

Docket: 2009-2494(IT)G

BETWEEN:

10737 NEWFOUNDLAND LIMITED,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeals heard on February 10, 2011, at Montréal, Québec.

Before: The Honourable Gerald J. Rip, Chief Justice

Appearances:

| | |
|-----------------------------|------------------------------------|
| Counsel for the Appellant: | Wilfrid Lefebvre Vincent Dionne |
| Counsel for the Respondent: | Natalie Goulard Pierre Cossette |

JUDGMENT

The appeals from the assessments made under the *Income Tax Act* for the 1999, 2000 and 2004 taxation years are allowed, with costs, and the assessments are referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that the appellant incurred an allowable capital loss in its 2002 taxation year and it may carry back the said loss to its 1999 and 2000 taxation years and carry forward part of the loss to its 2004 taxation year.

Signed at Ottawa, Canada, this 11th day of July 2011.

"Gerald J. Rip"

Rip C.J.

Citation: 2011 TCC 346
Date: 20110711
Docket: 2009-2494(IT)G

BETWEEN:

10737 NEWFOUNDLAND LIMITED,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Rip C.J.

[1] The appellant, 10737 Newfoundland Limited, appeals income tax assessments for 1999, 2000 and 2004 in which the Minister of National Revenue ("Minister") disallowed the appellant's claim in its 2002 taxation year for an allowable capital loss on a disposition of "exchangeable shares" in exchange for shares of a foreign corporation. The allowable capital losses were applied in 2002 and carried back to 1999 and forward to 2004. The Minister invoked what is generally referred to as "stop loss" rules in subsections 40(3.3), (3.4) and (3.5) of the *Income Tax Act* ("Act") to deny the capital loss. These rules defer recognition of capital losses.

[2] An "exchangeable share" has been described as "a share of a Canadian corporation (...) that, together with some ancillary rights, replicates as closely as possible the economics (and to some extent the legal rights engaged by holders) of a share of another corporation"¹.

[3] Another author has explained that the use of the exchangeable shares is particularly suited when a non-resident corporation, a "Foreign Acquiror", wishes to acquire shares of a Canadian resident corporation in certain circumstances. "The

¹ Steve Suarez and Pooja Samtani, "Using Exchangeable Shares in Inbound Canadian Transactions", 2007, 48:13, *Tax Notes Int'l* 1281.

principal purpose of [the use of exchangeable shares] from a Canadian tax perspective is to offer Canadian resident shareholders of [the Canadian resident corporation] the opportunity to tender their shares [...] in exchange for exchangeable shares issued by [the Canadian resident corporation] ..., in a manner that provides the Canadian resident selling shareholders with the opportunity to obtain a tax deferred disposition (i.e. rollover) of such shares for purposes of the *Income Tax Act*. The exchangeable shares are exchangeable into shares of the Foreign Acquiror and are intended in an economic sense to be equivalent to shares of the Foreign Acquiror²."

[4] Exchangeable shares of a Canadian corporation are usually created on the reorganisation of the capital of the corporation, converting common shares to exchangeable shares in proportion of one exchangeable share to one Foreign Acquiror, share for which the exchangeable shares will eventually be exchanged. The shares of the Foreign Acquiror that are exchanged for the shareholder's exchangeable shares represent payment for the acquisition of the shares of the Canadian corporation.

[5] The basic condition of an exchangeable share is generally the right of the holder of the exchangeable share to demand that the exchangeable share of the Canadian resident corporation be retracted (i.e. redeemed) by the Canadian corporation for an equal number of shares of the Foreign Acquiror or that the Foreign Acquiror purchase the exchangeable shares with payment of an equal number of its own shares. The rights and conditions of the Exchangeable Shares and the corporate agreements relating to the transaction describe the process by which the erstwhile shareholder of the Canadian resident corporation becomes the shareholder of the Foreign Acquiror.

[6] In 2002 the appellant disposed of a number of Newbridge Exchangeable Shares ("Exchangeable Shares") and, in return, acquired Alcatel American Depositary Shares ("Alcatel ADSs" or "ADSs") within the 61 day period described in paragraphs 40(3.3)(b) and (c). The appellant's cost base of the Exchangeable Shares was greater than the value of the ADSs at time of the disposition of the Exchangeable Shares and therefore the appellant incurred a capital loss. The Minister, on reviewing the facts leading to the disposition, was of the view that the appellant, as an owner of the Exchangeable Shares, had a right to redeem the Exchangeable Shares for ADSs. The Minister concluded that the appellant acquired property, the ADSs, identical to

² Geoffrey S. Turner, "Exchangeable Shares: Achieving Deferral in a Cross-Border Acquisition", Paper delivered at the Tax Smart Strategies for M&A Conference, June 10-11, 1999 (Toronto: The Canadian Institute, 1999), at 1.

the Exchangeable Shares within the meaning of paragraph 40(3.3)(b) of the *Act*, citing subsection 40(3.5), and denied the loss in accordance with paragraph 40(3.4)(a) of the *Act*.

[7] The appellant's position is that the Exchangeable Shares and the ADSs are not identical properties pursuant to paragraph 40(3.3)(b) of the *Act* but shares of two distinct and separate legal entities. An Exchangeable Share, counsel argued, is not a "right to acquire" an ADS within the meaning of paragraph 40(3.5)(a) of the *Act*. The appellant says that it did not dispose of "a right to acquire" the ADSs; it disposed of Exchangeable Shares. Therefore, paragraph 40(3.5)(a), which deems a "right to acquire a property" to be identical to the property, does not apply to the facts at bar.

[8] The evidence was adduced by the following "Partial Agreed Statement of Facts":³

Merger of Newbridge and Alcatel

1. On February 23, 2000, Newbridge Networks Corporation ("**Newbridge**") entered into a Merger Agreement with Alcatel, a corporation governed by the laws of France, pursuant to which Alcatel would, subject to certain conditions, become the indirect owner of all of the Common Shares of Newbridge⁴. Prior to the merger, Newbridge and Alcatel were not "affiliated" for the purpose of the *Income Tax Act*.
2. The merger was completed on May 25, 2000, under the terms of a court-approved Plan of Arrangement (the "Arrangement")⁵.
3. The terms of the Arrangement gave the shareholders of Newbridge the option to receive as consideration for their Common Shares, either:
 - a. 0.81 Alcatel American Depositary Share ("Alcatel ADS") for each Newbridge Common Share; or
 - b. 0.81 Exchangeable Shares of Newbridge (and certain ancillary rights) for each Newbridge Common Share; or

³ There was no other evidence; the Partial Agreed Statement included all the facts.

⁴ The Exhibits to the Statement of Facts are not included in these reasons.

⁵ Certificate of Arrangement, Articles of Arrangement and Plan of Arrangement were issued pursuant to the *Canada Business Corporations Act*, all dated May 25, 2000, the Arrangement involving Newbridge Networks Corporation and Alcatel / Notice of Special Meeting of Securityholders and Management Information Circular of Newbridge Networks Corporation, are dated April 10, 2000.

- c. a combination of the above.
4. Pursuant to the Arrangement the following events, among others, occurred:
 - a. the authorized share capital of Newbridge was reorganized by creating a new class of shares, the Exchangeable Shares;
 - b. each Newbridge Common Shares (other than those held by "Dissenting Shareholders"⁶ or held by Alcatel or any of its affiliates) was changed into 0.81 Exchangeable Shares;
 - c. Newbridge issued one Common Share to Alcatel Holdings Canada Corp. ("Alcatel Holdings"), a company wholly-owned indirectly by Alcatel;
 - d. each Exchangeable Share (other than the Exchangeable Shares that the holders elected to retain as Exchangeable Shares) was transferred by its holder to Alcatel Holdings in exchange for one Alcatel ADS;
 - e. each Exchangeable Share held by Alcatel Holdings was then transferred by Alcatel Holdings to Newbridge in exchange for that number of Newbridge Common Shares equal to one divided by the exchange ratio (0.81).
 5. Upon completion of the Arrangement, Alcatel Holdings held all of the issued and outstanding Common Shares of Newbridge. Former holders of Common Shares of Newbridge who had elected to receive Exchangeable Shares held all of the issued and outstanding Exchangeable Shares.

Exchangeable Shares

6. The Exchangeable Shares (together with certain ancillary rights) were intended to be economically equivalent to the Alcatel ADSs, with the exception that holders of the Exchangeable Shares are not entitled to attend or vote at any meeting of the shareholders of Alcatel (although they are entitled to notice thereof).
7. Holders of Exchangeable Shares are entitled to receive from Newbridge, subject to applicable law, dividends that are economically equivalent to any distributions paid on Alcatel ADSs resulting from dividends declared on the Alcatel Shares.

⁶ Those Registered Newbridge Shareholders who dissented in respect of the Arrangement Resolution who were consequently entitled to be paid the fair value of the Newbridge Common Shares held by them.

8. The Exchangeable Shares are subject to adjustment or modification in the event of a stock split or other change to the capital of Alcatel so as to maintain the initial one-to-one relationship between the Exchangeable Shares and the Alcatel ADSs.
9. The Management Information Circular of Newbridge, which describes the Arrangement, provides that "Exchangeable Shares may be exchanged at any time, on a one for one basis, for Alcatel ADSs at the option of the holder."
10. Holders of Exchangeable Shares are entitled at any time, subject to the exercise by Alcatel Holdings of its "Retraction Call Right", to require Newbridge to redeem any or all of the Exchangeable Shares registered in their name (the "Retracted Shares"). If Alcatel Holdings exercises its "Retraction Call Right", instead of Newbridge redeeming the Exchangeable Shares, Alcatel Holdings purchases the Retracted Shares from the holder.
11. Whether the Exchangeable Shares are redeemed by Newbridge or purchased by Alcatel Holdings, the amount paid per share is equal to the "Current Market Price" of an Alcatel ADS and is satisfied in full by either Newbridge or Alcatel Holdings causing to be delivered to the holder a certificate representing one Alcatel ADS for each Exchangeable Share (together with the full amount of all declared and unpaid dividend on the Exchangeable Share).
12. If, as a result of solvency requirements or applicable law, Newbridge is not permitted to redeem all Retracted Shares tendered by a retracting holder, Newbridge will redeem only those Retracted Shares as would not be contrary to applicable law and Alcatel Holdings is required to purchase the Retracted Shares not redeemed.

The transactions

13. On May 11, 2000, 3507271 Canada Inc. and 100935 Canada Ltd., who owned Common Shares of Newbridge through a holding company (3748278 Canada Inc.), transferred to Newbridge all of their issued and outstanding shares of 3748278 Canada Inc. in return for new Common Shares of Newbridge to be issued from its treasury. 3507271 Canada Inc. and 100935 Canada Ltd. received, in exchange for their 83,160,690 and 401,189,070 shares of 3748278 Canada Inc., 136,329 and 657,687 Common Shares of Newbridge respectively.
14. Both 3507271 Canada Inc. and 100935 Canada Inc. elected to receive Exchangeable Shares in consideration for their Common Shares of Newbridge and in fact received 110,426 and 532,726 Exchangeable Shares respectively.

15. The exchange of Newbridge Common Shares for Exchangeable Shares was not a taxable event for 3507271 Canada Inc. and 100935 Canada Inc., pursuant to subsection 86(1) of the *Income Tax Act*.
16. On June 29, 2000, the Appellant purchased 110,426 Exchangeable Shares from 3507271 Canada Inc. At that time, the fair market value of the 110,426 Exchangeable Shares was \$10,253,054, the paid-up capital was \$965,073 and the adjusted cost base was \$8,084,278. The transaction was done by way of rollover pursuant to subsection 85(1) of the *Income Tax Act* for an agreed amount of \$8,084,278. The consideration given by the Appellant was 100 shares of its treasury.
17. On June 29, 2000, the Appellant purchased 532,726 Exchangeable Shares from 100935 Canada Inc. At that time, the fair market value of the 532,726 Exchangeable Shares was \$49,463,609, the paid-up capital was \$4,655,766 and the adjusted cost base was \$37,097,707. The transaction was done by way of rollover pursuant to subsection 85(1) of the *Income Tax Act* for an agreed amount of \$37,994,120. The consideration given by the Appellant was 100 shares of its treasury. This transaction gave rise to a capital gain of \$896,413.
18. On September 30, 2002, the Appellant disposed of 342,652 Exchangeable Shares by requesting that Newbridge redeem the shares, as provided for in the Arrangement. At that time, each of the 342,652 Exchangeable Shares had an adjusted cost base of \$71.64 and a fair market value of \$3.71.
19. On the same day, the Appellant acquired 342,652 Alcatel ADSs, as per its rights under the Arrangement, and continued to hold those shares in the 30-day period that followed the disposition of the Exchangeable Shares. The Appellant still held the Alcatel ADSs at the end of the 2002 taxation year.
20. The Exchangeable Shares were capital property of the Appellant.
21. The Appellant was not a person "affiliated" with Alcatel for the purpose of the *Income Tax Act*.

Tax treatment

22. The Appellant reported a capital loss of \$23,276,350 on the disposition of the Exchangeable Shares in its 2002 tax return. Net capital losses of \$2,820,801 and \$10,413,407 were carried back to its 1999 and 2000 taxation years respectively. A net capital loss of \$11 was carried forward to its 2004 taxation year.
23. The Minister of National Revenue assessed the Appellant on the basis that subsection 40(3.4) of the *Income Tax Act* applies to suspend the recognition

of the capital loss realized by the Appellant on the disposition of its Exchangeable Shares in the 2002 taxation year. The Minister consequently disallowed the carry-back / carry-forward of the capital loss reported by the Appellant⁷.

Statutory provisions

[9] The relevant portions of subsections 40(3.3), (3.4) and (3.5) read as follows:

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| <p>(3.3) Subsection 40(3.4) applies when</p> <p><i>(a)</i> a corporation, trust or partnership (in this subsection and subsection 40(3.4) referred to as the “transferor”) disposes of a particular capital property (other than depreciable property of a prescribed class) otherwise than in a disposition described in any of paragraphs <i>(c)</i> to <i>(g)</i> of the definition “superficial loss” in section 54;</p> <p><i>(b)</i> during the period that begins 30 days before and ends 30 days after the disposition, the transferor or a person affiliated with the transferor acquires a property (in this subsection and subsection 40(3.4) referred to as the “substituted property”) that is, or is identical to, the particular property; and</p> <p><i>(c)</i> at the end of the period, the transferor or a person affiliated with the transferor owns the substituted property.</p> <p>(3.4) If this subsection applies because of subsection 40(3.3) to a disposition of a particular property,</p> | <p>(3.3) Le paragraphe (3.4) s’applique lorsque les conditions suivantes sont réunies :</p> <p><i>a)</i> une société, une fiducie ou une société de personnes (appelées « cédant » au présent paragraphe et au paragraphe (3.4)) dispose d’une immobilisation, sauf un bien amortissable d’une catégorie prescrite, en dehors du cadre d’une disposition visée à l’un des alinéas <i>c)</i> à <i>g)</i> de la définition de « perte apparente » à l’article 54;</p> <p><i>b)</i> au cours de la période qui commence 30 jours avant la disposition et se termine 30 jours après cette disposition, le cédant ou une personne affiliée à celui-ci acquiert le même bien ou un bien identique (appelés « bien de remplacement » au présent paragraphe et au paragraphe (3.4));</p> <p><i>c)</i> à la fin de cette période, le cédant ou une personne affiliée à celui-ci est propriétaire du bien de remplacement.</p> <p>(3.4) Lorsque le présent paragraphe s’applique par l’effet du paragraphe (3.3) à la disposition d’un bien, les</p> |
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⁷ Notice of assessment dated May 18, 2006 for the taxation year ended December 20, 1999; Notice of assessment dated May 25, 2006 for the taxation year ended December 20, 2000; Notice of assessment dated May 25, 2006 for the taxation year ended December 20, 2004; Notice of confirmation dated June 16, 2009.

présomptions suivantes s'appliquent :

(a) the transferor's loss, if any, from the disposition is deemed to be nil, and
...
(3.5) For the purposes of subsections 40(3.3) and 40(3.4),

(a) a right to acquire a property (other than a right, as security only, derived from a mortgage, hypothec, agreement for sale or similar obligation) is deemed to be a property that is identical to the property;
...

(a) la perte du cédant résultant de la disposition est réputée nulle;
...

(3.5) Les présomptions suivantes s'appliquent dans le cadre des paragraphes (3.3) et (3.4):

(a) le droit d'acquérir un bien (sauf le droit servant de garantie seulement et découlant d'une hypothèque, d'une convention de vente ou d'un titre semblable) est réputé être un bien qui est identique au bien;
...

[10] It is common ground among the parties that the "disposition of a particular capital property" referred to in paragraph 40(3.3)(a) is the disposition of the Exchangeable Shares, that is, the result of the appellant asking Newbridge to retract the Exchangeable Shares. However, the appellant disagrees with the Minister that, in the 61 day period referred to in paragraph 40(3.3)(b), the appellant acquired a property that was identical to the Exchangeable Shares, since a Newbridge Exchangeable Share cannot be identical to an Alcatel ADS.

Appellant's submissions

[11] I agree with Mr. Lefebvre that normally a share of one corporation is not identical to that of another corporation. That the shares may have the same economic equivalence does not make them identical. Indeed, it would be an exceptional circumstance for a share of one corporation to be identical to a share of another corporation. A share of Canadian Pacific valued at \$60 is not identical to a share of Bank of Montreal valued at \$60. The monetary values of the shares may be identical but the rights, conditions, restrictions in the different shares, let alone the underlying assets of the business carried on by each of the corporations, may be different. On the other hand, it is arguable that a preferred share of a corporation, convertible into a common share of the corporation, may be identical to the common share if the price, voting rights, dividends and other rights are the same. Here we are comparing a voting share of one company to a non voting share of another company, for example.

Absent subsection 40(3.5), all would agree that an Alcatel ADS was not identical to a Newbridge Exchangeable Share.

[12] Appellant's counsel referred to subsection 40(3.3) and submitted that while paragraph (a) applied to the facts in dispute, that is, the appellant disposed of the Newbridge Exchangeable Shares, paragraphs (b) and (c) do not apply since, during the 61 day period, the appellant did not acquire property identical to the Newbridge Exchangeable Shares and at the end of the 61 day period it did not own substituted or identical property. What his client acquired, he asserted, were Alcatel ADSs pursuant to the retraction right but what it disposed of were Newbridge Shares: these are shares of two different corporations that are not identical.

[13] The triggering of the events, i.e. the disposition of capital property for purposes of paragraph 40(3.3)(a), was not a disposition of a right to acquire shares but the disposition of Newbridge Shares, according to the appellant. The right to acquire ADSs was embedded in the Newbridge Exchangeable Shares. Counsel insisted that what was disposed of by the appellant were the Exchangeable Shares, not a right to acquire ADSs. The purchaser of the Exchangeable Shares, Alcatel (or Newbridge), was obliged to pay for each Exchangeable Share with an Alcatel ADS having the same value as an Exchangeable Share.

[14] If I understand counsel's analysis of paragraph 40(3.5)(a), it is that paragraph 40(3.5)(a) serves only to explain subsection 40(3.3). In counsel's view, for example, if one has a right to acquire a share of BCE Inc, then for purposes of subsection 40(3.5), the right to acquire the BCE share is a property that is identical to the BCE shares. In the appeals at bar, however, the right to acquire Alcatel ADSs is found in the Newbridge Exchangeable Shares, a property not identical to any Alcatel ADS.

[15] Mr. Lefebvre asserted that paragraph 40(3.5)(a) is concerned with the application of paragraph 40(3.3)(b), that, on the facts of these appeals, if the Newbridge Exchangeable Shares "somehow gave a right to acquire other Newbridge shares, then ... [paragraph 40(3.3)(b) and subsection 40(3.5)] would come into play and apply." However, "the right was to acquire an ADS share ... so therefore [there is] no application for [paragraph 40(3.3)] (b)."

[16] Appellant's counsel referred to the Federal Court of Appeal decision in *The Queen v. Cascades Inc.*⁸ as authority for his submissions that a right to acquire ADSs is identical to ADSs but that does not make it identical to the Exchangeable Shares, in particular at paragraph 32 where Nadon J.A. wrote that

... [i]n fact paragraphs 40(3.5)(a) and (b) must be consulted to understand the meaning of a "property that is identical", a phrase that is mentioned but not defined at paragraph 40(3.3)(b). Paragraphs 40(3.5)(a) and (b) indicate, first, that a right to acquire a property is deemed to be a property that is identical to the property itself and, second, that a share of a corporation that is acquired in exchange for another share is deemed to be a property that is identical to the other share.

[17] The importance of paragraph 40(3.5)(a), according to counsel, is that it is the option, the right to acquire, that is identical to the property itself. In appellant's view, then, subsection 40(3.5) does not have the effect of causing subsection 40(3.3) to "suddenly" create identical properties between the Newbridge Exchangeable Shares and the Alcatel ADSs. The property that is identical to the Alcatel ADSs is the right to acquire the ADSs, not the Newbridge Exchangeable Shares. Justice Nadon, counsel submitted, stated that the purpose of paragraph 40(3.5)(a) is "to put substance and interpretation to [paragraph] 40(3.3)(b)".

Respondent's submissions

[18] The respondent argued that at the end of the day, on September 30, 2002, the appellant was in the same position it was in at the beginning of the day; it held the same number of Alcatel ADSs as earlier in the day it held of Newbridge Exchangeable Shares. At all relevant times, both the ADSs and the Exchangeable Shares had the same economic value. In the respondent's view, the appellant did not dispose of anything; there was no true realization of loss. It simply exchanged an indirect interest in Alcatel for a direct interest in Alcatel.

[19] The purpose of subsection 40(3.3), according to respondent's counsel, is to deny a loss where a taxpayer incurs a loss on a disposition of property within an affiliated group or on disposing of its property in return for the same or identical property; in such a case, she stated, no real loss has actually been incurred: the appellant acquired property deemed identical to the Exchangeable Shares.

⁸ *The Queen v. Cascades Inc.*, 2009 FCA 135, [2010] 1 CTC 1, 2009 DTC 5093(Fr.) 2009 DTC 5139(Eng.).

[20] Counsel for the respondent explained that when a former common shareholder of Newbridge received Exchangeable Shares on the capital reorganization of Newbridge, subsection 86(1) of the *Act* deferred tax on any gain. When the Exchangeable Shares are then exchanged for ADSs, she stated, if there is a loss on the disposition of the Exchangeable Shares, the loss is recognised only when the ADSs, the identical property in her view, are sold to persons not affiliated with the appellant. It is the application of subsections 40(3.3) and (3.4) that deny the immediate loss on the disposition of the Exchangeable Shares for the ADSs.

[21] Crown counsel argued that notwithstanding that the Exchangeable Shares and ADSs are not identical, the deeming provision in paragraph 40(3.5) creates the fiction of making them identical. Because they are not identical, the statute makes them identical. The Exchangeable Shares contain a right to acquire the ADSs, as required in subsection 40(3.5); "[t]he Exchangeable Shares are precisely that, a right to acquire the Alcatel ADSs", counsel submitted, and therefore they are deemed to be identical to the Alcatel ADSs. She suggested that when the appellant purchased the Exchangeable Shares in 2000, it "was in fact purchasing ... Alcatel shares." The owner of an Exchangeable Share at any time could demand its exchange for an ADS.

[22] There is no dispute that provisions of subsections 40(3.3), (3.4) and (3.5) be given a textual interpretation while reading these provisions in context, that is, within the overall scheme of the *Act* itself. As the Chief Justice and Justice Major stated in *Canada Trustco Mortgage Co. v. Canada*:⁹

10 It has been long established as a matter of statutory interpretation that "the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament": see 65302 *British Columbia Ltd. v. Canada*, [1999] 3 S.C.R. 804 (S.C.C.), at para. 50. The interpretation of a statutory provision must be made according to a textual, contextual and purposive analysis to find a meaning that is harmonious with the Act as a whole. When the words of a provision are precise and unequivocal, the ordinary meaning of the words play a dominant role in the interpretive process. On the other hand, where the words can support more than one reasonable meaning, the ordinary meaning of the words plays a lesser role. The relative effects of ordinary meaning, context and purpose on the interpretive process may vary, but in all cases the court must seek to read the provisions of an Act as a harmonious whole.

⁹ *Canada Trustco Mortgage Co. v. The Queen*, [2005] 2 S.C.R. 601, [2005] 5 CTC 215, 2005 DTC 5523 at para. 10. See also comments of Lebel J. in *Placer Dome Canada Ltd. v. Ontario (Minister of Finance)*, 2006 SCC 20, [2006] 1 S.C.R. 715 (S.C.C.), at paras. 21, 22 and 23.

[23] In *Cascades*,¹⁰ the Court of Appeal made a textual analysis of subsection 40(3.5) as well as subsections 40(3.3) and (3.4) and concluded that:

... in light of the overall scheme of the legislation and of the provisions in question, they should be seen as establishing a stop-loss rule. As Gerald D. Courage points out in his article *Utilization of Tax Losses and Debt Restructuring*, 2006 Ontario Tax Conference, (Toronto; Canadian Tax Foundation, 2006), 9:1-86, at page 2:

... the *Act* contains a number of so called "stop-loss rules" where there has been a transfer of property with an accrued loss within a statutorily defined closely held group. While the transfer might otherwise be treated as a sufficient realization so as to permit recognition of the loss, nevertheless the loss is denied until the property (or, in some cases, property received in exchange on the transfer) is transferred out of the group, at which point there is effectively a "true" realization by the group of the loss for tax purposes.

[24] Obviously respondent's counsel did not agree with her confrère that the fact that the Newbridge Exchangeable Shares were not identical to the Alcatel ADSs was relevant. Paragraph 40(3.5)(a), she declared, demolishes any such relevance by deeming two properties ordinarily not identical to be identical. She cited *R. v. Verrette*,¹¹ where Beetz J. explained that:

... A deeming provision is a statutory fiction; as a rule it implicitly admits that a thing is not what it is deemed to be but decrees that for some particular purpose it shall be taken as if it were that thing although it is not or there is doubt as to whether it is. A deeming provision artificially imports into a word or an expression an additional meaning which they would not otherwise convey beside the normal meaning which they retain where they are used; it plays a function of enlargement analogous to the word "includes" in certain definitions; however, "includes" would be logically inappropriate and would sound unreal because of the fictional aspect of the provision.

[25] Counsel submitted that the ordinary meaning of the words in the phrase "a right to acquire a property" (« le droit d'acquérir un bien ») in paragraph 40(3.5)(a) is very wide and is limited only by its content. The only words limiting the scope of the phrase are the words in brackets immediately following the phrase:

(other than a right, as security only, (sauf le droit servant de garantie

¹⁰ *Supra*, note 8, at para. 34.

¹¹ *R. v. Verrette*, [1978] 2 S.C.R. 838, [1978] S.C.J. No. 40 (QL); at p. 845.

derived from a mortgage, hypothec, seulement et découlant d'une
agreement for sale or similar obligation) hypothèque, d'une convention de vente
ou d'un titre semblable)

[26] Respondent's counsel referred to the comments of Professor Sullivan on the "implied exclusion" argument to support her submission. According to Professor Sullivan:¹²

[a]n implied exclusion argument lies whenever there is reason to believe that if the legislature had meant to include a particular thing within its legislation, it would have referred to that thing expressly. Because of this expectation, the legislature's failure to mention the thing becomes grounds for inferring that it was deliberately excluded. Although there is no express exclusion, exclusion is implied. As Laskin J.A. succinctly put it, "legislative exclusion can be implied when an express reference is expected but absent". ...¹³

[27] Professor Sullivan explains that:

... [w]hen a provision specifically mentions one or more items but is silent with respect to other items that are comparable, it is presumed that the silence is deliberate and reflects an intention to exclude the items that are not mentioned. As explained by Noel J.A. in *Canada (Canadian Private Copying Collective) v. Canadian Storage Media Alliance*, dealing with a series of express exceptions, "if a statute specifies one exception (or more) to a general rule, other exceptions are not to be read in. The rationale is that the legislator has turned its mind to the issue and provided for the exemptions which were intended."¹⁴

[28] Thus, counsel submitted, it is only a right to acquire a property that is identified in the brackets that would not be deemed to be property identical to the property and be subject to paragraph 40(3.5)(a). All other rights to acquire a property are deemed to be property identical to the property. The right to acquire the ADSs is a right attached to the Exchangeable Shares and falls clearly within the provision and is identical to the ADSs.

[29] Parliament's intention in enacting paragraph 40(3.5)(a), counsel declared, was to include rights to acquire a property to be identical to the property to be acquired.

¹² Ruth Sullivan, *Sullivan on the Construction of Statutes*, 5th ed. (LexisNexis 2008), at 243-244.

¹³ *University Health Network v. Ontario (Minister of Finance)*, [2001] OJ 4485 (QL), 2002 DTC 6817 at para. 31.

¹⁴ *Canada (Canadian Private Copying Collective) v. Canadian Storage Media Alliance*, 2004 FCA 424, 247 DLR (4th) 193, at para. 96.

On the facts at bar there is a share, the Exchangeable Share, that has a right to acquire property, the Alcatel ADS, and once one acquires the ADS, the ADS and the Exchangeable Share are deemed to be identical properties. This interpretation, counsel added, is reasonable and is analogous to the share for share exchange rule in paragraph 40(3.5)(b).

[30] In interpreting a legal fiction such as a deeming provision, counsel asserted, what needs to be interpreted is its scope and not its force; once the facts fall within the wording of a provision, the deeming provision applies. Here, the wording is clear — there is a right to acquire a property and the right is deemed to be identical to the property. That, insisted counsel for the respondent, is the purpose of paragraph 40(3.5)(a). The provision's stop loss rule is what the Court of Appeal recognized in *Cascades*.

Analysis

[31] The question in these appeals is, whether during the 61 day period in paragraph 40(3.3)(b), either the appellant or a person affiliated with the appellant acquired a property identical to the Exchangeable Shares and either person owned the identical property at the end of the 61 days. There is no question that the appellant disposed of the Exchangeable Shares; the basic issue is whether the appellant also disposed of a right to acquire the ADSs.

[32] The creation of the Exchangeable Shares was to facilitate the acquisition by Alcatel of the shares of Newbridge owned by residents of Canada so that the Canadian residents would defer capital gains on the dispositions of their shares to Alcatel. This was part of a proper tax plan to assist a commercial transaction between Canadian resident shareholders of a Canadian corporation and a foreign corporation.

[33] The parties agree that for purposes of paragraph 40(3.3)(a) of the *Act*, the appellant disposed of capital property. Their dispute is whether the property was Newbridge Exchangeable Shares, in which case the appeals would be allowed, or was the disposition also of "a right to acquire a property" for purposes of paragraph 40(3.5)(a), in which case the appeals would be dismissed.

[34] A share was defined by Farwell J. in *Borland's Trustee v. Steel*:¹⁵

A share is an interest of a shareholder in the company measured by a sum of money, for the purpose of liability in the first place, and of interest in the second, but also

¹⁵ *Borland's Trustee v. Steel*, [1901] 1 Ch. 279 at 288.

consisting of a series of mutual covenants entered into by all shareholders *inter se* in accordance with ... the *Companies Act* ...

The contract contained in the articles of association is one of the original incidents of the share. A share is not a sum of money ... but is an interest measured by a sum of money and made up of various rights contained in the contract, including the right to a sum of money of a more or less amount.

(Emphasis added)

[35] This definition was approved by the House of Lords in *IRC v. Crossman*¹⁶. *Crossman* dealt with a question of share valuation. The estate duty laws directed the Internal Revenue Commissioner to assess duty based on the value of the property on the open market. However, the block of shares in question contained an overriding preemption right — before the shares could be sold on the open market they had to be offered to certain shareholders for a price set below the fair market value. The Commissioner argued that the value of the shares had to be assessed based on the open market rates. The House of Lords disagreed. The Lords concurred in their opinion that the preemption right could not be disregarded. Lord Russell wrote, at page 66, that:

[a] share in a limited company ... is the interest of a person in the Company, that interest being composed of rights and obligations which are defined in the *Companies Act* and by the memorandum and articles of association of the company. A sale of a share is a sale of the interest so defined ...

[36] And at page 67:

[i]f the property in question is that bundle of rights and obligations known as a share in a limited company, the entirety of the bundle must surely be the subject matter of the sale and not part only. The requirement that property be sold in the open market cannot alter the nature or the character of the property which is there offered for sale.

[37] Lord MacMillan stated, at page 69, that:

[w]ithin the law the rights and liabilities appurtenant to a share may vary widely. But it cannot exist independently of the inherent attributes with which it has been created.

¹⁶ *IRC v. Crossman*, [1937] AC 26.

[38] In Canada, the definition in *Borland's Trustee* was approved by LaForest J. writing in dissent in *McClurg v. Canada*¹⁷. Earlier, in *Sparling v. Québec (Caisse de dépôt & de placement)*,¹⁸ LaForest J. explained:

... A share is not an isolated piece of property. It is rather, in the well-known phrase, a "bundle" of interrelated rights and liabilities. A share is not an entity independent of the statutory provisions that govern its possession and exchange. Those provisions make up its constituent elements. ... A "share" and thus a "shareholder" are concepts inseparable from the comprehensive bundle of rights and liabilities created by the *Act*. Nothing in the statute, common sense or the common law indicates that this bundle can be parcelled out piecemeal at the whim of the Crown. It cannot pick and choose between the provisions it likes and those it does not. To do so would be to permit it to define an entity which is the creature of federal legislation. What the Caisse obtained was an integral whole.

[39] The Exchangeable Share had attached to it a right that allowed the appellant to receive an Alcatel ADS at any time within the five-year window described in the Partial Agreed Statement of Facts. This right was part of the bundle of rights in the Exchangeable Share. Even if the appellant took no action with respect to exchanging its Exchangeable Shares, it would have ended up with Alcatel ADSs at the end of the five-year term. It is clear that as owner of the Exchangeable Shares, the appellant could exercise a right to acquire Alcatel ADSs. The respondent's argument that the retraction right trumps all other rights in an Exchangeable Share appears to be inconsistent with this line of cases. Based on *Borland's Trustee*, *Crossman* and *Sparling*, cited above, a share should be looked at as a composite of different rights. By emphasizing the retraction right, the respondent arguably is proposing the existence of a distinct and separate property that the taxpayer did not own. The respondent is trying to parcel out piecemeal what suits its case.

[40] The respondent's submissions suggest that the Exchangeable Shares were substantially a vehicle for the shareholders of Newbridge to acquire Alcatel ADSs at their convenience within the five year term, while at the same time having the same benefits as shareholders of Alcatel. Counsel seems to suggest that the Exchangeable Share was not really a share. One cannot lose sight that there was a legal relationship between the appellant and Newbridge, one of shareholder and the corporation.

[41] In *Shell Canada*,¹⁹ McLachlin J. (as she then was) stated that:

¹⁷ *McClurg v. Canada*, [1990] 3 SCR 1020, [1991] 1 CTC 169, 91 DTC 5001 at para. 52.

¹⁸ *Sparling v. Québec (Caisse de dépôt et de placement)*, [1988] 2 SCR 1015, 55 DLR 63 (4th) 63 at para. 23.

39. This Court has repeatedly held that courts must be sensitive to the economic realities of a particular transaction, rather than being bound to what first appears to be its legal form: *Bronfman Trust*, supra, at pp. 52-53, per Dickson C.J.; *Tennant*, supra, at para. 26, per Iacobucci J. But there are at least two caveats to this rule. First, this Court has never held that the economic realities of a situation can be used to recharacterize a taxpayer's bona fide legal relationships. To the contrary, we have held that, absent a specific provision of the *Act* to the contrary or a finding that they are a sham, the taxpayer's legal relationships must be respected in tax cases. Recharacterization is only permissible if the label attached by the taxpayer to the particular transaction does not properly reflect its actual legal effect: *Continental Bank Leasing Corp. v. Canada*, [1998] 2 S.C.R. 298, at para. 21, per Bastarache J.

40. Second, it is well established in this Court's tax jurisprudence that a searching inquiry for either the "economic realities" of a particular transaction or the general object and spirit of the provision at issue can never supplant a court's duty to apply an unambiguous provision of the *Act* to a taxpayer's transaction. Where the provision at issue is clear and unambiguous, its terms must simply be applied: *Continental Bank*, supra, at para. 51, per Bastarache J.; *Tennant*, supra, at para. 16, per Iacobucci J.; *Canada v. Antosko*, [1994] 2 S.C.R. 312, at pp. 326-27 and 330, per Iacobucci J.; *Friesen v. Canada*, [1995] 3 S.C.R. 103, at para. 11, per Major J.; *Alberta (Treasury Branches) v. M.N.R.*, [1996] 1 S.C.R. 963, at para. 15, per Cory J.

[42] The appellant was a *bona fide* shareholder of Newbridge; it held Exchangeable Shares with all the rights and obligations attached to these shares. To say that the taxpayer disposed of "a right to acquire" Alcatel ADSs, ignoring that this right was attached to the Exchangeable Shares, would amount to a recharacterization of the legal relationship between the appellant as a shareholder of Newbridge and Newbridge itself.

[43] Because an Exchangeable Share was economically equivalent to the ADS, the Crown says that the appellant did not gain or lose anything economically when it exchanged the Exchangeable Shares for ADSs and therefore did not really occur a loss. This is a simplistic argument by the Crown. In any transaction where a fair market value price for property is negotiated, it can be said that the buyer and seller are exchanging properties of equivalent value, neither is a loser nor a winner economically in the transaction. However, where one party receives less for a property than he or she paid for it, the party has an economic loss and this is what

¹⁹ *Shell Canada Ltd v. Canada*, [1999] 3 SCR 622, [1999] 4 C.T.C. 313, 99 DTC 5669 at paras. 39 and 40.

happened here. The appellant disposed of the Exchangeable Shares at less than their cost base.

[44] Paragraph 40(3.5)(a) deems "a right to acquire a property" to be property to be identical to the property. The provision is directed to "a right to acquire a property" and the property itself. In other words, what is deemed identical is "a right to acquire the property" and the acquired property itself. At bar, the particular property disposed of in paragraph 40(3.3)(a) is not "a right to acquire a property", but another property altogether, the Exchangeable Shares. The appellant acquired the ADSs because it disposed of shares in Newbridge, shares with all the rights and conditions attached to them. The deeming provision in paragraph 40(3.5)(a) cannot apply because the properties it deems to be identical properties are not present.

[45] The appeals are allowed with costs.

Signed at Ottawa, Canada, this 11th day of July 2011.

"Gerald J. Rip"

Rip C.J.

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