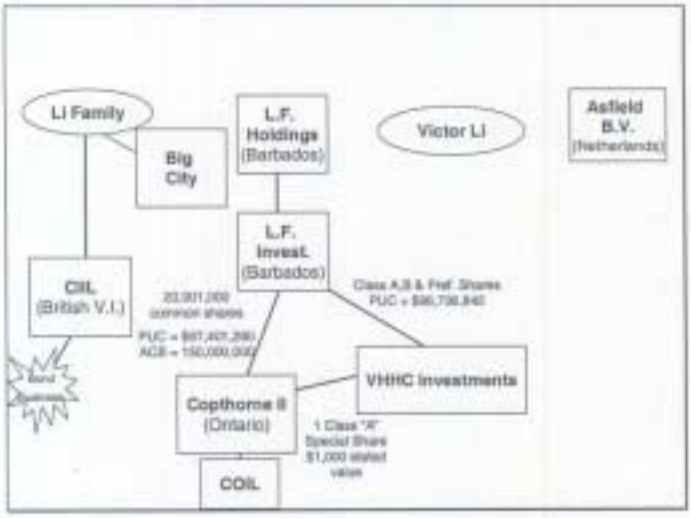
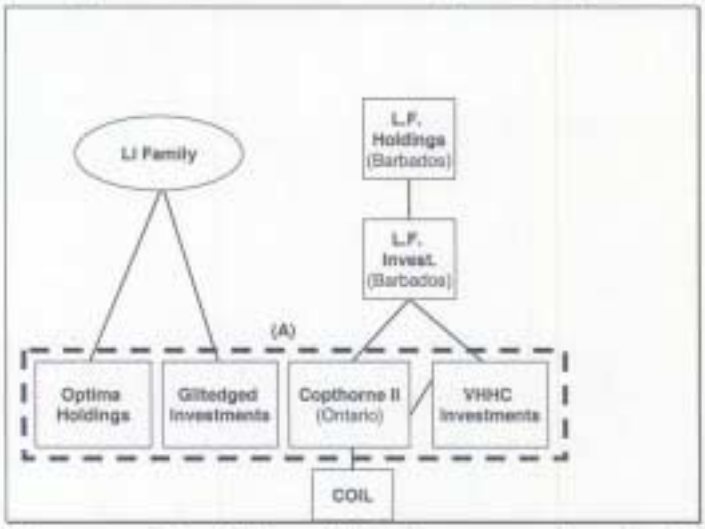
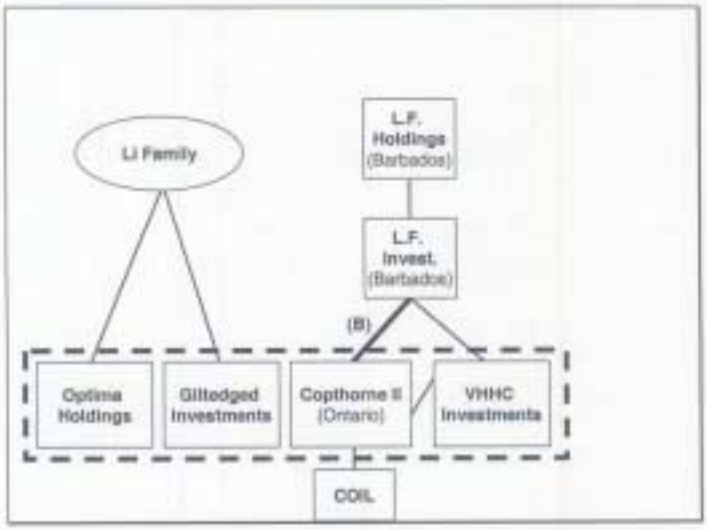


Diagram #9(i): Amalgamation and Creation of Copthorne III (January 1, 1995)



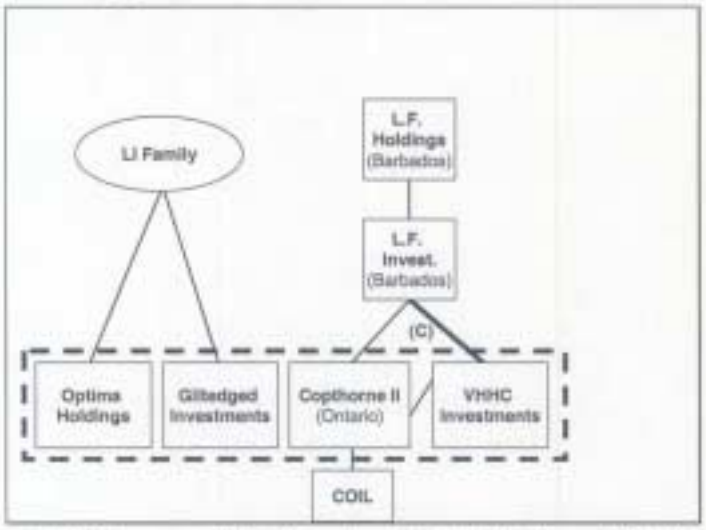
(A) Copthorne II, VHHC Investments, Optima Holdings and Giltedged Investments amalgamated to form "Copthorne III".

Diagram #9(ii): Exchange of Copthorne II's Shares



(B) 20,001,000 common shares of Copthorne II (PUC **$67,401,280**), exchanged for 1,000 Common Shares (PUC$1); 134,638,000 D Pref. Shares (PUC $134,638,000); and 15,361,000 F Pref. Shares (PUC $99).

Diagram #9(iii): Exchange of VHHC Investments' Shares



(C) 100 Class A shares of VHHC Investments (PUC $100) exchanged for 10 D Pref. Shares (PUC $10).
54,740,000 Class B shares of VHHC Investments (PUC **$43,020,466**) exchanged for 15 D Pref. Shares (PUC $15).
53,716,279 Pref. shares of VHHC Investments (PUC **$**53,716,279) exchanged for 29,500,000 D Pref. Shares (PUC $ 29,500,000).

Diagram #10(i): Summary of Copthorne III's PUC Calculation

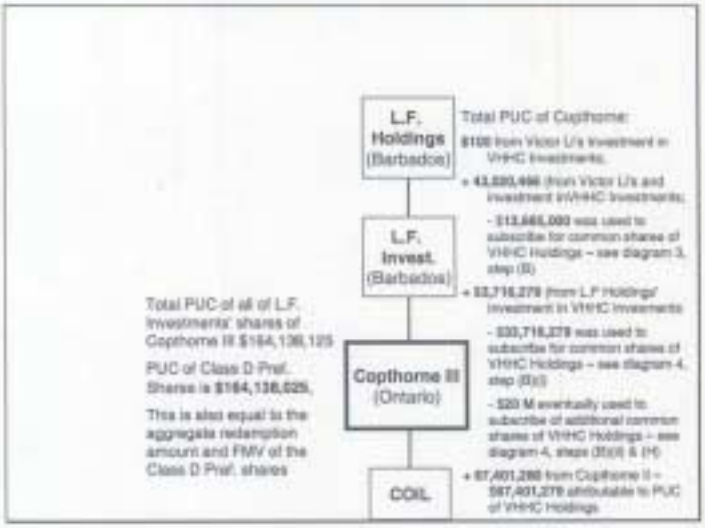
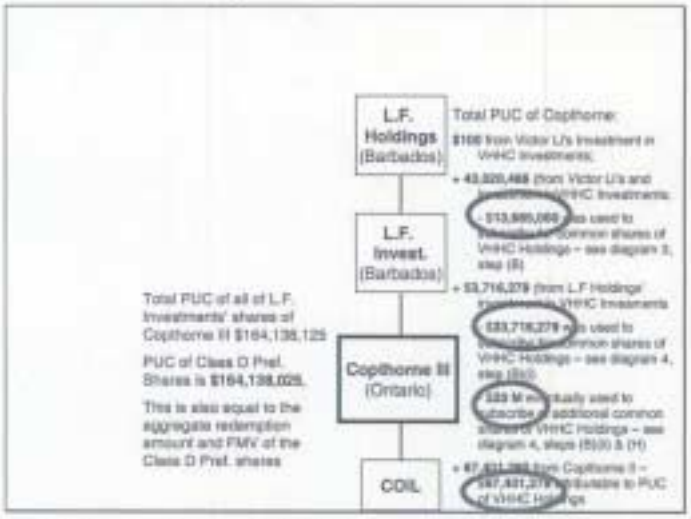
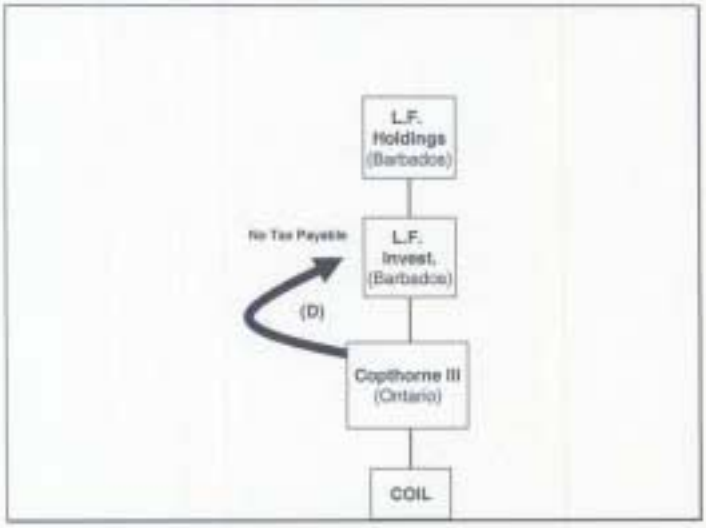


Diagram #10(ii): Double Counting of PUC



Therefore, the result of the series of transactions is that PUC, in the amount of $67,401,279, is essentially double counted in the total PUC of Copthorne III.

Diagram #11: Redemption of Class D Shares



(D) Copthorne III redeemed 142,035,895 of the Class D Pref. Shares by endorsing Note 4 ($142,035,895) that was received from CIIL. Because the total PUC of the Class D Pref. Shares redeemed was equal to the aggregate redemption amount, no income tax was payable under 84(3) and 212(2)(a).

CITATION:	2007TCC481
COURT FILE NO.:	2002-1316(IT)G
STYLE OF CAUSE:	Copthorne Holdings Ltd. and Her Majesty the Queen
PLACE OF HEARING:	Toronto, Ontario
DATE OF HEARING:	November 30 and December 1, 2006
REASONS FOR JUDGMENT BY:	The Honourable Justice Diane Campbell
DATE OF JUDGMENT:	August 28 2007

APPEARANCES:

Counsel for the Appellant:	Richard W. Pound, Q.C. and Pierre-Louis Le Saunier
Counsel for the Respondent:	Eric Noble Franco Calabrese Martin Beaudry

COUNSEL OF RECORD:

For the Appellant:

Name:	Richard W. Pound, Q.C. and Pierre-Louis Le Saunier
Firm:	Stikeman Elliott Montreal, Québec
For the Respondent:	John H. Sims, Q.C. Deputy Attorney General of Canada Ottawa, Canada