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THE SUPREME COURT DECISION IN COPTHORNE: A MOVE TO THE MIDDLE

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The most difficult issue in GAAR cases is whether an avoidance transaction is an abuse or misuse of the *Income Tax Act*. The decision of the Supreme Court in *Lipson*¹ exposed a deep rift between those members of the bench who focused on consistency and predictability and those who focused on fairness. The decision in *Copthorne*² reflects a desire to achieve consensus by having each side move to the centre. The move by the right was substantive while the move by the left was reflected in the tone of the language used and in the rigor of the analysis.

The Supreme Court in *Canada Trustco* held that determining whether there is abusive tax avoidance requires a two-part inquiry.³ The first step is to determine the object, spirit or purpose of the provisions of the ITA that are relied on for the tax

benefit. This is a question of law. The second step is to examine the factual context of the case in order to determine whether the avoidance transaction defeated or frustrated the legislative purpose of the provisions in issue. This is a question of fact.

The Supreme Court in *Canada Trustco* also held that the burden was on the Crown to establish that there was abusive tax avoidance and that if the existence of abuse “is unclear, the benefit of the doubt goes to the taxpayer”.⁴ In the case of *Evans v. R.*⁵ then Chief Justice Bowman made the following observations with respect to the burden on the Crown:

The words “burden of proof” of which the Supreme Court of Canada speaks may imply an evidentiary burden but primarily they impose a requirement that the Crown

⁴ *Ibid.* at para. 66.

⁵ 2005 TCC 684, [2006] 2 C.T.C. 2009, 2005 D.T.C. 1762 (General Procedure). See <http://decision.tcc-cci.gc.ca/en/2005/2005tcc684/2005tcc684.html>.

¹ *Lipson v. R.*, 2009 SCC 1, [2009] 1 C.T.C. 314, 2009 D.T.C. 5528. See <http://scc.lexum.org/en/2009/2009scc1/2009scc1.html>.

² *Copthorne Holdings Ltd. v. Canada*, 2011 SCC 63, 2011 CarswellNat 5201. See <http://scc.lexum.org/en/2011/2011scc63/2011scc63.html>.

³ *Canada Trustco Mortgage Co. v. R.*, 2005 SCC 54, [2005] 5 C.T.C. 215, 2005 D.T.C. 5523, at para. 55. See <http://scc.lexum.org/en/2005/2005scc54/2005scc54.html>.

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identify the object, spirit or purpose of the relevant legislation that is said to be frustrated or defeated. This might be described as a “burden of persuasion” although this is not the usual sense of the expression “burden of proof” It is sufficient to say that nothing that has been put before the Court in this case has persuaded me either as a matter of fact or as a matter of argument that there has been any abuse of the Act read as a whole. Indeed, if there were any doubt on this point, the Supreme Court of Canada has said that the benefit of doubt should go to the taxpayer.⁶

The following statements by Mr. Justice Rothstein in the Federal Court of Appeal decision in *OSFC Holdings Ltd.*⁷ are particularly relevant in determining how convincing the Court thought the Crown’s arguments of law must be:

It is also necessary to bear in mind the context in which the misuse and abuse analysis is conducted. ... This is not an exercise of trying to divine Parliament’s intention by using a purposive analysis where the words used in the statute are ambiguous. Rather, it is an invoking of a policy to override the words Parliament has used. I think, therefore, that to deny a tax benefit where there has been strict compliance with the Act, on the grounds that the

avoidance transaction constitutes a misuse or abuse, requires that the relevant policy be clear and unambiguous. ...⁸

In answer to the argument that such an approach will make the GAAR difficult to apply, I would say that where the policy is clear, it will not be difficult to apply. Where the policy is ambiguous, it should be difficult to apply. This is because [subsection 245\(4\)](#) cannot be viewed as an abdication by Parliament of its role as lawmaker in favor of the subjective judgment of the Court or particular judges. ... Where Parliament has not been clear and unambiguous as to its intended policy, the Court cannot make a finding of misuse or abuse, and compliance with the statute must govern.⁹

The recent decision in the case of *Global Equity Fund Ltd. v. R.*¹⁰ is a dramatic illustration of the requirement that clarity be established at both stages of the abuse analysis:

For this reason, I have concluded that the first step of the abuse analysis has not been satisfied by the Crown. In particular, the Crown has failed to establish that the object and spirit of the provisions relied on for the tax benefit is to restrict business losses to “real losses realized outside the economic unit.”¹¹

...

In light of this conclusion, it is not necessary for me to consider the second step in the abuse test, that is, whether the transactions at issue frustrate the object and spirit of the provisions relied on. I would comment, though, that had I agreed with the Crown’s position on the first step, I would have no hesitation in concluding that the second step is satisfied. The transactions undertaken by Global are clearly so vacuous that they would frustrate the object and spirit suggested by the Crown.¹²

It is against this background that the following statements by Mr. Justice Rothstein in *Cophthorne* must be viewed:

In order to determine whether a transaction is an abuse or misuse of the Act, a Court must first determine the “object, spirit or purpose of the provisions ...”¹³

...

Second, a Court must consider whether the transaction falls within or frustrates the identified purpose ... **at this stage**, the Minister must clearly demonstrate that the

⁸ *Ibid.* at para. 69.

⁹ *Ibid.* at para. 70.

¹⁰ 2011 TCC 507, 2011 CarswellNat 4286 (General Procedure). See <http://decision.tcc-cci.gc.ca/en/2011/2011tcc507/2011tcc507.html>.

¹¹ *Ibid.* at para. 100.

¹² *Ibid.* at para. 102.

¹³ *Supra*, note 2 at para. 60.

⁶ *Ibid.* at para. 35.

⁷ *OSFC Holdings Ltd. v. R.*, 2001 FCA 260, [2001] 4 C.T.C. 82, 2001 D.T.C. 5471. See <http://decisions.fca-caf.gc.ca/en/2001/2001fca260/2001fca260.html>.

transaction is an abuse of the Act, and the benefit of the doubt is given to the taxpayer.¹⁴ (emphasis added)

Limiting the burden on the Crown to the second stage of the abuse analysis is a giant step towards the centre.¹⁵ No longer will the Crown have to establish that a clear and unambiguous legislative purpose has been clearly defeated or frustrated. Establishing that the purpose determined by the Court to be the most reasonable has been clearly frustrated will now suffice.

The following observation by Daniel Sandler with respect to the Supreme Court decision in *Canada Trustco* was, in retrospect, prescient:

Both the minister and the taxpayer can make arguments about legislative intent – that is, they may both argue about the correct textual, contextual, and purposive interpretation of provisions, and both may refer to permissible extrinsic aids – but ultimately it is for the Court to interpret the provisions. In doing so, the Court should determine the most reasonable legislative intent; abuse should not be limited to frustration of a “clear and unambiguous” legislative intent. In this respect, I believe that the Supreme Court has lowered the “standard” for determining legislative intent from that exposed in *OSFC*.¹⁶

The movement by the left was not only reflected in the *de rigueur* references to the *Duke of Westminster* principle and the GAAR being a provision of last resort, but also in the admonition that “determining the rationale of the relevant provisions of the Act should not be conflated with a value judgment of what is right or wrong nor with theories about what tax law ought to be or ought to do”.¹⁷ This admonition was reinforced by the thorough step-by-step analysis conducted by the Court.

The movement to the centre by the Supreme Court in *Copthorne* will increase the level of uncertainty for taxpayers. The predictability of a position being sustained on its merits is usually communicated to a taxpayer by means of an opinion from a tax professional. Such opinions

range from “arguably” and “more likely than not” to “should” and “will”. Now that the GAAR can be applied in the absence of a clear and unambiguous legislative intent, professionals may no longer be able to issue opinions that the GAAR should or should not apply. In arranging their affairs, taxpayers may now have to rely on “more likely than not” opinions.

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SUPREME COURT REJECTS CONSTITUTIONALITY OF NATIONAL SECURITIES REGULATOR

In what must be a devastating blow to Finance Minister Flaherty and the federal government, the Supreme Court of Canada in a unanimous decision¹ has ruled that the creation of a national securities regulator as proposed is *ultra vires* the federal government though it leaves the door wide open for a negotiated deal with all provinces onside.

But while Alberta has recently tempered its negative approach to the notion, Quebec is firmly against.

The reference to the Court required it to determine whether the proposed *Securities Act* set out in Order in Council P.C. 2010-667 falls within the legislative authority of the Parliament of Canada.² The feds and several other provinces, notably Ontario, were supporting a positive answer. Alberta and Quebec led the opposition.

The federal government was relying on its power to regulate trade and commerce under article 92(1) of the *Constitution Act, 1867*. Alberta and Quebec took the position that securities

14 *Supra*, note 2 at paras. 71 and 72.

15 The fact that Mr. Justice Rothstein delivered the judgments in both *Copthorne* and *OSFC* may well have been intended to reinforce this message. Limiting the burden on the Crown to the second stage also resolves some embarrassing conflicts between the *Canada Trustco* and *Lipson* decisions. See David H. Sohmer, “Lipson, The Supreme Court and My Granddaughter,” *The Canadian Taxpayer*, Vol. XXXI, No. 6 at p. 43.

16 Daniel Sandler, “The Minister’s Burden Under GAAR,” 2006 *CTJ* 1 at p. 21.

17 *Supra*, note 2 at para. 70.

1 *Reference Re Securities Act (Canada)*, 2011 SCC 66, 2011 CarswellNat 5243. See <http://scc.lexum.org/en/2011/2011scc66/2011scc66.html>.

2 We wrote about this topic several times in 2011: see Vol. XXXIII of *The Canadian Taxpayer* at pages 33, 49 and 64.

regulation is a matter falling within s. 92(13) of the *Constitution Act, 1867*, which gives the provinces legislative jurisdiction over property and civil rights within their borders. A subsidiary argument for the opponents was that securities regulation relates to provincial jurisdiction over matters of a merely local or private nature, under s. 92(16) of the *Constitution Act, 1867*:

It is a fundamental principle of federalism that both federal and provincial powers must be respected, and one power may not be used in a manner that effectively eviscerates another. Rather, federalism demands that a balance be struck, a balance that allows both the federal Parliament and the provincial legislatures to act effectively in their respective spheres. Accepting Canada's interpretation of the general trade and commerce power would disrupt rather than maintain that balance. Parliament cannot regulate the whole of the securities system simply because aspects of it have a national dimension.

We therefore answer the reference question in the negative.

The Court then offered a way forward if the provinces and the feds choose to take it...which we believe will ultimately happen:

It is open to the federal government and the provinces to exercise their respective powers over securities harmoniously, in the spirit of cooperative federalism. The experience of other federations in the field of securities regulation, while a function of their own constitutional requirements, suggests that a cooperative approach might usefully be explored, should our legislators so choose, to ensure that each level of government properly discharges its responsibility to the public in a coordinated fashion.

After the success of the federal government's health care bombshell earlier in the week (see the article below, page 13), the decision which we suspect was quite unexpected in Ottawa has to have come as a bitter pill to the feds. But we should point out that Flaherty et al. had always bent over backwards to make participation by the provinces voluntary and we suspect, and hope, that some viable arrangement can be arrived at, perhaps including some sort of *modus vivendi* with Quebec.

The day the decision came out, Alberta's Finance Minister Ron Liepert issued the following statement:

I am pleased the Supreme Court has issued its decision on this matter. The court has provided clear direction that the regulation of securities is a provincial jurisdiction.

The court recommends a cooperative approach that respects provincial jurisdiction while allowing the federal government to deal with areas of national concern.

Alberta will work cooperatively with our provincial partners and with the federal government moving forward. At the end of the day, we all share the same goal—a stable, fair and efficient securities system that protects investors and is a model recognized as among the best in the world.

We had been advocating a national securities regulator since the late 1960s when we taught securities regulation at Queen's Law School. At the time we never thought that 40 more years would not see any progress on this matter.

TAX ANNOUNCEMENTS FOR 2012 REFLECT DIFFERENT VIEWPOINTS

If you were among the (presumably) few who were watching tax stories in the run-up to the start of the year, you could be forgiven for getting a skewed picture. It all depended upon whose story you were reading though in fact all sides were reasonably accurate.

The media made a big deal about the fact that payroll taxes were on the rise and quite correctly noted that there would be increased withholding for EI and CPP from paycheques in January. This is of course important, not just in terms of the economy but in fact reflects the first impact of tax changes for most workers. The Opposition (read Bob Rae) made a *pro forma* observation that the increase in EI would do nothing to help and might do much to harm job creation, not that anybody much cares with no election looming.

Meanwhile, the Department of Finance issued a press release highlighting some changes. Shorn of the rhetoric which has become the norm for government press releases, the release highlighted several changes but not, of course, higher EI payments.

The final stage of the tax reduction plan introduced by the government in 2007 came into force on January 1, 2012, when the federal general

corporate income tax rate was reduced to 15 percent. It goes on to justify the cut in economic terms but of course said nothing about its impact, if any, on the deficit fight.

The second item was that effective January 1, 2012, the Family Caregiver Tax Credit will provide new tax support for caregivers of infirm dependent family members. Announced in Budget 2011, this new 15-percent non-refundable tax credit on an amount of \$2,000 will provide tax relief for caregivers of all types of infirm dependent relatives, including, for the first time, spouses, common-law partners and minor children.

The temporary 50-percent straight-line accelerated capital cost allowance rate for investments in manufacturing or processing machinery and equipment was extended to include investments undertaken in 2012 and 2013. This extension was announced in Budget 2011 to help businesses in manufacturing and processing industries restructure and retool to position themselves for long-term success.

The press release then had one of the most ungrammatical comments we have seen from government in a long time.

“In addition to these changes, as of January 1, 2012, Canadians will have a new \$5,000 of room to invest in their Tax-Free Savings Account.”

We know what they are trying to say but surely somebody in Finance must have passed high school English!

The end of the year also saw another more routine announcement albeit one which has an impact on hundreds of thousands of taxpayers who use automobiles for business.

- The ceiling on the capital cost of passenger vehicles for capital cost allowance (CCA) purposes will remain at \$30,000 (plus applicable federal and provincial sales taxes) for purchases after 2011. This ceiling restricts the cost of a vehicle on which CCA may be claimed for business purposes.
- The limit on deductible leasing costs will remain at \$800 per month (plus applicable federal and provincial

sales taxes) for leases entered into after 2011. This limit is one of two restrictions on the deduction of automobile lease payments. A separate restriction prorates deductible lease costs where the value of the vehicle exceeds the capital cost ceiling.

- The maximum allowable interest deduction for amounts borrowed to purchase an automobile will remain at \$300 per month for loans related to vehicles acquired after 2011.
- The limit on the deduction of tax-exempt allowances paid by employers to employees using their personal vehicle for business purposes for 2012 will be increased by 1 cent to 53 cents per kilometre for the first 5,000 kilometres driven and to 47 cents for each additional kilometre. For Yukon, the Northwest Territories and Nunavut, the tax-exempt allowance is set 4 cents higher, and will also increase by 1 cent to 57 cents for the first 5,000 kilometres driven and to 51 cents for each additional kilometre. The allowance amounts reflect the key cost components of owning and operating an automobile, such as depreciation, financing, insurance, maintenance and fuel costs.
- The general prescribed rate used to determine the taxable benefit relating to the personal portion of automobile operating expenses paid by employers for 2012 will increase by 2 cents to 26 cents per kilometre. For taxpayers employed principally in selling or leasing automobiles, the prescribed rate will increase by 2 cents to 23 cents per kilometre. The amount of the benefit reflects the costs of operating an automobile. The additional benefit of having an employer-provided vehicle available for personal use (i.e., the automobile standby charge, which is not affected by this announcement) is calculated separately and is also included in the employee's income.

HEALTH FUNDING ULTIMATUM A SHORT TERM COUP FOR FLAHERTY

The announcement by Finance Minister Jim Flaherty that the feds have delivered a health funding package to the provinces looks like a political coup. In essence, Flaherty, instead of negotiating with the provinces as has been “traditional”, delivered a “take it or leave it” decision which has left the provinces split.

The key was that the feds were not asking for anything and thus obviated the need or possibility of ongoing negotiations.

The announced policy means increases will continue at the current rate of 6 percent annually until 2017 (promised in the election campaign), then slow to match the increase in the nominal gross domestic product (real growth plus inflation) until 2024. Annual increases will never be allowed to drop below 3 percent.

Media reporting suggests that Mr. Harper won't interfere with any province that experiments with or expands private delivery of publicly funded care. But user fees, fully private care or other major violations of the *Canada Health Act* will result in clawbacks.

Each province must either take the deal or walk away.

Initially, the three most western (and currently richest) provinces seem pleased with the federal decision...the other provinces less so.

The attractions to many of the provinces is that essentially Ottawa is opting out of health policy and ostensibly (with the *caveats* noted above) gives the provinces full power as to how to use the funding they get. The concept from Ottawa's point of view is that each province will make its own spending decisions.

The more general concern of many observers, however, is that disparate decisions with no overall national framework will mean distinctly different levels of medical services from province to province, a situation which the former approaches to health care financing were designed to eliminate or at least minimize.

This position was articulated by former Saskatchewan Premier Roy Romanow.

"This really is quite astounding and maybe unprecedented and I think potentially very dangerous to the future of medicare in Canada."

By offering money with no strings attached, Mr. Romanow said, richer provinces can experiment

with new services — via public or private routes — that other provinces can't afford.

The day after the deal (if that term can be used for a unilateral announcement) was made, Health Minister Leona Aglukkaq sent a letter to her provincial and territorial counterparts urging them to focus on how to reduce escalating health costs and to "put the divisive issue of funding behind us".

It will be some time, measured in years, not months, to determine which view (if either) is correct. But in the short run, Mr. Flaherty seems to have pulled off a coup simply because with the strength of de-centralizing ideology and a clear parliamentary majority, there is no way to challenge the action. We can only hope for the sake of the country that the doomsday scenario won't come to pass.

SEVEN NEW SENATORS APPOINTED

At the end of the first week of January¹ the Prime Minister appointed seven new senators, augmenting a solid Conservative majority in the upper house.

The list was, as to be expected, heavy on Conservative supporters. But from our perspective, there were two appointees of interest.

Betty Unger was named a senator from Alberta. Ms. Unger has been a "senator-in-waiting" since 2004, when she placed second in an election to Bert Brown, who was appointed to the Senate in 2007. She was a candidate for the Canadian Alliance in Edmonton West in the federal election of 2000, but lost to Liberal cabinet minister Anne McLellan. So it is a case of good things happening to those who wait.

Vernon White was named from Ontario. White has been the Chief of Police in Ottawa since May, 2007. He has also been head of the Regional Police

¹ At about 4.30 pm on a Friday to ensure minimal media coverage.

Service in Durham, Ontario, and spent more than 20 years with the Royal Canadian Mounted Police, leaving as an assistant commissioner. He had been a top candidate to become Commissioner so this may be a consolation prize. He has been a good Chief in Ottawa and in fairness his Senate salary is only about half of what he was earning.

The others named were:

- **JoAnne Buth** in Manitoba. Ms. Buth is president of the Canola Council of Canada.
- **Norman Doyle** in Newfoundland and Labrador. Mr. Doyle entered federal politics as a Progressive Conservative MP in 1997. He served in Newfoundland's House of Assembly from 1979 to 1993, holding several cabinet portfolios.
- **Ghislain Maltais** in Quebec. Mr. Maltais worked as a contractor for the Conservative Party of Canada from 2006 to 2007, and has been the director of the Conservative Party in Quebec since 2009.
- **Asha Seth** in Ontario. Dr. Seth is an obstetrician and gynecologist in Toronto and is best known for her philanthropic endeavours. She founded the NIMDAC Foundation, which has raised funds for organizations such as the Heart and Stroke Foundation.
- **Jean-Guy Dagenais** in Quebec. Mr. Dagenais was the Conservative candidate in the riding of Saint-Hyacinthe-Bagot in last year's federal election. He worked as a peace officer from 1972 to 1996 at the Sûreté du Québec. His appointment will take effect after he clears up some legal formalities, the Prime Minister's Office said.

According to the press release, "All new appointees have pledged to support the Government in its efforts to make the Senate more democratic and accountable, including legislation to limit the term lengths of senators and encouraging the provinces and territories to hold elections for Senate nominees. The new appointees also look forward to

working towards a strong economic recovery and safer communities across the country."

This does not of course mean that they will be bound by the proposal to limit Senate terms to eight years.

CRAMPTON NAMED CHIEF JUSTICE OF FEDERAL COURT

Paul C. Crampton has been named Chief Justice of the Federal Court, succeeding Alan Lutfy. Court watchers were somewhat surprised as Harper passed over Justice Simon Noel, a nine-year veteran of the Court, who has been acting Chief Justice since Lutfy's departure.

Harper named Crampton to the Federal Court two years ago. Given his age, Crampton could serve until 2035.

Crampton was an acknowledged expert in competition law. Before his appointment to the bench, he was a partner in the competition law group at the law firm of Osler, Hoskin & Harcourt in Toronto and previously worked for the OECD's competition division in Paris, overseeing the agency's work in the competition field with developing and transitioning countries.

Conspiracy theorists who watch court appointments in a way not usually seen in the past suspect that this is another step in a game plan to make the courts less activist and to put into place jurists who share the government's judicial philosophy. Now both Chief Justices at the Federal Court level have been appointed by Harper.

Within days, some academics and immigration lawyers were pointing to Crampton's (albeit short) record of turning down immigration appeals... with a lower rate of accepting such appeals than most of his colleagues. These cases make up almost 65 percent of the Federal Court's caseload.

On the same day, Mary J.L. Gleason, a lawyer with Norton Rose LLP in Ottawa, was appointed a judge of the Federal Court to replace Crampton.

Gleason received a Bachelor of Arts from the University of Ottawa in 1981 and a Bachelor of Laws from Dalhousie University in 1984. She was admitted to the Bar of Ontario in 1986. Gleason had been with Norton Rose LLP (formerly Ogilvy Renault) since 1986, and as a partner since 1993. Her main areas of practice were labour law, employment law and human rights.

SASKATCHEWAN THRONE SPEECH

We rarely report on either federal or provincial Throne Speeches for the simple reason that they tend to be long on rhetoric and short on substance, at least in terms of details. But the Saskatchewan Throne Speech delivered in the first week of December, less than a month after Premier Brad Wall and his Saskatchewan Party won a smashing re-election was very different.

It contained enough detail in terms of tax and related items which would qualify it as a mini-economic statement, and buoyed by a high flying provincial economy, it was a litany of good news items.

There was promised legislation to extend notice periods for rent increases from six months to one year for property owners who choose not to participate in the newly created tenant assistance initiative established by the Saskatchewan Rental Housing Industry Association.

Also on the housing front:

- Building on the Saskatchewan Advantage Housing Plan by exploring additional new-growth tax incentives to encourage construction of new, affordable rental housing.
- Starting January 1, 2012, improvements to the Secondary Suite Program will be implemented.
- Effective January 1, 2012, the Saskatchewan First-Time Homebuyers Tax Credit will provide a \$10,000 non-refundable income tax credit to all first-time homebuyers – creating savings of \$1,100.

Of more general interest were the following:

- Effective November 15, the Provincial Sales Tax exemption on children's clothing was extended to children under 18, up from age 14.
- Extend the Active Families Benefit to all children under 18.
- Starting next year, every new Saskatchewan high school graduate will be eligible for a \$2,000 credit toward post-secondary tuition—\$500 per year for up to four years.
- Further assistance to seniors by increasing Seniors Income Plan benefits by over 40 per cent over the next four years.
- A new Seniors Personal Care Home Benefit will subsidize the difference between a senior's monthly income and the cost of their personal care home space – up to a threshold of \$1,800 in 2012, increasing to \$2,000 by 2015.

The speech was an obviously auspicious start to Wall's new term in office...likely a lot different from some of his newly re-elected fellow premiers who find that the economic realities have outstripped election promises.