Docket: 2018-2717(IT)G

BETWEEN:

WUSWIG INC.,

Appellant,

and

HIS MAJESTY THE KING,

Respondent.



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Appeals heard on common evidence on April 25, April 26 and May 4, 2022, at Montréal, Quebec.
Written submissions filed on May 3, 2024, and on September 6, 2024.

Before: The Honourable Justice Sylvain Ouimet

Appearances:

| | |
|---|---|
| Counsel for the Appellant: | Elisabeth Robichaud<br>Sammy Cheaib<br>Alexandre Hamel |
| Counsel for the Respondent: | Sara Jahanbakhsh<br>Éliane Mandeville |

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**JUDGMENT**

The appeal from the determination of the Minister of National Revenue under the *Income Tax Act* in respect of the Appellant's 2007 taxation year is dismissed, in accordance with the attached reasons for judgment.

The appeal from the assessment of the Minister of National Revenue made under the ITA in respect of the Appellant's 2018 taxation year is dismissed, in accordance with the attached reasons for judgment.

Signed at Ottawa, Canada, this 14th day of October 2025.

"Sylvain Ouimet"

Ouimet J.

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BETWEEN:

WUSWIG INC.,

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and

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Respondent.

**REASONS FOR JUDGMENT**

Ouimet J.

## I. INTRODUCTION

[1] These are appeals by the Appellant ("Wuswig") from a determination made by the Minister of National Revenue (the "Minister") in respect of its 2007 taxation year and from an assessment made by the Minister in respect of its 2018 taxation year.[1] On April 21, 2022, on request of the parties, the two appeals were consolidated by this Court.

[2] On April 2, 2015, the Minister issued a notice of determination pursuant to subsection 152(1.11) and section 245 of the ITA with respect to Wuswig's 2007 taxation year. The Minister applied the general anti-avoidance rule (the "GAAR") and reduced Wuswig's capital loss carry-forward balance by $4,463,307. The amount of $4,463,307 represented the capital loss of $5,086,039 realized by Wuswig from the disposition of its shares of Wuswig Holdings 2007, which was entirely denied by the Minister in applying the GAAR, less the portions of the capital loss used by Wuswig against its capital gains in its 2007, 2010 and 2011 taxation years ($5,086,039 - $79,114 - $396,958 - $146,660 = $4,463,307). The Minister did not

[1] Re-re-amended Notice of Appeal, 2018-2717(IT)G, para 1 and Notice of Appeal, 2022-755(IT)G), para 1.

deny the portions of the capital loss totalling $622,732 that were used by Wuswig in the 2007, 2010 and 2011 taxation years because these taxation years were statute-barred.

[3] On December 10, 2018, the Minister issued a notice of assessment for Wuswig's 2018 taxation year. In the notice, the Minister denied the capital loss carryover by Wuswig from its 2007 taxation year to the 2018 taxation year ($334,176).[2] This amount was used by Wuswig against the capital gain it realized in its 2018 taxation year.

[4] Around 1955, the Webster family, a shareholder of Wuswig, purchased Detroit Marine Terminals Inc. ("Detroit Marine Terminals"), which operated a stevedoring business in Detroit, Michigan. The Webster family also made various real estate investments in the U.S.A. around that time.

[5] In 1990, the Webster family decided to gradually liquidate its U.S. business activities and investments. For that purpose, all existing U.S. activities and investments were regrouped in the same holding company, Noro Holdings Ltd. ("Noro Holdings"), which eventually became a subsidiary of Wuswig when it was incorporated in 1994 under the *Canada Business Corporations Act* (RSC 1985, c C-44) (the "CBCA"). The members of the Webster family eventually transferred their interests in the family's U.S. business activities and investments to Noro Holdings, and they received shares of Wuswig, with the exception of two U.S. family trusts, which received shares of Noro Holdings.

[6] In 1999, Southridge Holdings Ltd. ("Southridge Holdings") was incorporated in the U.S.A., and it was a wholly owned subsidiary of Wuswig. Noro Holdings' shareholders, including Wuswig and the two U.S. family trusts transferred 24,500 common shares and 9,200 preferred shares of Noro Holdings to Southridge Holdings and received in exchange 24,500 common shares of Southridge Holdings.

[7] Before 2007, Wuswig received exempt or tax-free dividends totalling $19,430,329 from Noro Holdings and Southridge Holdings. Both were foreign affiliates.[3]

[8] In 2007, Wuswig proceeded to carry out a corporate reorganization (the "Reorganization"). To realize the Reorganization, Wuswig entered into a series of

[2] Notice of Appeal, docket 2022-755(IT)G, para 2.
[3] Reply to Re-re-amended Notice of Appeal, part A., para 16, q).

transactions, which included the incorporation by Wuswig of a new wholly owned subsidiary, Southridge 2007 Inc. ("Southridge 2007"), under the laws of the State of Delaware. The same year, Southridge Holdings merged with Southridge 2007. Shares of the common stock of Southridge Holdings were converted into shares of the common stock of Southridge 2007.

[9] As a result of the series of transactions, Wuswig realized a capital loss of $5,086,039 on the disposition of its shares of Wuswig Holdings 2007 Inc. ("Wuswig Holdings 2007"), a wholly owned subsidiary located in Canada.

[10] Pursuant to subsections 93(2) and (2.01) of the ITA, upon the disposition of a share of the capital stock of a foreign affiliate resulting in a loss, a Canadian corporation must reduce the loss by any exempt dividends received on this share.

[11] In this case, subsections 93(2) and (2.01) of the ITA did not apply to the series of transactions. The parties admit that, had subsections 93(2) and (2.01) applied, the capital loss ($5,086,039) realized by Wuswig from the disposition of its shares of Wuswig Holdings 2007 would have been reduced by the amount of exempt or tax-free dividends received by Wuswig from Noro Holdings and Southridge Holdings before 2007 ($19,430,329). Consequently, Wuswig's capital loss on the disposition of its shares of Wuswig Holdings 2007 would have been nil.[4]

[12] Between the 2007 and the 2020 taxation years, pursuant to paragraph 111(1)(b) of the ITA, in computing its income Wuswig used a portion of the $5,086,039 capital loss realized on the disposition of its shares of Wuswig Holdings 2007 to offset capital gains. The portions of the capital loss carried forward (used) in those years are:

[4] *Ibid*, para 16(s).

| Taxation year | Status | Capital loss used against capital gains |
|---|---|---|
| March 31, 2007 | At issue in appeal – Statute-barred | $79,114 |
| March 31, 2010 | Statute-barred | $396,958 |
| March 31, 2011 | Statute-barred | $146,660 |
| March 31, 2012 | Held in abeyance | $18,458 |
| March 31, 2015 | Held in abeyance | $116,479 |
| March 31, 2018 | At issue in appeal | $334,176 |
| March 31, 2020 | Held in abeyance | $395,266 |



[13] In this appeal, only Wuswig's 2007 and 2018 taxation years are at issue. The 2012, 2015 and 2020 taxation years were assessed by the Minister, but they are being held in abeyance by the Canada Revenue Agency ("CRA") awaiting the outcome of this appeal.

## II. THE ISSUES

[14] The issues in this appeal are as follows:

1 - Did the Minister correctly deny the carryover of a capital loss of $334,176 for Wuswig's 2018 taxation year by applying the GAAR?

a. Did a tax benefit arise in 2018 from the series of transactions?

b. Was the series of transactions an avoidance transaction?

- Is it reasonable to conclude that the series of transactions was primarily made for *bona fide* purposes other than for obtaining a tax benefit?

c. Was the avoidance transaction abusive?

- What was the object, spirit and purpose of the provisions used to obtain the tax benefit?

- Did the avoidance transaction frustrate the object, spirit or purpose of the relevant provisions?

2 - Did the Minister correctly reduce Wuswig's capital loss balance by $4,463,307 for its 2007 taxation year by applying the GAAR?

a. Did a tax benefit arise in 2007 from the series of transactions?

b. Was the series of transactions an avoidance transaction?

- Is it reasonable to conclude that the series of transactions was primarily made for *bona fide* purposes other than for obtaining a tax benefit.

c. Was the avoidance transaction abusive?

- What was the object, spirit and purpose of the provisions used to obtain the tax benefit?

- Did the avoidance transaction frustrate the object, spirit or purpose of the relevant provisions?

d. Can the Minister rely on a notice of determination under subsection 152(1.11) of the ITA to deny a tax benefit and to apply the GAAR to a statute-barred year?

## III. THE RELEVANT LEGISLATIVE PROVISIONS

[15] The key applicable provisions of the ITA are as follows:

***Income Tax Act,* RSC 1985, c 1 (5th Supp)**

**93 (2)** Subsection (2.01) applies if

> **(a)** a particular corporation (referred to in subparagraph (2.01)(b)(ii) as the "vendor", as the context requires) resident in Canada has a particular loss, determined without reference to this section, from the disposition by it at any time (referred to in subsection (2.01) as the "disposition time") of a share (referred to in subsection (2.01) as the "affiliate share") of the capital stock of a foreign affiliate of the particular corporation; or
>
> **(b)** a foreign affiliate (referred to in subparagraph (2.01)(b)(ii) as the "vendor") of a particular corporation resident in Canada has a particular loss, determined without reference to this section, from the disposition by it at any time (referred to in subsection (2.01) as the "disposition time") of a share (referred to in subsection (2.01) as the "affiliate share") of the capital

stock of another foreign affiliate of the particular corporation that is not excluded property.

**Loss limitation on disposition of share of foreign affiliate**

**(2.01)** If this subsection applies, the amount of the particular loss referred to in paragraph (2)(a) or (b) is deemed to be the greater of

**(a)** the amount determined by the formula

**A – (B – C)**

where

**A** is the amount of the particular loss determined without reference to this section,

**B** is the total of all amounts each of which is an amount received before the disposition time, in respect of an exempt dividend on the affiliate share or on a share for which the affiliate share was substituted, by

**(i)** the particular corporation referred to in subsection (2),

**(ii)** another corporation that is related to the particular corporation,

**(iii)** a foreign affiliate of the particular corporation, or

**(iv)** a foreign affiliate of another corporation that is related to the particular corporation, and

**C** is the total of

**(i)** the total of all amounts each of which is the amount by which a loss (determined without reference to this section), from a previous disposition by a corporation, or a foreign affiliate described in the description of B, of the affiliate share or a share for which the affiliate share was substituted, was reduced under this paragraph in respect of the exempt dividends referred to in the description of B,

**(ii)** the total of all amounts each of which is twice the amount by which an allowable capital loss (determined without reference to this section), of a corporation or a foreign affiliate described in the description of B, from a previous disposition by a partnership of the affiliate share or a share for which the affiliate share was substituted, was reduced under paragraph (2.11)(a) in respect of the exempt dividends referred to in the description of B,

**(iii)** the total of all amounts each of which is the amount by which a loss (determined without reference to this section), from a previous disposition by a corporation, or a foreign affiliate described in the description of B, of an interest in a partnership, was reduced under paragraph (2.21)(a) in respect of the exempt dividends referred to in the description of B, and

**(iv)** the total of all amounts each of which is twice the amount by which an allowable capital loss (determined without reference to this section), of a corporation, or a foreign affiliate described in the description of B, from a previous disposition by a partnership of an interest in another partnership, was reduced under paragraph (2.31)(a) in respect of the exempt dividends referred to in the description of B, and

**(b)** the lesser of

**(i)** the portion of the particular loss, determined without reference to this section, that can reasonably be considered to be attributable to a fluctuation in the value of a currency other than Canadian currency relative to Canadian currency, and

**(ii)** the amount determined in respect of the vendor that is

**(A)** if the particular loss is a capital loss, the amount of a gain (other than a specified gain) that

**(I)** was made within 30 days before or after the disposition time by the vendor and that

**1** is deemed under subsection 39(2) to be a capital gain of the vendor for the taxation year that includes the time the gain was made from the disposition of currency other than Canadian currency, and

**2** is in respect of the settlement or extinguishment of a foreign currency debt that was issued or incurred by the vendor within 30 days before or after the acquisition of the affiliate share by the vendor and that was, at all times at which it was a debt obligation of the vendor owing to a person or partnership that dealt, at all times during which the foreign currency debt was outstanding, at arm's length with the particular corporation and can reasonably be considered to have been issued or incurred in relation to the acquisition of the affiliate share, or

**(II)** is a capital gain realized within 30 days before or after the disposition time by the vendor under an agreement that

**1** was entered into by the vendor within 30 days before or after the acquisition of the affiliate share by the vendor with a person or partnership that dealt, at all times during which the agreement was in force, at arm's length with the particular corporation,

**2** provides for the purchase, sale or exchange of currency, and

**3** can reasonably be considered to have been entered into by the vendor for the principal purpose of hedging the foreign exchange exposure arising in connection with the acquisition of the affiliate share, or

**(B)** in any other case, the amount of a gain (other than a specified gain or a capital gain) that was realized within 30 days before or after the disposition time by the vendor that is included in computing the income of the vendor for the taxation year that includes the time the gain was realized and

**(I)** that is in respect of the settlement or extinguishment of a foreign currency debt that

**1** was issued or incurred by the vendor within 30 days before or after the acquisition of the affiliate share by the vendor,

**2** was, at all times at which it was a debt obligation of the vendor owing to a person or partnership that dealt, at all times during which the foreign currency debt was outstanding, at arm's length with the particular corporation, and

**3** can reasonably be considered to have been issued or incurred in relation to the acquisition of the affiliate share, or

**(II**) under an agreement that

**1** was entered into by the vendor within 30 days before or after the acquisition of the affiliate share by the vendor with a person or partnership that dealt, at all times during which the agreement was in force, at arm's length with the particular corporation,

**2** provides for the purchase, sale or exchange of currency, and

> **3** can reasonably be considered to have been entered into by the vendor for the principal purpose of hedging the foreign exchange exposure arising in connection with the acquisition of the affiliate share.

…

**Deduction in respect of dividend received from foreign affiliate**

**113 (1)** Where in a taxation year a corporation resident in Canada has received a dividend on a share owned by it of the capital stock of a foreign affiliate of the corporation, there may be deducted from the income for the year of the corporation for the purpose of computing its taxable income for the year, an amount equal to the total of

> **(a)** an amount equal to such portion of the dividend as is prescribed to have been paid out of the exempt surplus, as defined by regulation (in this Part referred to as "exempt surplus") of the affiliate,
>
> …
>
> **(b)** an amount equal to the lesser of
>
> (i) the product obtained when the foreign tax prescribed to be applicable to such portion of the dividend as is prescribed to have been paid out of the taxable surplus, as defined by regulation (in this Part referred to as "taxable surplus") of the affiliate is multiplied by the amount by which
>
> (A) the corporation's relevant tax factor for the year
>
> exceeds
>
> (B) one, and
>
> (ii) that portion of the dividend,
>
> **(c)** an amount equal to the lesser of
>
> (i) the product obtained when
>
> (A) the non-business-income tax paid by the corporation applicable to such portion of the dividend as is prescribed to have been paid out of the taxable surplus of the affiliate
>
> is multiplied by
>
> (B) the corporation's relevant tax factor for the year, and

(ii) the amount by which such portion of the dividend as is prescribed to have been paid out of the taxable surplus of the affiliate exceeds the deduction in respect thereof referred to in paragraph 113(1)(b), and

**(d)** an amount equal to such portion of the dividend as is prescribed to have been paid out of the pre-acquisition surplus of the affiliate,

and for the purposes of this subsection and Subdivision I of Division B, the corporation may make such elections as may be prescribed.

…

**Immigration**

**128.1 (1)** For the purposes of this Act, where at a particular time a taxpayer becomes resident in Canada,

**…**

**Determination pursuant to s. 245(2)**

**152 (1.11)** Where at any time the Minister ascertains the tax consequences to a taxpayer by reason of subsection 245(2) with respect to a transaction, the Minister

**(a)** shall, in the case of a determination pursuant to subsection 245(8), or

**(b)** may, in any other case,

determine any amount that is relevant for the purposes of computing the income, taxable income or taxable income earned in Canada of, tax or other amount payable by, or amount refundable to, the taxpayer under this Act and, where such a determination is made, the Minister shall send to the taxpayer, with all due dispatch, a notice of determination stating the amount so determined.

…

**Definitions**

**245 (1)** In this section,

***tax benefit*** means a reduction, avoidance or deferral of tax or other amount payable under this Act or an increase in a refund of tax or other amount under this Act, and includes a reduction, avoidance or deferral of tax or other amount that would be payable under this Act but for a tax treaty or an increase in a refund of tax or other amount under this Act as a result of a tax treaty; (*avantage fiscal*)

***tax consequences*** to a person means the amount of income, taxable income, or taxable income earned in Canada of, tax or other amount payable by or refundable

to the person under this Act, or any other amount that is relevant for the purposes of computing that amount; (*attribut fiscal*)

***transaction*** includes an arrangement or event. (*opération*)

**General anti-avoidance provision**

(2) Where a transaction is an avoidance transaction, the tax consequences to a person shall be determined as is reasonable in the circumstances in order to deny a tax benefit that, but for this section, would result, directly or indirectly, from that transaction or from a series of transactions that includes that transaction.

**Avoidance transaction**

**(3)** An avoidance transaction means any transaction

> **(a)** that, but for this section, would result, directly or indirectly, in a tax benefit, unless the transaction may reasonably be considered to have been undertaken or arranged primarily for *bona fide* purposes other than to obtain the tax benefit; or
>
> **(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.

**Application of subsection (2)**

**(4)** Subsection (2) applies to a transaction only if it may reasonably be considered that the transaction

> **(a)** would, if this Act were read without reference to this section, result directly or indirectly in a misuse of the provisions of any one or more of
>
> > **(i)** this Act,
> > **(ii)** the *Income Tax Regulations*,
> > **(iii)** the *Income Tax Application Rules*,
> > **(iv)** a tax treaty, or
> > **(v)** any other enactment that is relevant in computing tax or any other amount payable by or refundable to a person under this Act or in determining any amount that is relevant for the purposes of that computation; or
>
> **(b)** would result directly or indirectly in an abuse having regard to those provisions, other than this section, read as a whole.

**Determination of tax consequences**

**(5)** Without restricting the generality of subsection (2), and notwithstanding any other enactment,

> **(a)** any deduction, exemption or exclusion in computing income, taxable income, taxable income earned in Canada or tax payable or any part thereof may be allowed or disallowed in whole or in part,
>
> **(b)** any such deduction, exemption or exclusion, any income, loss or other amount or part thereof may be allocated to any person,
>
> **(c)** the nature of any payment or other amount may be recharacterized, and
>
> **(d)** the tax effects that would otherwise result from the application of other provisions of this Act may be ignored,

in determining the tax consequences to a person as is reasonable in the circumstances in order to deny a tax benefit that would, but for this section, result, directly or indirectly, from an avoidance transaction.

**Request for adjustments**

**(6)** Where with respect to a transaction

> **(a)** a notice of assessment, reassessment or additional assessment involving the application of subsection 245(2) with respect to the transaction has been sent to a person, or
>
> **(b)** a notice of determination pursuant to subsection 152(1.11) has been sent to a person with respect to the transaction,

any person (other than a person referred to in paragraph 245(6)(a) or 245(6)(b)) shall be entitled, within 180 days after the day of mailing of the notice, to request in writing that the Minister make an assessment, reassessment or additional assessment applying subsection 245(2) or make a determination applying subsection 152(1.11) with respect to that transaction.

**Exception**

**(7)** 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.

> **Duties of Minister**
>
> **(8)** On receipt of a request by a person under subsection 245(6), the Minister shall, with all due dispatch, consider the request and, notwithstanding subsection 152(4), assess, reassess or make an additional assessment or determination pursuant to subsection 152(1.11) with respect to that person, except that an assessment, reassessment, additional assessment or determination may be made under this subsection only to the extent that it may reasonably be regarded as relating to the transaction referred to in subsection 245(6).

## IV. THE FACTS

[16] In 1850, Andrew Webster, the patriarch of the Webster family, began a coal importation business soon after immigrating to Canada from Scotland.[5] Upon his passing, his son and subsequently his grandson carried on the family business while diversifying and expanding the activities in Quebec and into the U.S.A.[6] Over the years, the family has held interests in different businesses and investments, including in stevedoring (Arrimage St-Laurent), salvaging (Quebec Salvage), media (The Globe and Mail), sports entertainment (the Toronto Blue Jays) and real estate.[7] The family has now been in Canada for six generations.[8]

[17] In or around 1955, the Webster family purchased Detroit Marine Terminals which operated a business in Detroit specializing in loading and offloading steel cargo from ships.[9] Detroit Marine Terminals' operations were dependent on steel imports into the U.S.A. and broader trends in the automotive industry.

[18] In parallel to Detroit Marine Terminals' operations, the Webster family made various real estate investments in the U.S.A., starting in the 1950s.[10] These investments were ultimately regrouped under PBI-Kinmont Inc. ("PBI-Kinmont"), which owned the Penobscot Building in Detroit, Michigan; various rental properties and land in Plattsburgh, New York, and California; as well as land in Texas and Oklahoma on which PBI-Kinmont held oil and gas leases.[11] PBI-Kinmont also had the following subsidiaries: the Penobscot Land Corporation and Penobscot, LLC, which owned undeveloped land at the Iron Horse Resort Retreat in Winter Park,

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[5] Partial Agreed Statement of Facts, para 6 ["PASF"].
[6] *Ibid*, para 7.
[7] *Ibid*, para 8.
[8] *Ibid*, para 9.
[9] *Ibid*, para 10.
[10] *Ibid*, para 11.
[11] *Ibid*.

Colorado, as well as the Durand Corporation, which owned a shopping/office plaza in Racine, Wisconsin.[12]

A. Wuswig's Corporate Structure Before the Reorganization

[19] Wuswig was incorporated on October 29, 1993, under the CBCA.[13] During the relevant period, it was a taxable Canadian corporation, as defined in subsection 89(1) of the ITA. Wuswig is part of a corporate group that is ultimately held by members of the Webster family and related entities, including the Imperial Windsor Group Inc.[14]

[20] On November 1, 1993, the U.S. holding company, Noro Holdings was incorporated under the laws of Michigan as a wholly owned subsidiary of Wuswig.[15]

[21] At that time, all members of the Webster family and their related entities who held interests in Detroit Marine Terminals and in PBI-Kinmont transferred their interests to Noro Holdings in exchange for shares of Wuswig, except for two U.S. family trusts, which received shares of Noro Holdings.[16]

[22] On March 31, 1997, the fair market value ("FMV") of Wuswig's investment in Noro Holdings was $46,655,040.[17]

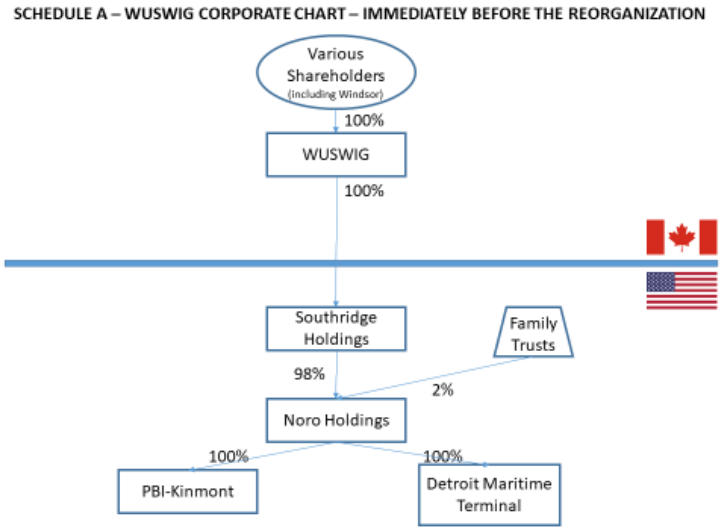
[23] Until March 26, 1999, Wuswig held the shares of Noro Holdings, which in turn held the shares of PBI-Kinmont and of Detroit Marine Terminals.[18]

[24] On March 26, 1999, Southridge Holdings was incorporated under the laws of Michigan, and Wuswig transferred its common and preferred shares of Noro Holdings to Southridge Holdings in exchange for common shares of Southridge Holdings.[19]

[12] *Ibid*.
[13] *Canada Business Corporations Act*, RSC 1985, c C-44 ["CBCA"].
[14] PASF, paras 3–5.
[15] *Ibid*, para 13.
[16] *Ibid*, para 14.
[17] *Ibid*, para 15.
[18] *Ibid*, para 16.
[19] *Ibid*, paras 17–18.

[25] The Penobscot Land Corporation, Penobscot, LLC, and Durand Corporation were wholly owned by PBI-Kinmont.[20]

[26] Each of Wuswig's foreign subsidiaries was a foreign affiliate of Wuswig within the meaning of subsection 95(1) of the ITA.[21]




B. Dividends Received by Wuswig from Noro Holdings and Southridge Holdings Before the Avoidance Transaction

1. 1999 Taxation Year

[27] During its 1999 taxation year, Wuswig received $13,404,400 in dividends from Noro Holdings.[22] For the purposes of computing its taxable income for the 1999 taxation year, with respect to the 1999 dividends, Wuswig deducted the following amounts from its income under section 113 of the ITA:[23]

| Dividends | Provision of the ITA |
|---|---|
| $35,951 | paragraph 113(1)(a) |
| $2,971,382 | paragraph 113(1)(b) |
| $840,242 | paragraph 113(1)(c) |
| $6,982,607 | paragraph 113(1)(d) |

[20] *Ibid*, para 20.
[21] *Ibid*, para 21.
[22] *Ibid*, para 23.
[23] *Ibid*, para 24.

[28] At the end of its 1999 taxation year, Wuswig's book value of capital stock in Southridge Holdings was $35,587,344, with underlying assets totalling 26,151,820 USD.[24]

2. 2000 Taxation Year

[29] During its 2000 taxation year, Wuswig received $17,550,330 in dividends from Southridge Holdings.[25] For the purposes of computing its taxable income for the 2000 taxation year, Wuswig deducted the following amounts from its income under section 113 of the ITA:

| Dividends | Provision of the ITA |
|---|---|
| $4,033,680 | paragraph 113(1)(a) |
| $13,516,650 | paragraph 113(1)(d) |

[30] At the end of its 2000 taxation year, Wuswig's book value of capital stock in Southridge Holdings was $25,981,514 with underlying assets totalling 21,879,347 USD.[26]

3. 2001 Taxation Year

[31] During its 2001 taxation year, Wuswig received $11,810,176 in dividends from Southridge Holdings.[27] For the purposes of computing its taxable income for the 2001 taxation year, Wuswig deducted the following amounts from its income under section 113 of the ITA:

| Dividends | Provision of the ITA |
|---|---|
| $11,549,074 | paragraph 113(1)(a) |
| $50,127 | paragraph 113(1)(b) |
| $34,356 | paragraph 113(1)(c) |
| $11,660 | paragraph 113(1)(d) |

[24] *Ibid,* para 26.
[25] *Ibid,* para 27.
[26] *Ibid,* para 30.
[27] *Ibid,* para 31.

4. The Impact of the Payment of Dividends out of the Pre-acquisition Surplus for the 1999 to 2001 Taxation Years

[32] As a result of a portion of the dividends being paid out of the pre-acquisition surplus in the 1999, 2000 and 2001 taxation years, the adjusted cost base of Wuswig's common shares in Southridge Holdings was reduced to $7,777,125 pursuant to subsection 92(2) and paragraph 53(2)(b) of the ITA.[28]

C. The Value of Southridge Holdings' Assets at the End of Its 2006 Taxation Year

[33] By the end of its 2006 taxation year, Southridge Holdings' assets totalling 8,336,662 USD on March 31, 2002, decreased to 1,976,667 USD.[29]

D. Detroit Marine Terminals' Advance Balances from Affiliates at the End of Its 2006 Taxation Year

[34] By March 31, 2006, Detroit Marine Terminals had received 3,309,675 USD in advances from its affiliates. It received 2,214,725 USD from Southridge Holdings, 6,000 USD from Noro Holdings and 1,088,950 USD from PBI-Kinmont.[30]

E. The FMV of Wuswig's Investment in Southridge Holdings at the End of Its 2007 Taxation Year

[35] The FMV of Wuswig's investment in Southridge Holdings was $2,691,086 as of March 23, 2007.[31]

F. Wuswig's Reorganization

[36] In December 2005, Wuswig requested that its tax advisors, KPMG, review the Canadian tax consequences of a liquidation of its foreign affiliates located in the

[28] *Ibid,* para 33.
[29] *Ibid,* para 34.
[30] *Ibid,* para 35.
[31] *Ibid,* para 36.

U.S.A. into Wuswig.[32] At that time, the shares of Southridge Holdings held by Wuswig had an adjusted cost base of $7,777,125 and an FMV of $2,691,086.[33]

[37] KPMG concluded that "[b]ecause exempt dividends received by each corporation from its foreign affiliate are greater that [sic] the loss sustained on the disposition of their shares in the liquidating affiliate, the loss is denied for Canadian tax purposes (no economic loss in the transaction)."[34]

[38] In February 2006, KPMG wrote a memorandum indicating that Wuswig requested that KPMG review the Canadian tax consequences of an alternative to claim a capital loss sustained by Wuswig upon the disposition of the shares of Southridge Holdings.[35]

[39] KPMG proposed a reorganization that would allow Wuswig to claim the loss on the shares of Southridge Holdings in accordance with the specific technical rules outlined in the ITA.[36]

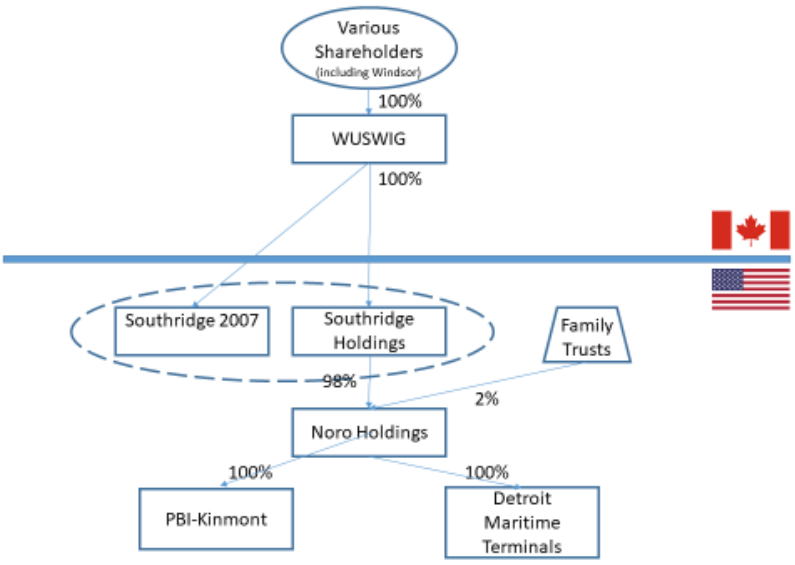
[40] In 2007, as proposed by KPMG, Wuswig carried out a reorganization in order to dissolve its U.S. structure. For the purpose of the Reorganization, Wuswig made the following transactions:[37]

1- On February 12, 2007, Wuswig incorporated a new wholly owned subsidiary, Southridge 2007, under the laws of Delaware;

2- On March 13, 2007, Southridge Holdings and Southridge 2007 merged;

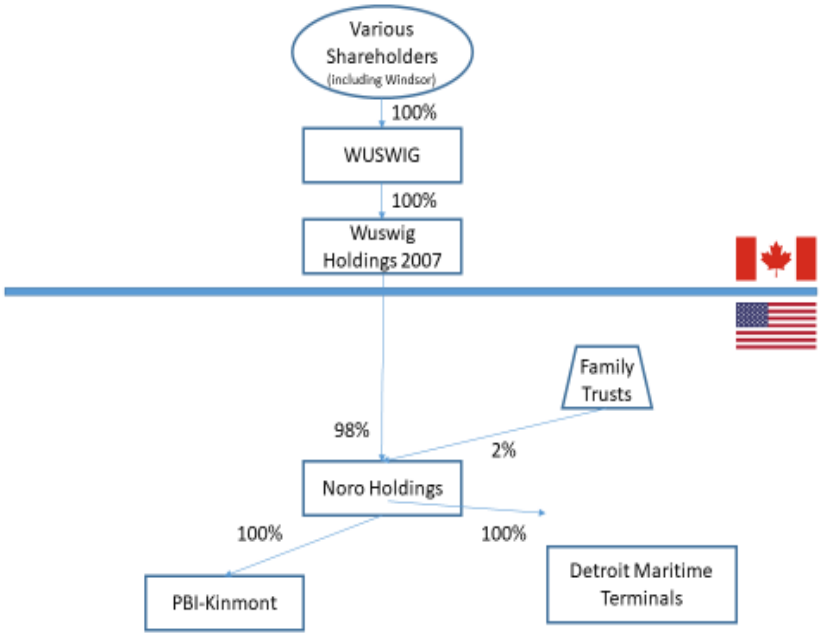
[32] *Ibid*, para 37.
[33] *Ibid*, para 38.
[34] *Ibid*, para 39.
[35] *Ibid*, para 40.
[36] *Ibid*, para 41.
[37] *Ibid*, para 42.

SCHEDULE B – WUSWIG CORPORATE CHART – MARCH 13, 2007 – AMALGAMATION OF SOUTHRIDGE 2007




3- On March 23, 2007, the resulting entity, Southridge 2007, was continued into Canada pursuant to the CBCA and became a resident in Canada. Pursuant to section 128.1 of the ITA, on immigration, Southridge 2007 was deemed to have disposed of its shares of Noro Holdings at their FMV ($2,691,086) and to have acquired them at the same value. Southridge 2007 was renamed Wuswig Holdings 2007 upon immigration;

SCHEDULE C – WUSWIG CORPORATE CHART – MARCH 23, 2007 – CORPORATE IMMIGRATION OF HOLDINGS INTO CANADA



4- On March 23, 2007, Wuswig Holdings 2007 issued 100,000 preferred shares to Windsor, a shareholder of Wuswig for $100,000; and

5- On March 30, 2007, Wuswig Holdings 2007 was wound up pursuant to subsection 88(2) of the ITA.



[41] On March 30, 2007, Wuswig held 2,450 common shares of Wuswig Holdings 2007.[38] The FMV and the paid-up capital ("PUC")[39] of the Wuswig Holdings 2007 shares was $2,691,086, and their adjusted cost base was $7,777,125.[40] Pursuant to subsections 69(5) and 88(2) of the ITA, upon the wind-up, Wuswig was deemed to have disposed of its common shares of Wuswig Holdings 2007 at their FMV, therefore realizing the capital loss of $5,086,039. Wuswig was also deemed to have acquired the shares of Noro Holdings at their FMV, which was $2,691,086.[41]

[42] On March 31, 2008, Wuswig's American subsidiaries were dissolved, and Noro Holdings was wound up into Wuswig.[42]

## G. Testimony of the Witnesses

### 1. Howard Davidson

[43] Mr. Davidson graduated from Concordia University in 1980 with a Bachelor of Commerce. He is Wuswig's president, and he has worked with the Webster family since 1980. When Wuswig was incorporated in 1993, Mr. Davidson became its assistant secretary.[43]

[44] According to Mr. Davidson, after the death of R. Howard Webster (who ran what would be the Webster family operations) in 1990, the Webster family decided

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[38] *Ibid*, paras 43–44.
[39] As defined in subsection 89(1), "paid-up capital" means that the PUC calculation essentially begins with the stated capital of a class of shares under corporate law, with certain subsequent adjustments for tax purposes; see *Copthorne Holdings Ltd v Canada*, 2011 SCC 63 at paras 75–78 [*Copthorne*].
[40] PASF, para 44.
[41] *Ibid*, paras 45–47.
[42] *Ibid*, para 48.
[43] Transcript of proceedings dated April 25, 2022, testimony of Mr. Davidson, pages 109–10, 113–14.

to form Wuswig to encapsulate all of the Webster family's U.S. assets that were held by various entities at that time.[44]

[45] Mr. Davidson explained that, prior to Wuswig's incorporation, all of the Webster family's U.S. assets were owned by two U.S. corporations, PBI-Kinmont and Detroit Marine Terminals. These two corporations were owned by Canadian corporations and Canadian individuals. After Wuswig was incorporated specifically to hold all of the U.S. assets, Noro Holdings was incorporated to own the two main categories of U.S. assets (the real estate assets in PBI-Kinmont and the stevedoring assets in Detroit Marine Terminals). This made it possible for two U.S. resident trusts to own shares of the U.S. corporations. According to Mr. Davidson, Southridge was inserted in order to manage dividends to be paid efficiently to shareholders as well as to retain money in the U.S.A. for operations as deemed necessary.[45]

[46] Mr. Davidson testified that, between 1997 and the early 2000s, PBI-Kinmont and Detroit Marine Terminals sold assets. The assets are the following:[46]

1- Land related to golf was sold for a realized value of 1,508,000 USD (estimated value of 1,700,000 USD);

2- Elmwood Plaza was sold for a realized value of 2,900,000 USD (estimated value of 2,000,000 USD);

3- The Iron Horse Resort was sold for a realized value of 5,705,825 USD (estimated value of 5,400,000 USD);

4- Vacant land related to the Iron Horse Resort was sold for a realized value of 1,164,777 USD (estimated value of 300,000 USD);

5- Penobscot Building was sold for a realized value of 17,625,000 USD (estimated value of 17,000,000 USD); and

6- River Rouge property was sold for a realized value of 15,709,004 USD (estimated value of 8,000,000 USD).

[44] *Ibid,* page 114.
[45] *Ibid,* pages 115–17.
[46] *Ibid,* pages 163–65.

[47] Mr. Davidson testified that, between 1999 and 2001, PBI-Kinmont and Detroit Marine Terminals distributed a total of approximately $42,000,000 in dividends to Wuswig with the sale of the assets.[47] More specifically, in 2000 and 2001, Detroit Marine Terminals paid 13,000,000 USD in dividends. They did not pay any other dividends before or after that period.[48]

[48] Mr. Davidson explained that Detroit Marine Terminals' stevedoring business involved loading and unloading steel and other cargo that figured into the manufacturing processes for the industries in Detroit. In the early 2000s, the tech boom and bust, the events surrounding 9/11 and the tariffs on the importation of foreign steel imposed by the U.S. government contributed to a reduction in the volume of steel and cargo going through the Detroit Marine Terminals' port. According to Mr. Davidson, Detroit Marine Terminals was "bleeding money", because its source of income was rapidly deteriorating. Detroit Marine Terminals had losses from about 2001 until it ceased its operations.[49]

[49] Mr. Davidson testified that, starting in the summer of 2001, Wuswig financed Detroit Marine Terminals' operations with the proceeds of the sale of some of its U.S. assets as described above.[50] Detroit Marine Terminals did not pay any dividends to Wuswig after that point in time.[51] Later, Detroit Marine Terminals received loans totalling 3,309,657 USD from either its parent or affiliated companies and they were never repaid.[52] Ultimately, Detroit Marine Terminals suffered a deficit of 3,495,094 USD, which it never recovered from.[53] On April 20, 2004, Detroit Marine Terminals ceased its operations and closed its facilities due to economic conditions. According to Mr. Davidson, Wuswig's investment in Detroit Marine Terminals at that point was nil.[54]

2. Lise Gauthier

[50] Ms. Gauthier is retired. She was previously a tax auditor with the CRA in the Large Businesses department, and she conducted Wuswig's audit.[55] In the course of

[47] *Ibid*, pages 199–200.
[48] *Ibid*, page 171.
[49] *Ibid*, page 153.
[50] *Ibid*, pages 156–57.
[51] *Ibid*, page 158.
[52] *Ibid*, page 159.
[53] *Ibid*, pages 159–60.
[54] *Ibid*, pages 160–61, 168.
[55] *Ibid*, pages 45–46.

her audit, Ms. Gauthier reviewed the appraisal reports of Coopers & Lybrand.[56] In the CRA's permanent record file, she saw a table that stated that the FMV of the Noro Holdings shares was $40,445,040 in 1997[57] and $2,691,086 in 2007. She used these amounts for the purposes of demonstrating that Noro Holdings had lost value between 1997 and 2007.[58] She also had the data to establish the adjusted cost base ("ACB")[59] of the shares in Noro Holdings.[60] Ms. Gauthier similarly took into account the FMV of the shares ($2,691,086) in 2007.

[51] After reviewing the financial statements for Wuswig's American subsidiaries and seeing the decrease in their income, Ms. Gauthier concluded that the subsidiaries decreased in value and that the FMV of the shares decreased as well.[61]

## V. THE PARTIES' POSITIONS

### A. The Legal Framework

[52] The parties agree on the legal framework applicable to the GAAR. The parties submit that the GAAR allows the Minister to deny the tax benefits arising out of certain arrangements, even if these arrangements comply with a literal interpretation of specific provisions of the ITA. This is because these arrangements amount to an abuse of these provisions.[62]

[53] The parties submit that, in order to determine whether the GAAR is applicable, this Court must conduct the following three-step analysis:

- First step: determine whether there is a "tax benefit" arising from a transaction or series of transactions within the meaning of subsection 245(1) of the ITA;

- Second step: determine whether the transaction (or at least one of the transactions in the series of transactions) that gave rise to the tax benefit is

[56] *Ibid*, pages 74, 77, Exhibit A-2, 16.1.
[57] *Ibid*, page 69.
[58] *Ibid*, pages 73–74, 103–04.
[59] ACB is defined in section 53 of the ITA; it is essentially the cost to the taxpayer of the property, with some adjustments detailed in specific subsections.
[60] Transcript of proceedings dated April 25, 2022, pages 72–73.
[61] *Ibid*, page 105.
[62] Appellant's plan of argument, para 7; Respondent's written submissions, para 50; *Canada Trustco Mortgage Co v Canada*, 2005 SCC 54 at para 16 [*Canada Trustco*].

an avoidance transaction under subsection 245(3) of the ITA, in the sense that it was not arranged primarily for *bona fide* purposes. Under this view, a transaction that primarily seeks to obtain a tax benefit will be an avoidance transaction because it is not considered a *bona fide* purpose; and

- Third step: determine whether the avoidance transaction is abusive within the meaning of subsection 245(4) of the ITA.[63]

[54] The parties submit that these three steps constitute the three conditions that must be met for the GAAR to apply to an avoidance transaction.[64]

[55] With respect to the first step, the parties submit that, pursuant to subsection 245(1) of the ITA, the tax benefit is established when there is a reduction, avoidance or deferral of tax or an increase in a tax refund or other amount covered by the ITA.[65]

[56] With respect to the second step, the parties did not say much. They only submitted that whether the series of transactions contains an avoidance transaction is not at issue in these appeals.

[57] With respect to the third step, the parties submit that the approach adopted by the Supreme Court of Canada to determine if there was an abuse of a provision of the ITA requires the Court to conduct a two-part inquiry:[66]

- The first part consists of identifying the object, spirit and purpose of the provisions of the ITA that give rise to the tax benefit, having regard to the scheme of the ITA, the relevant provisions and the admissible extrinsic means; and



[63] Appellant's plan of argument, para 8; Respondent's written submissions, para 51; *Canada Trustco*, above, footnote 63, at para 17; *Copthorne*, above, footnote 40, at paras 32–33.
[64] Appellant's plan of argument, para 8; Respondent's written submissions, para 51.
[65] Appellant's plan of argument, para 13, Respondent's written submissions, para 53; *Canada Trustco*, above, footnote 63, at para 19; ITA, above, footnote 1, at s 245(1).
[66] Appellant's plan of argument, para 37; Respondent's written submissions, para 55. *Deans Knight Income Corp v Canada*, 2023 SCC 16 at para 57 [*Deans Knight*].

- The second part consists of determining whether the avoidance transaction frustrates the object, spirit or purpose of the provisions that are relied upon to obtain the tax benefit.[67]

[58] Finally, the parties submit that it is His Majesty the King ("HMTK") who bears the burden of establishing that the avoidance transaction constitutes an abuse of the provisions of the ITA.[68]

## B. The Application of the GAAR

### 1. Wuswig's Position

#### a) The 2018 Taxation Year

[59] Counsel for Wuswig submits that the GAAR does not apply to the 2018 taxation year. According to counsel, this is because there was no misuse or abuse of subsections 93(2) and 93(2.01) of the ITA.[69]

##### (1) Did a Tax Benefit Arise from the Series of Transactions?

[60] Counsel for Wuswig admits that, in its 2018 taxation year, Wuswig received a tax benefit from the series of transactions. A portion of the capital loss realized from the series of transactions was used by Wuswig against the capital gain it realized in its 2018 taxation year, resulting in a reduction of tax payable for that year.[70] Consequently, counsel admits that, for the 2018 taxation year, the first condition for the application of the GAAR is met.[71]

##### (2) Was the Series of Transactions an Avoidance Transaction?

[61] Counsel for Wuswig admits that the series of transactions made by Wuswig for the purpose of the Reorganization was carried out primarily in order to obtain a tax benefit. Therefore, the series of transactions is an avoidance transaction pursuant

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[67] *Canada Trustco,* above, footnote 63, at paras 44–45; *Copthorne*, above, footnote 40, at paras 69–71.
[68] Appellant's plan of argument, para 42; Respondent's written submissions, para 52.
[69] Appellant's plan of argument, para 11 and transcript of proceedings dated April 25, 2022, page 15, lines 13–16.
[70] Transcript of proceedings dated April 25, 2022, page 25, lines 13–23.
[71] Appellant's plan of argument, para 10.

to subsection 245(3) of the ITA. Consequently, counsel admits that, for the 2018 taxation year, the second condition for the application of the GAAR is met.[72]

### (3) Was the Avoidance Transaction Abusive?

[62] Counsel for Wuswig submits that the third condition necessary for the application of the GAAR is not met. According to counsel, the avoidance transaction did not result directly or indirectly in a misuse or an abuse of subsections 93(2) and 93(2.01) of the ITA.[73]

#### (a) The Object, Spirit and Purpose of Subsections 93(2) and 93(2.01) of the ITA

[63] Counsel for Wuswig submits that a textual, contextual and purposive interpretation of subsections 93(2) and (2.01) of the ITA reveals that their underlying rationale is to prevent the creation of artificial losses on the disposition of foreign affiliate shares and that they do not apply to foreign affiliates once they have immigrated to Canada. Counsel's conclusion is based on the following:

1- The location of the provisions in the ITA;

2- A comparison of subsections 93(2) and 93(1) of the ITA;

3- The fact that stop-loss rules are circumscribed to specific situations;

4- The complete code governing the immigration of foreign affiliates to Canada;

5- The underlying rationale of the capital gains system as a whole;

6- The legislative history of the provisions; and

7- The available extrinsic aids.[74]

[72] *Ibid.*
[73] *Ibid,* para 11.
[74] *Ibid,* para 50.

(i) Textual Analysis

[64] The submissions of counsel for Wuswig on the textual analysis can be summarized as follows:

i. A capital loss on the disposition of shares of a foreign affiliate by a taxpayer is calculated in accordance with ordinary principles; that is, it is the amount by which the taxpayer's ACB of the shares exceeds the taxpayer's proceeds of disposition. Subsections 93(2) and (2.01) of the ITA contain a dividend stop-loss rule, which applies to further reduce the loss realized by a taxpayer on the disposition of foreign affiliate shares by the amounts of tax-free dividends received on those shares or substituted shares. This rule is analogous to the rule found in subsections 112(3) of the ITA and following, which apply more generally to reduce a gain on a disposition of shares and not only to shares of foreign affiliates.[75]

ii. The statutory scheme governing subsections 93(2) and (2.01) of the ITA is complex. Subsection 93(2) provides that subsection 93(2.01) applies where a particular corporation resident in Canada (the "particular corporation") has a particular loss from the disposition of shares of a foreign affiliate of the particular corporation (the "affiliate share"). If these three conditions are met, the loss computation rule at subsection 93(2.01) applies, and the loss on the disposition of the affiliate share is calculated as follows:

> the amount of the loss determined without reference to section 93 (Variable A), less
>
> the total amount received by the taxpayer or another corporation related to the taxpayer in respect of an "exempt dividend" on the affiliate share ("exempt dividends") or "on a share for which the affiliate share was substituted" ("substituted shares") (Variable B), less, very generally, the amount of exempt dividends on the affiliate share or on substituted shares that was previously applied to reduce a loss on the disposition of the affiliate share (Variable C).[76]

iii. "Exempt dividends" refers to dividends received by a corporation resident in Canada to the extent that they are deductible by that corporation under paragraphs 113(1)(a) and (c) of the ITA. Very generally,

[75] *Ibid*, para 43.
[76] *Ibid*, para 44.

> paragraphs 113(1)(a) and (c) allow a corporation resident in Canada that receives a dividend on a share of a foreign affiliate to deduct this dividend amount where (1) it is prescribed to be paid out of certain surplus balances maintained in respect of that foreign affiliate, or (2) the foreign affiliate was taxed in its home jurisdiction on its earnings.[77]



(ii) Contextual Analysis

[65] Counsel submits that a textual, contextual and purposive interpretation of subsections 93(2) and (2.01) of the ITA reveals that they are not intended to apply to reduce a loss of a taxpayer on a disposition of shares of a Canadian corporation with respect to dividends received by the taxpayer from the corporation when it previously was a foreign affiliate and before it was continued into Canada pursuant to the CBCA. These rules are meant to prevent the artificial creation of losses. This emerges from a contextual analysis of the following elements:

1- Location of subsections 93(2) and (2.01) in the ITA (context in the ITA);

2- Interaction of subsections 93(2) and (2.01) with subsection 93(1) of the ITA;

3- Circumscribed stop-loss rules;

4- Complete code governing the continuance of foreign affiliates into Canada; and

5- Overall scheme of the capital gains system.

(a) Location of Subsections 93(2) and (2.01) in the ITA

[66] Counsel's submissions on this topic can be summarized as follows:

i. Subsections 93(2) and (2.01) of the ITA are part of the broader foreign affiliate regime. The foreign affiliate rules have been described as among the most complex rules in the ITA. The foreign affiliate rules are in Subdivision I of Division B of the ITA, which concerns the computation of income in respect of "shareholders of corporations not resident in Canada" (the title of Subdivision I). Other than the foreign affiliate rules, this subdivision contains

[77] *Ibid*, para 45.

more general rules governing the taxation of shareholders of non-resident corporations, as well as the offshore investment fund property rules in section 94.1 of the ITA and the deemed resident trust rules in section 94 of the ITA.[78]

ii. Subsections 93(2) and (2.01) are not the only dividend stop-loss rules in Subdivision I of the ITA. There are a series of companion rules that ensure the application of the stop-loss rule where a corporation directly or indirectly holds affiliate shares through a partnership.[79]

iii. Subsection 112(3) of the ITA is the "domestic" equivalent to the dividend stop-loss rule found in subsections 93(2) and (2.01). It limits a loss recognized by a corporation on the disposition of any shares (affiliate shares or otherwise) to the extent that the corporation has received certain tax-free dividends, such as capital dividends or deductible inter-corporate dividends on those shares. As in the foreign affiliate context, there are companion provisions that ensure the application of the rule when a corporation holds shares through a partnership or a trust.[80]

iv. The dividend stop-loss rules in subsections 93(2) and 112(3) are among a broader set of stop-loss rules in the ITA, which generally apply to deny, reduce or defer a loss on a disposition of property in certain specific circumstances. There are, very generally, two types of stop-loss rules in the ITA:

1- Rules that deny the immediate recognition of a loss on transactions involving related or affiliated persons and typically defer the recognition of the loss to some future time; and

2- Rules that permanently deny all or a portion of a loss otherwise arising from a transaction under certain conditions, whether the transaction involves related or affiliated persons.[81]

[78] *Ibid,* para 46.
[79] *Ibid,* para 47.
[80] *Ibid,* para 48.
[81] *Ibid,* para 49.

(b) Interaction Between Subsections 93(2), 93(2.01) and 93(1) of the ITA

[67] Counsel's submissions on this topic can be summarized as follows:

i. Counsel for Wuswig submits that it may be argued that the underlying rationale of subsections 93(2) and (2.01) of the ITA is not to target the artificial creation of losses, but rather, more broadly, to ensure that losses are not overstated. This assumes that tax-free dividends, by their nature, reduce the value of shares in a way that requires that we vary the standard calculation of capital losses. If so, it is reasonable that tax-free dividends should be accounted for in calculating both capital gains and losses, since the effect of tax-free dividends is the same in calculating gains and losses—and the rules should apply to increase a capital gain just as they apply to decrease a capital loss. However, a comparison of subsections 93(2) and (2.01) on the one hand and subsection 93(1) of the ITA on the other clearly suggests an asymmetry in the treatment of dividends in the calculation of capital gains and losses.[82]

ii. Subsection 93(1) of the ITA is a rule that allows a corporation disposing of shares of a foreign affiliate to elect to treat the gain on that disposition, or a portion thereof, as a dividend payable on those shares. As in the case of ordinary dividends payable by foreign affiliates, this deemed dividend may be received tax free by the taxpayer if it is offset by a deduction under subsection 113(1) of the ITA.

> Using the Example, consider scenario D, where, prior to the sale of Class A common shares, Canco elects to treat $100 of the capital gain as a dividend. The dividend will be prescribed to be paid out of Forco's exempt surplus, and will be received by Canco on a tax-free basis. Meanwhile, Canco's gain on the sale will be reduced to nil. Canco has thus effectively reduced its capital gain to zero by leveraging Forco's exempt surplus balance.

iii. Not only is this type of transaction entirely permissible, but subsection 93(1) even provides taxpayers with a facilitative election allowing them to reduce the gain on the disposition of their foreign affiliate shares to the extent that they have unused surplus balances without even paying a dividend. In other words, subsection 93(1) indicates that this type of value stripping to reduce a

[82] *Ibid,* para 63.

gain is encouraged by the ITA. However, subsection 93(1) of the ITA cannot be used to create a loss.

> Using the Example, consider scenario E, whereby Canco elects to treat $150 of the capital gain as a dividend. Canco will thus be disposing of its Class A common shares at a loss, but that loss will be stopped under the ordinary operation of subsections 93(2)/(2.01), since the amount of amount of the loss will be ground down by the amount of the exempt dividend ($150).

iv. These scenarios demonstrate clearly that embedded within the ITA is a policy of asymmetry in respect of the reduction of capital gains and the increase of capital losses. Yet, the reduction of a capital gain or the increase of a capital loss lies on the same economic continuum, such that value stripping through the payment of dividends achieves the same economic result in both cases. Nevertheless, the reduction of capital gains is allowed under the ITA, whereas the increase in capital losses is stopped. This suggests that the policy underlying subsections 93(2) and (2.01) is not simply to provide a more accurate formula for the calculation of a loss but rather to limit the creation of artificial capital losses. Otherwise, the ITA would have to have a similar policy of limiting the reduction of capital gains on the disposition of shares to the extent that tax-free dividends have been paid on those shares.[83]

(c) Circumscribed Stop-Loss Rules

[68] Counsel's submissions on this topic can be summarized as follows:

i. Where there are specific provisions with a clearly delineated scope, the Federal Court of Appeal has embraced a presumption in GAAR cases that, the limited scope of those provisions was a deliberate policy choice by Parliament. For instance, in *Landrus*, a decision in which the Minister alleged the abuse of the underlying policy of the stop-loss rules applying to transfers among related persons, the Tax Court held as follows:

> [116] In a paper presented at the 1995 Canadian Tax Foundation Conference entitled "*New Rules, Old Chestnuts, and Emerging Jurisprudence: The Stop-Loss Rules*", at p. 34:1, Edward Heakes described the policy underlying those rules in the *Act* as follows:
>
> > Tax legislators have long recognized that, in order to prevent undue erosion of the tax base, special rules are needed to deal with the

[83] *Ibid*, paras 64–67.

> recognition, denial, or deferral of losses for tax purposes that might otherwise be recognized on transfers of property between persons having a degree of connection or relationship with each other. The Income Tax Act is no exception and contains numerous provisions, commonly referred to as "stop-loss rules", that are intended to deal with this concern...
>
> [117] Parliament has addressed the problem by creating a series of provisions that deny losses that would otherwise be allowed under the *Act*, in specific situations. These rules are precisely drafted and set out detailed conditions for the denial of a loss that would otherwise arise on the disposition of a particular type of property. Those conditions vary from one stop-loss rule to the other. An important variation, for the purposes of this case is in the degree of connection or relationship required between the transferor and transferee.
>
> ...
>
> [120] In my view, the particularity with which Parliament has specified the relationship that must exist between the transferor and transferee for the purpose of each stop-loss rule referred to by the Respondent is more indicative that these rules are exceptions to a general policy of allowing losses on all dispositions. In other words, where there is a general provision in the *Act* allowing for the deduction of a loss, subject to a restriction or exception in certain circumstances, the limited nature of the exception can be seen as underscoring the general policy of the *Act* to allow the loss. Furthermore, it is not accurate to say that these rules deny losses on transfers between all related parties. As seen above, the distinct relationship that Parliament sought to target in each case is clear.

On appeal, the Federal Court of Appeal endorsed this view, finding that "where it can be shown that an anti-avoidance provision has been carefully crafted to include some situations and exclude others, it is reasonable to infer that Parliament chose to limit their scope accordingly". This Court has taken a similar view in its decision in *Gwartz*, arguing that Parliament's choice not to amend an anti-avoidance provision to curtail well-known planning techniques used to circumvent that provision suggests that its underlying rationale is not frustrated by those planning techniques.[84]

ii. The text of subsection 93(2), which is a rule of application, reveals that subsection 93(2.01) is intended to apply only where there is a disposition of shares of a foreign affiliate of a corporation. The rule could have easily applied

[84] *Ibid*, paras 78–79.

to the dispositions of any shares of the taxpayer, not just to a disposition of affiliate shares. It would have thus captured a situation where a taxpayer receives exempt dividends from a foreign affiliate, the foreign affiliate subsequently continues into Canada and its shares are sold by the taxpayer at a loss.

In contrast, the text of subsection 112(3) of the ITA indicates that it is intended to apply to a disposition of all shares, and it provides that the loss on such disposition will be reduced only to the extent that the taxpayer has received dividends that were deductible under section 112 or subsections 115(1) or 138(6) of the ITA, dividends in respect of which an election was made under subsection 83(2) of the ITA, and a life insurance capital dividend. This rule could have just as easily included dividends deductible under section 113, which would have captured any exempt dividends previously paid on those shares that would be caught by subsection 93(2) of the ITA.

To note, subsection 112(3) is clearly intended to reduce a loss on a disposition of affiliate shares where that corporation was previously resident in Canada and paid deductible dividends to its shareholder prior to emigration. In this sense, there is a clear asymmetry between subsections 93(2) and (2.01) and subsection 112(3) in respect of how they treat dividends received from immigrating and emigrating corporations, respectively.[85]

iii. The dividend stop-loss rules are generally construed narrowly. This was clearly established by the Federal Court of Appeal in *Toronto-Dominion Bank*, which concerned the application of subsection 112(3) of the ITA to a disposition by a taxpayer of one class of shares of a corporation (Class E shares), where that taxpayer had received prior tax-deductible dividends on a substantially similar class of shares in that corporation (common, Class A and Class B shares). The Minister took the position that the transactions violated former subsection 55(1) of the ITA, and, in the alternative, that subsection 112(3) should reduce the capital loss on the disposition of Class E shares by the amount of tax-free dividends declared on common, Class A and Class B shares held by the taxpayer. The Federal Court of Appeal soundly rejected both arguments. On subsection 112(3), the Court wrote as follows:

> [60] The Crown alleges that TD was only able to claim a loss on the disposition as a result of a manipulation of Oxford's share structure and

[85] *Ibid*, paras 80–82.

> thereby evaded the policy underlying the stop-loss provisions of subsection 112(3). The essence of the Crown's argument is that subsection 112(3) should be interpreted to offset dividends received on shares against capital losses sustained on the disposition of materially similar shares in the same corporation. This interpretation would be consistent with the purpose of subsection 112(3): the prevention of corporate value-stripping through the issue of tax-free dividends out of contributed capital and the creation of a corresponding capital loss. Parliament cannot have intended, counsel says, to permit taxpayers to evade subsection 112(3) by the creation of new classes of shares that are virtually identical to those on which dividends have been paid.
>
> [61] I do not agree. Like other legislation, the provisions of tax statutes are to be interpreted in light of their text, context and objectives. However, the following passage from *Canada Trustco* (at para. 11) is apt here:
>
> > … the particularity and detail of many tax provisions have often led to an emphasis on textual interpretation. Where Parliament has specified precisely what conditions must be satisfied to achieve a particular result, it is reasonable to assume that Parliament intended that taxpayers would rely on such provisions to achieve the result they prescribe.
>
> See also *Placer Dome Canada Ltd. v. Ontario (Minister of Finance)*, 2006 SCC 20, [2006] 1 S.C.R. 715 at paras. 21-24. In my opinion, what the Crown urges as the correct interpretation of subsection 112(3) is, because of the specificity of its text, more properly characterized as a proposed amendment.[86]

iv. In addition to the rules in subsections 93(2), 93(2.01) and 112(3), the ITA contains specific (and circumscribed) rules to ensure that the dividend stop-loss rules apply across certain transformative transactions, allowing for a limited degree of tracking of dividends. Subsection 248(5) of the ITA, combined with the "substituted share" concept in subsection 93(2.01) of the ITA, operates to provide for tracking of dividends where shares of a foreign affiliate are substituted for shares in another foreign affiliate through internal transactions within the foreign affiliate group. This is intended to ensure the underlying rationale is not easily frustrated on exchanges of affiliate shares within the corporate group.

[86] *Ibid*, para 83.

> Similarly, subsection 112(7) of the ITA provides that, where there is a share exchange under sections 51, 85.1, 86 or 87 of the ITA, any dividends received on the old shares are deemed to have been received on the new shares for the purposes of subsection 112(3) of the ITA. Exchanges under section 85 of the ITA are excluded from this list. Paragraph 87(2)(u) of the ITA provides that, for the purposes of subsection 93(2.01), where a new corporation is formed following an amalgamation of two predecessor corporations, and a predecessor corporation held affiliate shares that were acquired by the new corporation on the amalgamation, the affiliate shares are deemed to be owned by the new corporation throughout the period they were owned by the predecessor corporation, and any exempt dividend declared on those shares is deemed to have been received by the new corporation.
>
> Similarly, paragraph 87(2)(x) of the ITA provides that, for the purposes of subsection 112(3), where a new corporation is formed following an amalgamation of two predecessor corporations, and a predecessor corporation held shares that were acquired by the new corporation on the amalgamation, any dividends received by the predecessor corporation on a tax-free basis are deemed to have been received by the new corporation;
>
> Paragraph 88(1)(e.2) of the ITA provides that the stop-loss continuity rules in paragraphs 87(2)(u) and (x) of the ITA also apply in respect of a wind-up of a Canadian corporation under subsection 88(1) of the ITA. Notably, these rules do not apply on a wind-up governed by subsection 88(2) of the ITA.
>
> On the other hand, there are no rules ensuring the tracking and continuity of stop-loss attributes where foreign affiliates become resident in Canada. More generally, the ITA contains no specific rules bridging or integrating both sets of dividend stop-loss rules.[87]

Taken together, these rules demonstrate that, though Parliament has turned its mind to the operation and continuity of stop-loss rules against certain transactions, with respect to both the domestic and the foreign affiliate context, it chose not to institute a rule allowing for the continuity of stop-loss rules on the immigration of a foreign affiliate into Canada.[88]

[87] *Ibid*, paras 84–85.
[88] *Ibid*, para 86.

(d) Complete Code Governing the Continuance of Foreign Affiliates into Canada

[69] Counsel submits that it may be argued that Parliament simply forgot to enact a rule ensuring the continuity of the dividend stop-loss rules where a foreign affiliate becomes resident in Canada. However, counsel submits that this argument is difficult to sustain considering the highly complex and technical rules governing the immigration of foreign affiliates to Canada.[89]

[70] Counsel's submissions regarding the code governing the continuance of foreign affiliates into Canada can be summarized as follows:

i. When a foreign affiliate immigrates to Canada, it is subject to the general rules governing the immigration of a corporation to Canada. For instance, it will be subject to a deemed year end immediately prior to the time of immigration, and the tax cost in most of its property will be stepped up to its fair market value at that time. On immigration, the corporation may be subject to certain paid-up capital adjustments, and certain deemed dividends may be triggered in respect of its shareholders. Moreover, the foreign affiliate importation rules, which are among the most highly detailed and complex provisions in the foreign affiliate system itself, will apply to trigger foreign accrual property income ("FAPI") for the affiliate in respect of its taxation year ending immediately prior to the time of immigration. These rules are highly technical; however, very generally, they operate to recognize a "terminal" FAPI return based on available surplus and other foreign affiliate specific balances. Practically, these rules operate to effectively wipe clean and reset prior tax attributes once a foreign affiliate immigrates to Canada.[90]

ii. The technical rules governing the immigration of foreign affiliates to Canada manifestly do not provide for the continuity of stop-loss rules in the case of immigration of a foreign affiliate to Canada. The omission of any stop-loss continuity rule within the foreign affiliate importation rules suggests a deliberate choice not to extend subsections 93(2) and (2.01) of the ITA in respect of corporations that have become resident in Canada.

iii. The immigration of foreign affiliates to Canada is hardly an obscure occurrence. Under standard common law principles, foreign affiliates may

[89] *Ibid*, para 87.
[90] *Ibid*, para 88.

become resident in Canada simply by virtue of their "mind and management" moving to Canada, which is far from being remote in the foreign affiliate context. In this sense, the immigration of foreign affiliates to Canada is and was entirely foreseeable to the legislature when it enacted and repeatedly amended subsections 93(2) and (2.01) of the ITA. Accordingly, when the legislature introduced subsection 93(2) of the ITA and amended it over the years, it had to be aware that the dividend stop-loss rules would not apply on the immigration of a foreign affiliate to Canada. Put differently, and to paraphrase the Supreme Court of Canada's reasons in *Alta Energy*, the continuance of foreign affiliates into Canada "was far from being a novel phenomenon that emerged subsequently to" the latest amendments to subsections 93(2) and (2.01), and, as such, "[t]his is not a case where Parliament did not or could not have foreseen" the types of transactions employed by the taxpayer.[91]

iv. The rules governing the immigration of foreign affiliates to Canada are arguably exhaustive. The fact that Parliament did not enact a rule to ensure continuity in such a situation speaks volumes. By seeking to use the GAAR to effectively read into the ITA a new stop-loss continuity rule, the Crown not only engages in impermissible gap filling, but does so within an already complete code of foreign affiliate importation rules.[92]

(e) Overall Scheme of Capital Gains System

[71] Counsel submits that the capital gains system aims to tax increases in "economic power" and to recognize capital losses where there are real economic losses. Counsel's submissions regarding the overall scheme of the capital gains system can be summarized as follows:

i. The underlying rationale of limiting artificial losses is consistent with the overall purpose of the capital gains system as a whole. The capital gains system, at its core, seeks to recognize a capital loss where there is an underlying economic loss and to deny a capital loss where there is no underlying economic loss.[93] The stop-loss rules in subsections 93(2) and (2.01) of the ITA and in subsection 112(3) of the ITA are consistent with this purpose. This principle dates back to the Carter Commission, which

[91] *Ibid*, paras 89–90.
[92] *Ibid*, para 91.
[93] *Ibid*, paras 68–69.

established that, where a taxpayer realizes a gain or loss on a disposition of capital property, it should, very generally, be subject to a related income inclusion or deduction, as the gain or loss represents a real increase or decrease in the taxpayer's economic power. The purpose of the deduction in respect of allowable capital losses is thus to give tax relief "in circumstances where a taxpayer has suffered an economic loss on the disposition of property". Conversely, where a taxpayer does not suffer an economic loss on the disposition of capital property, they should not be entitled to a deduction in respect of allowable capital losses.[94]

ii. This principle was firmly established in three decisions of the Federal Court of Appeal dealing with the application of the GAAR to various loss-generating transactions.

The first decision is *Landrus*. It concerned the fair-market-value transfer of a building with a latent loss from a partnership to another non-arm's length partnership, allowing the transfer to recognize a significant capital loss on the building. The transfer was not subject to any stop-loss rules in the ITA. The Minister denied the loss on the basis of the GAAR, arguing that, even though no stop-loss rule applied to limit the recognition of the loss on the transfer, the transfer frustrated the underlying rationale of the stop-loss rules applying to transfers between related persons, which is to disregard the dispositions of property among persons within the "same economic unit".

The Tax Court allowed the taxpayer's appeal, noting it "does not involve a scheme whereby the [taxpayer] is trying to claim a loss incurred by some other taxpayer" and that the taxpayer had "suffered a real economic loss". With respect to the stop-loss rules at issue, the Court rejected the Minister's view that there is a general policy in the ITA to disregard dispositions of property to persons within the "same economic unit", finding instead that each stop-loss rule was specifically tailored by the legislature to address a specific situation and that this precision must be given effect even in a GAAR case. The Federal Court of Appeal affirmed the Tax Court decision stating that "where it can be shown that an anti-avoidance provision has been carefully crafted to include some situations and exclude others, it is reasonable to infer that Parliament chose to limit their scope accordingly".[95]

[94] *Ibid*, para 69.
[95] *Ibid*, para 71.

*Landrus* was followed by *Triad Gestco Ltd* and *1207192 Ontario Ltd*, which both concerned the use of stock dividends to shift value across share classes and create artificial losses. In both cases, the taxpayers had transferred property to a newly incorporated corporation in exchange for common shares with an ACB and FMV equal to the FMV of the transferred property. Each corporation then declared a stock dividend on the common shares payable by the issuance of high-value preferred shares to the taxpayer. The preferred shares soaked up the value in the corporation, and the common shares, now of nominal value, were sold by the taxpayer to a related trust at a substantial loss. The transfer of common shares to the trusts was not subject to any stop-loss rule, since the definition of "affiliated person" did not at the time capture trusts.

Contrary to the finding in *Landrus*, the Tax Court of Canada concluded that the GAAR applied in both *Triad Gestco Ltd* and *1207192 Ontario Ltd*, but did so for different reasons. In *Triad Gestco Ltd*, the Court concluded that the recognition of a capital loss pursuant to a transfer within the same economic unit was contrary to the object, spirit and purpose of the various stop-loss provisions. This reasoning was explicitly rejected in *1207192 Ontario Ltd*, wherein this Court, echoing its finding in *Landrus*, held that there was no general policy in the ITA to disallow losses on a transfer of property between persons within the same economic unit. However, the Court, relying on Carter Commission reports, held that the underlying rationale of the general capital loss deduction provision is to allow for a tax deduction where a taxpayer has suffered an economic loss. Accordingly, the deduction by the taxpayer in respect of an artificial (or paper) loss was held to frustrate that rationale.[96]

The Federal Court of Appeal dismissed both appeals, adopting the reasons of the Tax Court in *1207192 Ontario Ltd* and rejecting those in *Triad Gestco Ltd*. More generally, the Federal Court of Appeal held that the underlying rationale of the capital loss deduction rule was frustrated where a capital loss was claimed where there was no corresponding economic loss.

i. The cases also addressed former subsection 55(1) of the ITA, which had been repealed effective 1988 and did not apply to the transactions at issue. Prior to its repeal, subsection 55(1) was a general stop-loss rule that limited the recognition of a loss where a taxpayer had engaged in transactions that "may reasonably be considered to have artificially or unduly" created or increased

[96] *Ibid*, para 73.

> the loss. In this sense, it constituted a clear anti-avoidance rule. Subsection 55(1) was repealed, effective 1988, following the enactment of the GAAR, and the notes accompanying the repeal provided that since "the scope of that general anti-avoidance rule is broad enough to cover the transactions to which subsection 55(1) was intended to apply, that subsection is no longer necessary". The Federal Court of Appeal noted that "the fact that Department of Finance officials believed that the GAAR would fill the void is consistent with the continued existence of the overarching policy" of denying capital losses on artificial losses. Taken together, this trilogy of cases demonstrates that it may be appropriate to apply the GAAR to deny benefits that result from schemes to generate artificial capital losses, but that it should not apply where there is a real underlying economic loss. This is consistent with the underlying rationale of subsections 93(2) and (2.01) of the ITA, that is, to limit the recognition of artificial losses.[97]

(iii) Purposive Analysis

[72] Counsel submits that the underlying rationale of subsections 93(2) and 93(2.01) of the ITA is to limit the artificial creation of losses on the disposition of shares of foreign affiliates through tax-free dividends.[98] According to counsel, subsections 93(2) and 93(2.01) of the ITA seek to limit the recognition of real capital losses on the disposition of shares of a foreign affiliate when a taxpayer has received tax-free dividends from the affiliate.

[73] Counsel submits that a purposive interpretation of subsections 93(2) and (2.01) of the ITA reveals that their underlying rationale is to prevent the creation of artificial losses on the disposition of foreign affiliate shares. Counsel submits that this emerges clearly from an examination of the available extrinsic aids and the legislative history of the provision.

[74] Counsel submits that subsection 93(2.01) of the ITA is a mechanical loss computation rule and nothing more. Counsel submits that the rule can be described as one of the technical counting reconciliation rules found in the ITA. Counsel submits that it does not share any of the hallmarks of traditional specific anti-avoidance rules such as safe-income rules found in subsection 55(2) of the ITA,

[97] *Ibid*, para 76.
[98] *Ibid*.

which are designed to limit surplus-stripping transactions that reduce a capital gain on a disposition of shares.[99]

[75] Counsel's submissions on this topic can be summarized as follows:

i. Subsections 93(2) and (2.01) of the ITA apply mechanically and do not contain hallmarks of an anti-avoidance rule like a purpose test, for example. For this reason, it is not readily apparent that subsections 93(2) and (2.01) should be characterized as a specific anti-avoidance rule. Instead, counsel takes the view that these subsections contain a counting or reconciliation rule.[100]

ii. The Supreme Court of Canada held in *Trustco,* that extrinsic aids may be used in determining the object, spirit and purpose of a particular provision. Regardless of whether subsections 93(2) and (2.01) of the ITA are characterised as anti-avoidance rules, extrinsic aids reveal that they have a clearly defined underlying rationale, that is, to limit the recognition of losses where such losses were artificially created through the extraction of corporate value on a tax-free basis. Subsections 93(2) and 112(3) of the ITA were enacted with the 1972 reform, which introduced capital gains taxation in Canada and enacted substantive changes to foreign affiliate taxation in Canada. In the 1969 Proposals for Tax Reform white paper (the "White Paper"), which preceded the 1972 reform and which the Supreme Court of Canada recently relied on in *Loblaw* to ascertain the purpose of a provision in the foreign affiliate rules, Minister of Finance Benson described the overall purpose of the rule that was eventually enacted as subsection 93(2) in the following terms:

> 6.19 Subject to the limitation noted below, the general capital gains provisions would apply to the shares of controlled foreign corporations—gains realized on the disposal of them would be fully taxable and losses fully deductible (except of course to the extent that the gain or loss accrue prior to valuation day). However, because full corporate tax would not be collected on dividends from such corporations it would be necessary to place a limit on the deductibility of losses if the system as a whole is to be effective. Otherwise, Canadian corporations could purchase control of foreign corporations, arrange to receive most of the assets of the company as a special dividend, and then sell the shares for the value of the remaining assets. The dividend would bear little or no Canadian tax because of the

[99] *Ibid,* para 51.
[100] *Ibid.*

> foreign tax credit or the exemption, but the loss would reduce taxable income and save Canadian tax. This tax result is clearly inappropriate since the Canadian corporation would not, in fact, have suffered an over-all loss on its investment. To avoid this consequence, it is proposed to reduce the deductible loss on such shares by reference to the dividends received from the corporation that did not bear full Canadian corporation fax.[101]

This is best explained by way of example (the "Example"). Consider a Canadian corporation ("Canco") that owns all issued and outstanding Class A common shares in its foreign affiliate ("Forco"). There are no other issued and outstanding shares in Forco. Canco's shares in Forco have an adjusted cost base of $100, and a fair market value of $200. Forco is engaged in an active business and has an exempt surplus balance of $150.

> Scenario A: Canco decides to sell its shares in Forco to an arm's length party at fair market value. If it did so without undertaking any other transactions, it would recognize a capital gain of $100 on the sale, which would be taxable in Canada.
>
> Scenario B: Prior to the sale, Forco declares a dividend of $150 on the shares held by Canco, which dividend is prescribed to be paid out of Forco's exempt surplus balance, and is therefore received by Canco on a fully tax-free basis. This dividend has the effect of reducing the fair market value of the Class A common shares by $150. Canco then disposes of the shares of Forco for their new fair market value of $50, thereby recognising a capital loss of $50.

In sum, instead of recognizing a capital gain of $100 on the disposition of shares in Forco (Scenario A), Canco was able to generate a capital loss of $50 on the disposition through the prior payment of tax-free dividends (Scenario B). However, this $50 capital loss does not reflect a genuine economic loss for Canco, but was manufactured through the payment of an entirely deductible dividend to Canco. Put differently, the decrease in value on Forco's Class A shares is entirely attributable to the dividend and not to an underlying economic loss in the value of the Class A common shares.[102]

In order to prevent this artificial result, subsection 93(2) operates to grind the capital loss down to Canco by reducing the amount of the loss ($100) by the amount of the exempt surplus dividends ($150). Canco's manufactured loss

[101] *Ibid*, para 52.
[102] *Ibid*, para 54.

is thus denied. This purpose has long been recognized in doctrinal commentary by learned authors on subsection 112(3) of the ITA.

> The [domestic dividend] stop-loss rules are divided into two major groups: those for shares that are capital property (found in subsections 112(3), (3.1), (3.2), and (7)) and those that relate to inventory shares (found in subsections 112(4), (4.1), (4.2), and (4.3)).
>
> The general purpose of all of these provisions is to ensure that a corporation does not strip value out of an investee corporation by paying tax-deductible dividends and then selling the shares. In addition, section 112 is intended to avoid the realization of a loss if a share is bought shortly before a dividend is paid and then sold after the dividend is received, and an economic loss is realized on the share equal to the tax-deductible dividend. The provisions are worded so broadly, however, that they clearly will eliminate losses even if the dividend recipient has no control over the payment of dividends, and even if the payment itself has little or no effect on the value of the shares. These provisions can merely reduce or eliminate a loss on shares. They have no effect if a dividend reduces a gain without creating a loss.

And

> Generally, subsection 112(3) applies to reduce the loss to a taxpayer other than a trust. [...] The policy rationale here should be evident. If this provision did not exist, value stripping could be accomplished by way of non-taxable dividends and a corresponding capital loss to the taxpayer.

And

> Net decreases in share values may result in a reduced capital gain or in a capital loss in a greater amount than would otherwise occur. Typically, this will be the case in subsidiary corporations making deduction transfers and thus possibly forgoing the full benefits of realized losses against incomes. This probably will decrease the value of the subsidiary because of reduced after-tax retained earnings. Special tax rules will be required in certain cases to deny any resulting losses, and in other cases to +adjust for gains and losses perceived to have been artificially altered. Stop-loss rules similar to those now contained in subsection 112(3) of the Act (for example, treating a deduction transfer in a manner similar to dividend distribution) should provide the solution in those cases where affected shares are sold by a Canadian corporation at a loss produced in part by the net impact of deduction transfers and payments. Artificial shifts in gains and losses will be adjusted to eliminate those shifts to the extent produced by

> the net impact of deduction transfers and payments therefor by the application of rules similar to those now found in section 55.[103]

iii. In its initial form, this dividend stop-loss rule in subsection 93(2) of the ITA constituted a relatively straightforward version of the calculation rule currently in paragraph 93(2.01)(a) of the ITA. Though subsequent amendments have added significant complexity to the rule, these amendments and the accompanying technical notes are consistent with the overall purpose of targeting the artificial creation of losses and demonstrate that the provision has evolved over time to better fulfill this purpose.

For instance, subsection 93(2) was amended in 1991 to introduce the notion of a substituted share. This was necessary to ensure that subsection 93(2) could not be frustrated by simply exchanging the class of affiliate shares on which the dividend had been declared for another class of affiliate shares prior to a disposition.

> Using the Example, consider Scenario C in which Forco has declared exempt surplus dividends on Class A shares (as in Scenario B), but instead of disposing of the Class A shares, Canco were to exchange its Class A common shares for Class B common shares on a tax-deferred basis under subsection 85.1(3), such that the Class B common shares would inherit the FMV of $50 and ACB of $100 of the Class A shares common shares. Canco could then dispose of its Class B common shares, and the rule, as drafted prior to this amendment, would not have limited the loss on this disposition. The "substituted share" notion was introduced to ensure that all dividends paid on Class A common shares would reduce the loss to Canco on the disposition of Class B shares.

Subsection 93(2) was repealed and replaced with the current version of subsections 93(2) and (2.01) on June 26, 2013, effective to 2004. The most significant change was the inclusion of a new loss preservation rule, found in paragraph 93(2.01)(b), which aimed to preserve, in specific circumstances, the portion of a loss on the disposition of shares of a foreign affiliate that can reasonably be considered to be attributable to a fluctuation in the value of a foreign currency relative to Canadian currency.

In sum, though the rule has been amended over the years, its underlying rationale has generally remained consistent with Minister Benson's statement in the White Paper: to prevent the artificial creation of losses on the sale of

[103] *Ibid*, paras 56–58.

shares through the payment of value-stripping tax-free dividends on those shares.[104]

(b) Does the Avoidance Transaction Defeat or Frustrate the Object, Spirit or Purpose of Subsections 93(2) and 93(2.01) of the ITA?

[76] Counsel submits that the avoidance transaction did not defeat or frustrate the object, spirit or purpose of subsection 93(2) of the ITA for the following two reasons:

1- The rules governing the immigration of foreign affiliates to Canada do not contain any stop-loss continuity rules, and subsections 93(2) and 93(2.01) of the ITA should not apply to Wuswig Holdings 2007 after its immigration to Canada; and

2- Wuswig suffered a real economic loss.

(i) The Rules Governing the Immigration of Foreign Affiliates to Canada Do Not Contain Any Stop-Loss Continuity Rules

[77] Counsel's submissions on this topic can be summarized as follows:

i. Subsections 93(2) and (2.01) of the ITA should not apply to Wuswig Holdings 2007 after its immigration to Canada. The immigration of Southridge 2007 to Canada under the name Wuswig Holdings 2007 was at the centre of the Reorganization, and counsel submits that the rules governing immigration of foreign affiliates to Canada are both highly technical and exhaustive, and they do not contain any stop-loss continuity rules.[105] By applying subsections 93(2) and (2.01) of the ITA to the immigration of Wuswig Holdings 2007 to Canada, counsel submits that the Minister has proceeded to engage in impermissible gap filling. The Minister is attempting to read into the ITA a new stop-loss continuity rule in an otherwise complete set of foreign affiliate importation rules, which is a prototypical example of legislative gap filling.[106]

[104] *Ibid*, paras 59–62.
[105] *Ibid*, para 93.
[106] *Ibid*, para 94.

(ii) Wuswig Suffered a Real Economic Loss.

[78] Counsel's submissions on this topic can be summarized as follows:

i. Wuswig suffered a real economic loss from the decrease of Detroit Marine Terminals' value, which was reflected in the value of its shares of Southridge Holdings. The loss was attributable to the operating losses suffered by Detroit Marine Terminals starting in its 2002 taxation year. These operating losses were the result of Detroit Marine Terminals' business decline caused by the tariffs on steel imports, combined with the long agony of the automobile industry and other aggravating factors, such as the aftermath of September 11, 2001. Shortly after the tariffs were imposed, Detroit Marine Terminals lost its major clients and was ultimately forced to lay off most of its employees. It completely ceased its operations in April of 2004, but continued incurring expenses in the course of its liquidation. As a result, from the 2002 to the 2006 finanncial and taxation years, Detroit Marine Terminals lost on average 1,000,000 USD per year. Consequently, Detroit Marine Terminals suffered a real economic loss, a loss that was not attributable to the payment of dividends. Such loss can be determined by analyzing the decrease in the fair market value of the shares of Noro Holdings/Southridge Holdings between the pre-dividend period and the date of the Reorganization. This economic loss is made evident when the various financial documents in evidence before the Court are properly analyzed and the financial statements of Detroit Marine Terminals and Southridge Holdings for the reference period. Such analysis shows that the real economic loss sustained was somewhere between $5,000,000 and $5,500,000, which exceeds the amount of capital loss of $4,463,307 denied by the Minister in the notice of determination.[107]

ii. Between 1997 and 2007, Detroit Marine Terminals' value decreased by 17,823,140 USD. During that same period, 13,000,000 USD were paid in dividends following the condemnation of the Rouge property in 1999 by the City of Detroit. Factoring in all the dividends distributed by Detroit Marine Terminals to Noro Holdings or Southridge Holdings, the economic loss sustained by Detroit Marine Terminals was equal to 4,823,140 USD (17,823,140 USD - 13,000,000 USD), approximately 5,521,846.10 CAD.

[107] *Ibid*, paras 96–100.

This loss was attributable to the cumulated business and economic losses suffered by Detroit Marine Terminals starting in its 2001 taxation year.[108]

iii. Most of the loss of 4,823,140 USD suffered by Detroit Marine Terminals was shifted to the other affiliates of the U.S. corporate group, which provided financing to Detroit Marine Terminals using the profits earned from their real estate activities. As evidenced by Southridge Holdings' financial statements, Detroit Marine Terminals received advances in the aggregate amount of 3,309,765 USD from Southridge Holdings, Noro Holdings and PBI-Kinmont between 2000 and 2006 (most of which were received after 2002). These advances were never repaid. Detroit Marine Terminals relied on its sister and parent companies to be able to meet its financial liabilities. This internal financing led to a loss of 3,309,675 USD sustained in the corporate group (that is, the unrepaid advances made to Detroit Marine Terminals), the equivalent of approximately 3,866,461.63 CAD.[109]

iv. Detroit Marine Terminals' economic loss was ultimately reflected in Southridge Holdings' shares. Between 1997 and 2007, the year in which the Reorganization took place, Southridge Holdings' value decreased by 45,267,858.31 CAD. During that same period, tax-free dividends of 40,190,688 CAD were paid to Wuswig. The 1997 value provides a benchmark against which to measure whether losses in value are attributable to tax-free dividends, since there had been no payments of dividends to Wuswig at the time. Based on these figures, it is clear that Southridge Holdings sustained an economic loss of at least $5,077,170.31, being the decrease in value that cannot be attributed to dividends paid by Southridge Holdings. Put differently, only 40,190,688 CAD of the 45,267,858.31 CAD decrease in value can be attributed to tax-free dividends, leaving $5,077,170.31 that should be attributed to genuine economic loss. The difference between this figure and the 5,521,846.10 CAD loss sustained in Detroit Marine Terminals is attributable to at least two elements: (i) the currency and the timing of conversion; and (ii) the realization value of the other real estate properties held by the U.S. corporate group (totalling 2,503,602 USD) when compared to the 1997 initial appraised value. Therefore, no matter how we approach the analysis, the financial statements always lead to the same conclusion: the loss sustained by the Appellant was not the result solely of tax-free dividends, but

[108] *Ibid*, paras 101–03.
[109] *Ibid*, paras 104–05.

rather of the financial hardship of Detroit Marine Terminals after the tariffs on steel imports were put in place in the calendar year 2001.[110]

(iii) The Alternative Transaction Argument

[79] Counsel submits that Wuswig could have made an alternative transaction in order to achieve the same result as the series of transactions did.[111] Counsel submits that the fact that an alternative transaction could have been entered into demonstrates in itself that there was no abuse or misuse of subsections 93(2) and 93(2.01) of the ITA, regardless of the rationale behind those provisions.[112] According to counsel, the alternative transaction is a metaphor that this Court can use at the second step of the two-step abuse inquiry to determine whether or not the transaction in the case at hand is abusive.[113] Counsel's submissions on this topic can be summarized as follows:

i. Detroit Marine Terminals' operations were financed by loans totalling 3,309,765 USD. The funds for the loans were coming out of the profitable real estate activities from affiliates located in the U.S.A. These loans were never repaid by Detroit Marine Terminals. Instead of providing these loans, Wuswig could have financed Detroit Marine Terminals' activities through loans using its own liquidities. These liquidities would have come from the payment of dividends by Southridge 2007, which would come from funds received from the Noro Holdings subsidiary's profitable real estate activities. The dividends received by Wuswig would have been deducted from its taxable income under section 113 of the ITA, less a 5% withholding tax. Wuswig could have then directly provided loans to Detroit Marine Terminals to finance its operations. Counsel submits that subsection 50(1) of the ITA allows a creditor to recognize capital losses on bad debt when the debtor becomes insolvent. In this case, because Detroit Marine Terminals was insolvent, Wuswig could have realized capital losses on the loans it had made. Therefore, the alternative transaction would lead to the same result as the series of transactions, which is a capital loss.[114]

ii. By putting in place the Reorganization, Wuswig obtained the same result as the result it would have obtained had it received dividends (paid with the

[110] *Ibid*, paras 106–08.
[111] *Ibid*, para 109.
[112] *Ibid*, para 114.
[113] Transcript of proceedings dated May 4, 2022, page 10, lines 5–8.
[114] Appellant's plan of argument, para 110.

money available from its profitable U.S. real estate activities) and used the money received to finance the activities of Detroit Marine Terminals (the "alternative transaction") through loans, as opposed to funding the liabilities of Detroit Marine Terminals with advances made by the U.S. corporate group.[115] With the alternative transaction, counsel submits that a capital loss would have been made available to Wuswig by application of subsection 50(1) of the ITA.[116]

iii. The alternative transaction is comparable to the Reorganization when taking a broad view of the events leading up to the liquidation of the U.S. corporate group, that is, the internal funding received by Detroit Marine Terminals from its parent companies. There is no doubt that, had the alternative transaction occurred, the ITA and the GAAR would not have prevented Wuswig from reporting a capital loss in respect of the disposition of the loans made to affiliates when they become insolvent. Counsel submits that the very purpose of subsection 50(1) of the ITA is to allow taxpayers such as Wuswig to recognize a capital loss in such situations. Relying on the Federal Court of Appeal decision in *Univar*,[117] counsel submits that alternative arrangements that would have achieved the same result as the one achieved by the taxpayer in a GAAR case are relevant to determining whether the transactions under attack misused or abused the provision at issue.[118]

iv. If the taxpayer can illustrate that there are other transactions that could have achieved the same results without triggering any tax, then, in counsel for Wuswig's view, this would be a relevant consideration in determining whether the Avoidance Transaction is abusive.

v. The fact that there was an alternative transaction that could have been made and would have led to the same result as that of the Reorganization demonstrates in itself that there was no abuse or misuse of subsections 93(2) and (2.1) of the ITA. Put differently, achieving a result that is uncontroversial under the ITA but through an alternative means cannot constitute an abuse of a provision of the ITA.

[115] *Ibid*, para 109.
[116] *Ibid*, para 110.
[117] *Univar Holdco Canada ULC v Canada*, 2017 FCA 207 [*Univar*].
[118] Appellant's plan of argument, paras 111–12.

vi. Specifically, the already described alternative transactions are relevant and demonstrate that the Reorganization was not abusive for purposes of the GAAR.

vii. First, the alternative transactions are available under the ITA. Had the alternative transactions occurred, the ITA would not have prevented Wuswig from declaring a capital loss in respect of the disposition of its advances made to Detroit Marine Terminals, which later became insolvent. Indeed, the very purpose of subsection 50(1) is to allow taxpayers to recognize a capital loss in situations such as the one Wuswig would have found itself in had it financed Detroit Marine Terminals with debt: Wuswig was creditor to an insolvent entity. The fact that Wuswig did not in fact proceed by way of cross-border loans, and instead decided to finance Detroit Marine Terminals from retained earnings in the various U.S. subsidiaries, "does not detract from the fact that the ITA allowed for these transactions".[119]

viii. Second, the alternative transactions are not so remote as to be practically infeasible. The alternative transactions could realistically have been carried out. Retained earnings in the U.S. group could have been distributed to Wuswig—as they had in the past—and then re-advanced to finance Detroit Marine Terminals' operations during its winding-up. Indeed, prior to the incorporation of Southridge in 1999, retained earnings in the group were typically distributed to Wuswig and to the U.S. Trusts. Southridge was incorporated as a top U.S. holding company for Wuswig to allow distributions to be made to the U.S.A. without requiring concomitant cross-border distributions to be made to Wuswig. The goal was to allow the U.S. Trusts to receive dividends while keeping funds destined for Wuswig in the U.S.A. to finance operations during the winding-up of the group. This was a practical decision, but nothing could have prevented such amounts from being distributed to Wuswig (to be reinvested in Detroit Marine Terminals), as they had prior to the incorporation of Southridge.[120]

ix. Third, the alternative transactions have a high degree of commercial and economic similarity to financing of Detroit Marine Terminals by the U.S. subsidiaries. The alternative transactions would have resulted in Detroit Marine Terminals' being financed by Wuswig in the same manner as it would have been financed by the other U.S. subsidiaries. All parties would have been

[119] Appellant's Supplementary Submissions, para 36(a).
[120] *Ibid*, para 36(b).

in the same economic position if the alternative transactions had been carried out as they were following the Reorganization, the only difference being that bad debts would be held by Wuswig rather than by the foreign subsidiaries.[121]

x. Fourth, the alternative transactions would generate tax consequences approximately as favourable as the Reorganization. The alternative transactions would have enabled Wuswig to benefit from a capital loss in respect of the earnings from the U.S. group that were used to finance Detroit Marine Terminals' operating losses. This would have resulted in Wuswig's realizing a capital loss roughly equal to the capital loss realized during the Reorganization.[122]

xi. Fifth, the alternative transactions are not abusive of the GAAR. The alternative transactions would have enabled Wuswig to realize a capital loss on the winding-up of the U.S. group without attracting the application of the GAAR. There is nothing to suggest that the alternative transactions would in any way be offensive to subsections 93(2) and (2.01) of the ITA, the scheme of the ITA relating to capital losses, or any other provisions in the ITA. As outlined previously, the capital loss represented a real economic loss.[123]

[80] In conclusion, counsel submits that the alternative transactions demonstrate that the Reorganization did not misuse or abuse subsections 93(2) and 93(2.01) of the ITA and of the capital gains regime in the ITA of which they are part.[124]

b) The 2007 Taxation Year

[81] Counsel submits that the Minister could not issue a notice of determination for Wuswig's 2007 taxation year.

[82] Counsel submits that the GAAR cannot apply to the 2007 taxation year because Wuswig did not obtain a tax benefit from the series of transactions in that year. Counsel also submits that the avoidance transactions were not abusive within

[121] *Ibid*, para 36(c).
[122] *Ibid*, para 36(d).
[123] *Ibid*, para 36(e).
[124] *Ibid*, para 38.

the meaning of subsection 245(4) of the ITA.[125] Therefore, two of the three conditions for the application of the GAAR to the 2007 taxation year are not met.

(1) Did a Tax Benefit Arise from the Series of Transactions?

[83] Counsel submits that the term "tax benefit" is defined in subsection 245(1) of the ITA as a reduction, avoidance or deferral of tax or as an increase in a refund of tax or another amount under the ITA.[126]

[84] Subsection 152(1.11) of the ITA in turn allows the Minister to issue a notice of determination under the GAAR if the conditions for the application of subsection 245(2) are met. Subsection 152(1.11) reads as follows:

> (1.11) Where at any time the Minister ascertains the tax consequences to a taxpayer by reason of subsection 245(2) with respect to a transaction, the Minister
>
> (a) shall, in the case of a determination pursuant to subsection 245(8), or
>
> (b) may, in any other case,
>
> determine any amount that is relevant for the purposes of computing the income, taxable income or taxable income earned in Canada of, tax or other amount payable by, or amount refundable to, the taxpayer under this Act and, where such a determination is made, the Minister shall send to the taxpayer, with all due dispatch, a notice of determination stating the amount so determined.

[85] At the hearing, counsel for Wuswig submitted that under subsection 152(1.11) of the ITA, a notice of determination may be issued to correct an abuse where the GAAR applies, but the issuance is conditional on the three conditions for the GAAR to apply being met. Counsel submitted that the first condition necessary for the application of the GAAR is not met for the 2007 taxation year.[127] According to counsel, the notice of determination issued by the Minister for the 2007 taxation year should therefore be vacated because Wuswig did not receive a tax benefit from the series of transactions in the 2007 taxation year.[128] Counsel also submitted that this is because a notice of determination under subsection 152(1.11) of the ITA cannot by

[125] Appellant's plan of argument, para 10 and transcript of proceedings dated April 25, 2022, page 15, lines 2–6 and 10–16.
[126] Appellant's plan of argument, para 13.
[127] *Ibid*, para 10.
[128] *Ibid*, para 36.

itself create a tax benefit. The purpose of a notice of determination is only to deny the tax benefit.[129]

[86] Counsel further submitted that the purpose of the notice of determination was to reduce Wuswig's capital loss balance. For counsel, an amount coming from a capital loss balance is a "tax attribute" similar to the paid-up capital of shares, and it only becomes a "tax benefit" when it is used and therefore deducted against a capital gain.[130] According to counsel, the increase of a tax attribute does not constitute a tax benefit for the purpose of the GAAR.[131] Counsel submits that a capital loss balance is not a tax benefit, and it does not, by itself, reduce tax or increase the amount of a refund.

[87] Finally, counsel submitted that the notice of determination did not affect Wuswig's tax payable for the 2007 taxation year.[132] Counsel submits that the capital loss applied in 2007 was not denied or reduced. Therefore, the Minister could not issue a notice of determination under subsection 152(1.11) of the ITA for the 2007 taxation year because he did not apply the GAAR to deny a tax benefit for that year.[133]

[88] From these submissions, this Court understands that Wuswig's position is that the Minister is trying to "create" a tax benefit by issuing a notice of determination for the 2007 taxation year, whereas Wuswig submits that there was no tax benefit for that year. Therefore, because there was no tax benefit in the 2007 taxation year, the Minister could not issue the notice of determination under subsection 152(1.11) since the GAAR could not apply to that taxation year.

[89] Alternatively, counsel submitted that Wuswig had a capital loss balance available from previous years that could have been used to offset its capital gain of $79,114 for the 2007 taxation year. Since it could have used this available capital loss balance to offset its capital gain for the year, Wuswig did not receive a tax benefit in that year resulting from the avoidance transaction.[134]

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[129] *Ibid*, paras 14, 22, 27.
[130] *Ibid*, para 25.
[131] *Ibid*, para 22.
[132] Appellant's plan of argument, para 26 and transcript of proceedings dated April 25, 2022, page 23, lines 5–15.
[133] Appellant's plan of argument, paras 23, 28.
[134] *Ibid*, para 34

[90] At the hearing, this Court asked for additional submissions on this issue, including on the adequacy of issuing a notice of determination with respect to a taxation year that is statute-barred.[135]

[91] In Wuswig's written submissions, counsel submits that the Minister cannot rely only on a notice of determination under subsection 152(1.11) of the ITA to deny a tax benefit and apply the GAAR to a statute-barred year.[136] According to counsel, by doing so, the Minister is trying to reassess a statute-barred taxation year through a notice of determination.[137]

[92] Counsel submits that, to issue a notice of determination under subsection 152(1.11) of the ITA with respect to a taxation year in the context of the application of the GAAR, the Minister must actually deny a tax benefit for that taxation year under the GAAR. In this case, the Minister could not deny a tax benefit for the 2007 taxation year because the year was statute-barred. Therefore, counsel submits that the GAAR cannot apply for that year.[138]

[93] Finally, counsel submits that the Minister is trying to go back in time and do indirectly what he cannot do directly because of subsection 152(4) of the ITA, which is to challenge a loss assessed in a statute-barred year.[139]

### (2) Was the Series of Transactions an Avoidance Transaction?

[94] The second step of the GAAR analysis is not in question for the 2007 taxation year. As stated above, counsel admits that the transactions within the series of transactions were avoidance transactions.[140]

### (3) Was the Avoidance Transaction Abusive?

[135] Transcript of proceedings dated April 26, pages 55–56.
[136] Appellant's additional submissions dated June 3, 2022, page 4.
[137] *Ibid,* page 5.
[138] *Ibid,* page 6.
[139] *Ibid,* page 5.
[140] PASF, para 54. Transcript of proceedings dated April 25, 2022, page 15, lines 10–12.

[95] Counsel submits that the same analysis must be done by this Court for the 2018 and 2007 taxation years. Consequently, the conclusion that will be drawn by this Court from this analysis applies to both taxation years.[141]

[96] Counsel submits that a textual, contextual and purposive interpretation of subsections 93(2) and (2.01) of the ITA reveals that their underlying rationale is to prevent the creation of artificial losses on the disposition of foreign affiliate shares and that they do not apply to foreign affiliates after they have immigrated to Canada.

2. HMTK's Position

[97] Counsel submits that all three conditions for the application of the GAAR were met for the 2018 and 2007 taxation years.[142]

a) The 2018 Taxation Year

[98] Counsel submits that, for the 2018 taxation year, the three conditions for the application of the GAAR are met. First, Wuswig received a tax benefit when it carried over a capital loss of $334,176 to reduce its income for the 2018 taxation year. Second, the transactions that gave rise to the tax benefit were all avoidance transactions, and finally, they were abusive because their primary purpose and result were to circumvent the application of subsection 93(2) of the ITA.[143]

(1) Did a Tax Benefit Arise from the Series of Transactions?

[99] Counsel submits that the term "tax benefit" is defined in subsection 245(1) of the ITA as a reduction, avoidance or deferral of tax or as an increase in a refund of tax or other amount under the ITA. Whether a tax benefit exists is a factual determination. What must be determined is whether Wuswig reduced, avoided or deferred tax payable under the ITA. The burden of proof is on the taxpayer to refute the existence of a tax benefit. In some instances, the tax benefit is clear. In other instances, the existence of the tax benefit will need to be established by comparison with an alternative arrangement.[144]

[100] In *Gladwin* and in *1245989 Alberta Ltd*, the Federal Court of Appeal concluded that the GAAR does not apply to transactions that result in an increase in

[141] Transcript of proceedings dated April 26, page 15, lines 6–8.
[142] Respondent's written submissions, paras 71, 94, 153.
[143] Transcript of proceedings dated April 25, 2022, page 18 line 20 to page 19 line 3.
[144] Respondent's written submissions, paras 63–66.

a tax attribute where there has not been a tax-free distribution to a recipient capable of benefiting from its distribution in a tax-free manner. For example, an increase of the paid-up capital of shares does not constitute a tax benefit until it has been materialized, such as through a return of paid-up capital, that is, a payment to the shareholder equivalent to the amount of the paid-up capital. Indeed, once a tax attribute is claimed in reduction of the tax, the tax benefit materializes, even if only part of the tax attribute is claimed.

[101] In the present case, in 2007, Wuswig disposed of the 2,450 common shares it held in Wuswig Holdings 2007 and realized a capital loss of $5,086,039. Because of the literal application of the provisions of the ITA, subsection 93(2) did not apply to reduce the loss by the exempt dividends that Wuswig had received on those shares over the years. Had subsection 93(2) applied, the amount of the capital loss would have been nil because the exempt dividends received by Wuswig from Wuswig Holdings 2007 and its predecessor would have reduced this capital loss. For the 2007 taxation year, Wuswig claimed an amount of $79,114 of this loss in reduction of its income. Therefore, Wuswig materialized a portion of the loss in 2007 and enjoyed a tax benefit. Furthermore, Wuswig materialized the loss when it claimed additional amounts of the loss in reduction of its income for the 2010, 2011, 2012, 2015, 2018 and 2020 taxation years. Namely, in 2018, Wuswig claimed a portion of $334,176 of the capital loss in reduction of its income for the 2018 taxation year. Therefore, Wuswig realized a tax benefit when it claimed portions of the capital loss in reduction of its income in the 2007, 2010, 2011, 2012, 2015, 2018 and 2020 taxation years.

[102] Counsel submits that the tax benefit for the 2018 taxation year resulted from Wuswig's carrying over a capital loss of $334,176 from the 2007 taxation year to that year. The capital loss carried over is a portion of the $5,086,039 capital loss realized form the series of transactions, and it was applied against Wuswig's capital gain for the year in order to reduce its taxable income for the 2018 taxation year.[145]

(2) Was the Series of Transactions an Avoidance Transaction?

[103] Counsel submits that the transactions were part of a series because they were preordained to produce a final result, which was to realize the capital loss on the

[145] *Ibid*, paras 73–74.

disposition of the shares.[146] Counsel submits that the series is composed of transactions all of which are avoidance transactions because they were undertaken in order to obtain a tax benefit.[147] Counsel submits that the transactions that are part of the series of transactions cannot be reasonably considered to have been undertaken or arranged primarily for *bona fide* purposes other than to obtain the tax benefit, and are consequently avoidance transactions within the meaning of subsections 245(2) and 245(3) of the ITA.[148]

### (3) Was the Avoidance Transaction Abusive?

[104] Counsel submits that the avoidance transaction was abusive within the meaning of subsection 245(4) of the ITA. Had Wuswig not proceeded with the series of transactions, subsections 93(2) and 93(2.01) would have applied and Wuswig would not have realized a loss on the disposition of the shares of Wuswig Holdings 2007. According to counsel, this is because the capital loss of $5,086,039 realized from the series would have been reduced by the amount of exempt dividends ($19,430,329) received by Wuswig before 2007.[149] Consequently, according to counsel, the series of transactions resulted directly or indirectly in a misuse and abuse of these provisions, having regard to the provisions of the ITA read as a whole.[150]

#### (a) The Object, Spirit and Purpose of Subsections 93(2) and 93(2.01) of the ITA

[105] Counsel submits that the determination of whether a transaction is abusive requires this Court to identify the underlying rationale of the provisions that were relied on to obtain the tax benefit. Counsel submits that this can be achieved by conducting an analysis of the "object, spirit or purpose" of these provisions having regard to the scheme of the ITA, the relevant provisions and permissible extrinsic

[146] Respondent's written submissions, paras 83–84. Transcript of proceedings dated May 4, 2022, page 50, lines 6–8.
[147] Transcript of proceedings dated April 25, 2022, page 18, lines 23–25. PASF, para 54 and Transcript of proceedings dated May 4, 2022, page 50, lines 10–16.
[148] Respondent's written submissions, paras 79, 83, 94.
[149] Respondent's written submissions, para 151, Reply to the Re-re-amended notice of appeal, Part A, para 16(s).
[150] Respondent's written submissions, paras 152–53; Transcript of proceedings dated April 25, 2022, page 18, line 26 to page 19, line 3.

aids.[151] The ultimate issue is to identify what the legislator intended.[152] Following this analysis, counsel for HMTK submits that the underlying rationale of subsection 93(2) of the ITA is to avoid the overstatement of a capital loss, for Canadian tax purposes, on the disposition of shares of a foreign affiliate where the disposing corporation has benefitted from an economic return on the shares in the form of exempt dividends.[153]



(i) Textual Analysis

[106] Counsel's submissions on this topic can be summarized as follows:

i. Subsection 93(2) of the ITA is part of Division B - Computation of Income, Subdivision I. This portion of the ITA contains a set of rules applicable to shareholders of corporations not resident in Canada.[154]

ii. Subsection 93(2) of the ITA limits the loss resulting from the disposition of a share of a foreign affiliate of a corporation resident in Canada by reducing the loss otherwise calculated by the total amount of the exempt dividends received on that share or shares for which it was substituted.[155]

iii. Subsection 93(2) of the ITA was originally enacted on December 23, 1971. The rule was simple and provided that, where a corporation resident in Canada disposed of a share of the capital stock of a foreign affiliate, the amount of any capital loss was deemed to be the amount of the loss minus all exempt dividends received by the disposing corporation on the share.[156]

iv. Subsection 93(2) of the ITA was amended on December 17, 1991, to provide that it applies in determining the loss, rather than the capital loss of the disposing corporation; and to ensure that subsection 93(2) operates effectively when shares of a foreign affiliate have been transferred within a corporate group.[157]

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[151] Respondent's written submissions, para 95 and *Canada Trustco*, above, footnote 63, at para 55.
[152] Respondent's written submissions, para 95 and *Mathew v Canada*, 2005 SCC 55, para 43 [*Mathew*].
[153] Respondent's written submissions, para 144.
[154] *Ibid*, para 98.
[155] *Ibid*, para 99.
[156] *Ibid*, para 100.
[157] *Ibid*, para 101.

v. On June 14, 2001, subsections 93(2.1), (2.2) and (2.3) of the ITA were added to deal with the disposition of shares by a partnership, by a corporation of a partnership interest and by a partnership of an interest in another partnership.[158]

vi. Subsection 93(2) of the ITA was amended on June 26, 2013. The amendments apply to dispositions of shares and partnership interests that occurred after February 27, 2004. The 2013 amendments split subsection 93(2) into two subsections:

- New subsection 93(2), which defines the losses to which the loss limitation rule applies; and

- Subsection 93(2.01), which sets out the loss limitation rules.

A new subsection 93(2.02) of the ITA was also added to define the term "specified gain" for the purposes of paragraph 93(2.01)(b). The main substantive amendment in June 2013 was the addition of a new loss preservation rule, found in subsection 93(2.01). This rule aims to preserve, in certain very limited circumstances, the portion of a loss on the disposition of shares of a foreign affiliate that can reasonably be attributable to a fluctuation in the value of a foreign currency relative to Canadian currency.[159]

vii. For the year at issue in this appeal, subsections 93(2) and (2.01) of the ITA limit the loss of a Canadian resident corporation on the disposition of shares of a foreign affiliate to the extent that the Canadian corporation has received exempt dividends from these shares. Subsections 93(2) and (2.01) apply as follows; if, pursuant to subsection 93(2), a corporation resident in Canada has a loss from the disposition of a share of a foreign affiliate, by virtue of the

[158] *Ibid*, para 102.

[159] Respondent's written submissions, paras 103–06, *Technical Tax Amendments Act, 2012*, SC 2013, c 34, Technical Notes of the Department of Finances for 93(2), October 24, 2012, and Jim Samuel, "When Do the Stop-Loss Rules Apply? Transactions Involving Foreign Affiliates After the 2012 Technical Bill" (2016) 63:3 *Canadian Tax Journal*, 561–600, page 20 of the printed version.

application of subsection 93(2.01), the amount of the loss arising on the disposition of the shares of the foreign affiliate is limited to the greater of:

a. The amount determined by the formula A - (B - C) where:

A is the amount of the loss without reference to this section

B is the total exempt dividends paid on the share of the foreign affiliate (or a share for which the affiliate share was substituted)

C is the total amounts of dividends included at B but which were applied to compute the loss from a prior disposition of the shares of the foreign affiliate (or a share for which the affiliate share was substituted)

b. The lesser of:

the portion of the loss realized that can reasonably be attributed to a fluctuation in the value of foreign currency relative to the Canadian dollar, and

the amount of a gain if, under limited circumstances, the characterization of the gain (as capital or as income) matches that loss in respect of the shares of the foreign affiliate.[160]

– For the purpose of the application of subsection 93(2) of the ITA, exempt dividends are defined in subsection 93(3) and refer to dividends received by a Canadian corporation that are deductible from the income of the corporation for the purpose of computing the taxable income under paragraphs 113(1)(a) to (c).[161]

(ii) Contextual Analysis

[107] Counsel's submissions on this topic can be summarized as follows:

i. The rules of statutory interpretation require that the larger legislative context be considered in determining the meaning of a statutory provision, and subsection 245(4) of the ITA specifically requires that the question of abusive

[160] Respondent's written submissions, para 107.
[161] *Ibid*, para 108.

tax avoidance be determined having regard to the provisions of the ITA, read as a whole.[162] Counsel submits that the Supreme Court of Canada said in *Trustco* that the specific provisions at issue must be interpreted in their legislative context, together with other related and relevant provisions, in light of the purposes that are promoted by those provisions and their statutory schemes.[163]

ii. The consideration of context involves the examination of other provisions of the ITA, which can shed light on what Parliament intended, as well as the examination of permissible aids.[164] The provisions that will be relevant to the contextual analysis are those that are related because they are grouped together or because they work together to give effect to a plausible and coherent plan.[165]

iii. The relevant context for the analysis of the object, spirit and purpose of subsection 93(2) of the ITA regroups the scheme of the ITA related to the computation of capital gains and losses, the scheme related to dividend stop-loss rules, the application of paragraph 92(2)(c) of the ITA and the restricted relief for certain foreign exchange losses on the disposition of shares of foreign affiliates as of 2013.[166]

(a) Computation of Capital Gains and Capital Losses in the ITA

[108] The submissions of counsel for HMTK on the computation of capital gains and capital losses in the ITA and on the relationship between the computation and the "stop-loss rules" can be summarized as follows:

i. Capital gains and losses are the subject of a lengthy and complex statutory scheme. The original version of these provisions came into effect in 1972. Before that time, capital gains were not subject to tax and capital losses were not recognized for income tax purposes.[167]

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[162] *Ibid*, para 110.
[163] Respondent's written submissions, para 110 and *Canada Trustco*, above, footnote 63 at para 51.
[164] Respondent's written submissions, para 111 and *Copthorne*, above, footnote 40 at para 91.
[165] *Ibid*.
[166] Respondent's written submissions, para 112.
[167] Respondent's written submissions, para 113 and *Triad Gestco Ltd*, 2012 FCA 258, para 27 [*Triad Gestco (FCA)*].

ii. A capital gain is an increase in the value of an asset and, conversely, a capital loss is a decrease in the value of an asset. A capital gain or loss can arise only when a taxpayer disposes of "capital property".[168]

iii. A taxpayer's capital gain from the disposition of property is the difference between the "proceeds of disposition" and the sum of the "adjusted cost base" and expenses related to the disposition. A taxpayer's capital loss from the disposition of property is the amount by which the "adjusted cost base" and selling expenses exceed the "proceeds of disposition".[169]

iv. The regime of taxation of capital gains and losses is aimed at taxing increases in "economic power".[170] The scheme is understood to apply to real gains and losses.[171]

v. Generally, a capital loss arises for income tax purposes when capital property is sold by a taxpayer for "proceeds of disposition" that are less than the "adjusted cost base" of the property sold, in accordance with paragraphs 39(l)(b) and 40(1)(b) of the ITA.[172]

vi. Capital losses are not, per se, deductible in computing income; they may be applied to offset taxable capital gains.[173] In addition, a few specific anti-avoidance provisions in the ITA, such as a set of provisions known as the "stop-loss rules", preclude a taxpayer from claiming tax relief for capital losses.

vii. As explained by Vincent De Angelis, "[t]he stop-loss provisions are scattered throughout the Income Tax Act. These provisions have one of two objectives. The first is to influence the timing of a loss realization or, in certain circumstances, to transfer the loss from one taxpayer to another. The second

[168] Respondent's written submissions, para 114.
[169] *Ibid*, para 115.
[170] Respondent's written submissions, para 116 and Report of the Royal Commission on Taxation, volume 3. Taxation of Income. Part A - Taxation of Individuals and Families, page 325
[171] Respondent's written submissions, para 116 and *Triad Gestco (FCA)*, above, footnote 168, at paras 27, 41–42.
[172] Respondent's written submissions, para 117 and *Triad Gestco (FCA)*, above, footnote 168, at paras 29–30.
[173] Respondent's written submissions, para 118 and *Triad Gestco (FCA)*, above, footnote 168, at paras 32–34.

is to affect the quantum of the loss that may be realized; in certain circumstances, this includes an outright denial of the loss."[174]

(b) Dividend Stop-Loss Rules in the ITA

[109] Counsel's submissions on subsection 93(2) and subsection 112(3) of the ITA, the computation of capital gains and capital losses in the ITA and on the relationship between the computation and the stop-loss rules can be summarized as follows:

i. A subgroup of the ITA stop-loss rules is colloquially known as the "dividend stop-loss rules". Subsection 93(2) of the ITA is one of these rules.[175]

ii. "Dividend stop-loss rules" apply to reduce the loss that a taxpayer may claim on the disposition of a share by the amount of tax-free dividends received by the taxpayer on the share. Subsection 93(2) applies for losses sustained on the disposition of shares of a foreign affiliate by a Canadian resident corporation.[176]

iii. The ITA contains a similar rule that applies in the domestic context and can be found in subsection 112(3) of the ITA. Subsection 112(3) limits the loss of a Canadian corporation on the disposition of shares of another Canadian corporation by the amount of dividends that have been received free of tax on those shares.[177]

iv. Except for certain specific exceptions, subsections 93(2) and 112(3) of the ITA have the same purpose of limiting the amount of capital losses that may result from the disposition of shares of a subsidiary. Therefore, these rules are aimed at preventing the overstatement of a capital loss realized on the disposition of shares.[178]

v. According to these rules, any tax-deductible dividends received are to be considered in computing the capital loss, without regard to the fact that the loss was caused by the receipt of tax-deductible dividends (manufactured loss)

[174] Vincent De Angelis, CA, "The Stop-Loss Rules: Pitfalls and Opportunities" in *Report of Proceedings of Fifty-Fifth Tax Conference, 2003 Conference Report* (Toronto: Canadian Tax Foundation, 2004), 50:1-16, at page 1 (of the print-out).
[175] Respondent's written submissions, para 120.
[176] *Ibid*, para 121.
[177] *Ibid*, para 122.
[178] *Ibid*, para 123.

or whether it stems from fluctuations of foreign currency or from the decline of activities of the corporation that issued the shares.[179]

vi. The dividend stop-loss rules are therefore not concerned by the source of the loss, nor do they contemplate or provide a distinction based on the source of the loss.[180]

(c) An Indication of the Policy Intent Behind the Dividend Stop-Loss Rules from the Scheme of the ITA

[110] Counsel's submissions on this topic can be summarized as follows:

i. The existence of paragraph 92(2)(c) of the ITA as well as the interaction between subsection 93(2) and paragraph 92(2)(c) of the ITA is an indication of the policy intent behind the "dividend stop-loss rules". This policy intent behind the dividend stop-loss rules is strengthened by the existence of paragraph 92(2)(c). Under this provision, a dividend paid out of an affiliate's surplus accumulated before the acquisition by the corporation of the affiliate's shares (referred to as a pre-acquisition surplus) reduces the ACB on the relevant shares.[181]

ii. Dividends paid out of pre-acquisition surpluses of a foreign affiliate will, in the same manner as other dividends received by the Canadian corporation, not be taxed in the hands of the Canadian corporation. However, instead of reducing the loss when those shares are disposed of, pursuant to the application of paragraph 92(2)(c) of the ITA, they will reduce the ACB of those shares.[182]

iii. Over the years, some have argued that subsection 93(2) of the ITA is not warranted since paragraph 92(2)(c) of the ITA provides a complete answer to the possible manufacture of a capital loss in a foreign affiliate context.[183]

[179] *Ibid*, para 124.
[180] *Ibid*, para 125.
[181] *Ibid*, para 126.
[182] *Ibid*, paras 127–28.
[183] Respondent's written submissions, paras 129–30. See Submission Letter from the Joint Committee on Taxation of the Canadian Bar Association and the Canadian Institute of Chartered Accountants to the Department of Finance in its September 18, 2003 (page 26 of print-out), Submission of the Joint Committee on Taxation of The Canadian Bar Association

> Subsection 93(2) was never repealed. It has been amended a few times, and its main function of reducing a loss by the amounts of exempt dividends has consistently been maintained. Therefore, the fact that both subsection 93(2) and paragraph 92(2)(c) are included within the ITA provides a clear indication that a capital loss incurred on the shares of a foreign affiliate is to be reduced by the amount of any tax-deductible dividend received regardless of whether or not it can be determined that the purpose of the dividend was to artificially create a capital loss.[184]

(a) Restriction Relief for Certain Foreign Exchange Losses Only

[111] Counsel submits that the 2013 amendments to the ITA are another indication that subsection 93(2) of the ITA was meant to apply to all capital losses regardless of their source.[185] Counsel's submissions can be summarized as follows:

i. In June 2013, the ITA was amended to add a new loss preservation rule, which is found at subsection 93(2.01) of the ITA. This rule aims to preserve, in certain very limited circumstances, the portion of a loss on the disposition of shares of a foreign affiliate that can reasonably be considered to be attributable to a fluctuation in the value of a foreign currency relative to Canadian currency.[186]

ii. This rule is essentially limited to the portion of such loss that is offset by a corresponding gain realized by the taxpayer in respect of certain indebtedness or hedges that are closely tied to the acquisition of the foreign affiliate shares in respect of which the loss was realized. In addition, the offsetting gain must be a gain made within the 30 days before or after the time when a foreign affiliate's shares are disposed of. Outside these limited circumstances, a taxpayer's capital loss on shares of a foreign affiliate that is due to fluctuations

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and The Canadian Institute of Chartered Accountants regarding the August 19, 2011 Legislative Proposals in Respect of Foreign Affiliates.

[184] Respondent's written submissions, paras 129–31.

[185] *Ibid*, para 132.

[186] *Ibid*, para 133. See Technical Notes of the Department of Finances for 93(2), October 24, 2012, See also Jim Samuel, "When Do the Stop-Loss Rules Apply? Transactions Involving Foreign Affiliates After the 2012 Technical Bill" (2016) 63:3 *Canadian Tax Journal*, 561–600.

of foreign exchange, however real that loss may be, will be reduced by the exempt dividends received on those shares.[187]

iii. This further demonstrates that, even in situations where a loss is attributable to real circumstances, be it a change in the foreign exchange rates, a fall in commodities or a natural catastrophe, Parliament's intent was that subsection 93(2) applies to the extent the taxpayer has already benefitted from exempt dividends on those shares.[188]



(iii) Purposive Analysis

[112] Counsel submits that a corporation cannot avoid the application of the dividend stop-loss rule found at subsection 93(2) of the ITA by simply transferring its foreign affiliate share on which exempt dividends were received to another foreign affiliate within the corporate group. According to counsel, the legislative intent is to follow tax-free dividends even if the shares have been substituted to others.[189]

[113] Counsel further submits that, in circumstances such as the ones of this case, where shares of a foreign affiliate were "substituted" for shares of a domestic corporation, the legislative intent that provides for a continuity of the effect of the exempt dividends is therefore defeated.[190]

[114] According to counsel, the dividend stop-loss rules found in subsection 93(2) of the ITA are intended to treat the amount of any tax-free dividend received as part of the economic return on shares. It is necessary to prevent the overstatement of the loss on a share upon disposition for Canadian tax purposes.[191] Counsel for HMTK submits that a number of indications support this rationale. These indications along with counsel's submissions can be summarized as follows:

i. First indication: In policy terms, subsections 93(2) of the ITA is an anti-avoidance provision. The Department of Finance's technical notes describe its purpose as follows:

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[187] Respondent's written submissions, paras 134–35.
[188] *Ibid*, para 136.
[189] *Ibid*, para 142.
[190] *Ibid*, para 143.
[191] *Ibid*, para 137.

> Subsection 93(2) is an anti-avoidance rule. It reduces a loss arising on a disposition of a share of the capital stock of a foreign affiliate of a corporation resident in Canada by the amount of exempt dividends received on the share before the disposition. The rule applies to the corporation resident in Canada and any foreign affiliate of such a corporation in respect of a share of a foreign affiliate of the corporation resident in Canada.[192]

ii. Second indication: A statement made by the Minister of Finance prior to the reform of the ITA in 1972. The statement reads as follows:

> Subject to the limitation noted below, the general capital gains provisions would apply to the shares of controlled foreign corporations - gains realized on the disposal of them would be fully taxable and losses fully deductible (except of course to the extent that the gain or loss accrue prior to valuation day). However, because full corporate tax would not be collected on dividends from such corporations it would be necessary to place a limit on the deductibility of losses if the System as a whole is to be effective. Otherwise, Canadian corporations arrange to receive most of the assets of the company as a special dividend, and then sell the shares for the value of the remaining assets. The dividend would bear little or no Canadian tax because of the foreign tax credit or the exemption, but the loss would reduce taxable income and save Canadian tax. This tax result is clearly inappropriate since the Canadian corporation would not, in fact, have suffered an over-all loss on its investment. To avoid this consequence, it is proposed to reduce the deductible loss on such shares by reference to the dividends received from the corporation that did not bear full Canadian corporation tax.[193]

Counsel submits that it is clear from this statement that the legislative intent was to place a limit on the deductibility of losses stemming from the sale of shares of a corporation on which tax-free dividends were received. This is because the dividend would bear no tax, but the loss would reduce taxable income. The Minister of Finance viewed this tax result as inappropriate since the corporation would not in fact have suffered an overall loss on its investment.[194]

iii. Third indication: The amendments of 1991 were made to ensure the provision operates effectively when shares of a foreign affiliate have been transferred

[192] Respondent's written submissions, paras 137–38. Technical Notes of the Department of Finances for 93(2).
[193] Respondent's written submissions, para 139. E.J. Benson, *Proposals for Tax Reform* (Ottawa: Queen's Printer, 1969), at paragraph 6.19.
[194] Respondent's written submissions, para 140.

within a corporate group, as per the Technical Notes of the Department of Finance for 93(2) dated May 1991[195]:

> As amended, subsection 93(2) will apply to reduce the capital loss of a disposing corporation on a share of a foreign affiliate by all prior exempt dividends previously received on that share or a share for which it was substituted by the disposing corporation, any related corporation, or any foreign affiliate of the disposing corporation or of a related corporation.

(iv) Conclusion

[115] Counsel submits that the underlying rationale of subsection 93(2) of the ITA is to avoid the overstatement of a capital loss on the disposition of shares of a foreign affiliate where the disposing corporation has benefitted from an economic return on the shares in the form of exempt dividends.[196]

[116] Counsel submits that the ITA considers the exempt dividends received on the shares to be part of the economic return on the shares. According to counsel, subsection 93(2) of the ITA is meant to "stop" all losses and is not concerned by the source of the loss. Therefore, even in situations where a loss is attributable to real circumstances, such as a change in the foreign exchange rates, a fall in commodities or a natural catastrophe, Parliament's intent was that subsection 93(2) apply to reduce the amount of the loss to the extent that the corporation benefitted from exempt dividends on the shares disposed of.[197]

[117] Counsel submits that, read together, subsections 93(2) and 93(2.01) of the ITA are a dividend stop-loss rule. According to counsel, this stop-loss rule is intended to prevent the taxpayer from benefitting from an economic return on the shares in the form of tax-free dividends and from a loss on disposing of the shares at the same time.

[118] Therefore, any tax-deductible dividends received have to be considered in computing the loss on the disposition of shares, regardless of the source of the loss. Whether the loss was manufactured (caused by the receipt of dividends on the shares) or caused by genuine economic circumstances is not relevant. Consequently, in the circumstances, counsel submits that the source of the loss has no impact on

[195] *Ibid*, para 141.
[196] *Ibid*, para 144.
[197] *Ibid*, paras 145–47.

the dividend stop-loss rules; it is meant to stop all losses from an affiliate if exempt dividends were paid by the affiliate.[198]

[119] Additionally, counsel submits that the intent of Parliament is to track exempt dividends when there is an exchange of shares within a corporate group. Therefore, when Wuswig substituted the shares of a foreign affiliate for shares of a domestic corporation, it frustrated the purpose of the dividend stop-loss continuity rules.[199]

(b) Does the Avoidance Transaction Defeat or Frustrate the Object, Spirit or Purpose of Subsections 93(2) and 93(2.01) of the ITA.

[120] Counsel submits that Wuswig was able to achieve a result that subsections 93(2) and 93(2.01) of the ITA seek to prevent, that is, the overstatement of the loss realized on the disposition of shares, by not taking into consideration the exempt dividends it received on the shares (or on the shares for which those shares were substituted).[200]

[121] Counsel submits that the alternative transaction proposed by Wuswig is not relevant in determining whether there was an abuse of subsections 93(2) and 93(2.01) of the ITA. The transaction is not informative of the provisions that were abused.[201] Counsel submits that a relevant alternative transaction is one that achieves the same result (i.e., the same tax benefit) under the same provisions of the ITA or the same scheme as the transaction.[202] Wuswig's proposed alternative transaction is therefore not relevant because, while subsection 93(2) would have still applied, the economic result may have been different, considering that the losses sustained by Wuswig would have originated from the unpaid loans.[203] Additionally, counsel submits that the alternative transaction proposed by Wuswig is not informative of the provisions at issue (subsection 93(2)), because it puts in play section 50 of the ITA, a different provision under the ITA.[204]

[122] Counsel submits that the transactions realized for the purpose of the 2007 Reorganization were all avoidance transactions, and they circumvented the

[198] *Ibid*, paras 124–25, 131, 145–46.
[199] *Ibid*, paras 141–43, 158.
[200] *Ibid*, paras 152–57.
[201] *Ibid*, para 166.
[202] *Ibid*, paras 162–63.
[203] *Ibid*, para 167.
[204] Transcript of proceedings dated May 4, 2022, page 101, lines 18–25.

application of the relevant provisions of the ITA in a manner that is abusive, because their result frustrated the underlying rationale of those provisions.[205] Therefore, the GAAR should apply to deny the tax benefit.

(i) The Effect of the Series of Transactions

[123] Counsel submits that, to determine the effect of the series of transactions carried out by Wuswig, it is useful to start by comparing the situation before the series of transactions was carried out to the situation after.[206] Counsel's submissions on this topic can be summarized as follows:

i. Before the Reorganization, Wuswig had shares of an American corporation, which shares had an ACB of $7,777,125 and a fair market value of $2,691,086. Therefore, the shares had an unrealized loss of $5,086,039.[207]

ii. Had Wuswig decided to wind down its U.S. structure before the series of transactions was carried out, it would not have been able to claim the capital loss of $5,086,039 on its shares of Wuswig Holdings 2007 pursuant to subsection 93(2) of the ITA. However, after the series of transactions was carried out, Wuswig was able to preserve the amount of $5,086,036 from the disposition of shares of a newly constituted Canadian corporation.[208]

iii. By creating a new corporation and having it immigrate to Canada only to have it immediately wound up, Wuswig circumvented the legislative intent and frustrated the application of this provision of the ITA. Had the provisions of the ITA operated in accordance with their underlying rationale and their legislative intent, Wuswig would not have been able to realize a capital loss of $5,086,036. Such capital loss was overstated because it did not consider the economic return from which Wuswig had already benefitted when it had received dividends exempted from taxation. Furthermore, this result goes against the intent of Parliament when it amended subsection 93(2) in 1991 to specifically provide for continuity of the dividend stop-loss rule where shares on which the exempt dividends had been received were substituted for shares of the new foreign affiliate. In light of this amendment, it is hard to argue that avoiding the application of the dividend stop-loss rule by simply substituting

[205] Respondent's written submissions, paras 94, 152, 155, 156.
[206] *Ibid*, para 149.
[207] *Ibid*, para 150.
[208] *Ibid*, paras 151–58.

the shares of a foreign affiliate with shares of a domestic corporation is in accord with this clear legislative intent.[209]

(ii) The Alternative Transaction Argument

[124] Counsel's submissions on this topic can be summarized as follows:

i. Wuswig's alternative scenario argument, whereby as of 2002, instead of diverting profits from one profitable subsidiary to another, Wuswig would have received dividends from PBI-Kinmont and then financed the operations of Detroit Marine Terminals by way of loans is not valid. This is because, in this alternative and during the winding-up of Detroit Marine Terminals, these loans would have been settled for no proceeds given that Detroit Marine Terminals had no net assets allowing it to repay the loans at the time of the wind-up. The alternative transaction would have therefore resulted in a capital loss for Wuswig.[210]

ii. In *Univar*,[211] the Federal Court of Appeal held that, in determining whether there has been an abuse of a provision of the ITA, alternative transactions can be a relevant factor. Counsel submits that the Court explained in this decision that, where the taxpayer can illustrate that there are other transactions that could have achieved the same result without triggering any tax, this would be a relevant consideration in determining whether or not the avoidance transaction was abusive.[212] In that case, the alternative transactions considered by the Court were transactions that could have achieved the same result as the actual transactions, under the same provision of the ITA, that is, section 212.1. Therefore, the alternative transaction suggested in *Univar* achieved the same result, but without triggering the provision that was allegedly abused.[213] Counsel submits that, for an alternative transaction to be relevant when the Court has to determine whether avoidance transactions are abusive, it must

[209] *Ibid*, paras 155–60.
[210] *Ibid*, paras 159–60.
[211] *Univar*, above, footnote 118.
[212] Respondent's written submissions, para 161, and *Univar*, above, footnote 118, at para 19.
[213] *Ibid*, para 162.

put in play the same provisions of the ITA or the same scheme, which was the case in *Univar*.[214]

iii. If the alternative transaction proposed by a taxpayer does not involve the same provisions and schemes of the ITA that were actually involved in the transactions at issue, it cannot inform the Court on whether or not a provision has been abused. The decision of the Federal Court of Appeal in *Univar* does not change the analytical framework that has to be used by the Court in a GAAR case. The test for abuse remains to determine whether, after conducting a textual, contextual and purposive analysis of the relevant provisions, the series of transactions that has been carried out by the taxpayer was abusive.[215]

iv. The alternative scenario presented by Wuswig is not relevant and does not inform the Court of the underlying rationale of the provisions that have been abused. In the alternative transaction scenario presented by Wuswig, it would have received an amount of exempt dividends that is higher than in the actual scenario. Section 93(2) of the ITA would have still applied on the winding-up of the U.S. structure, but the overall economic result may have been different if Wuswig also had a capital loss on the settlement of unpaid loans from Detroit Marine Terminals. Therefore, the alternative transaction scenario submitted by Wuswig is not comparable to the scenario that was considered by the Federal Court of Appeal in *Univar*, that is, an alternative transaction that would achieve the same result but without triggering subsection 93(2). The alternative transaction proposed by Wuswig is merely an allegation of an alternative commercial approach that the corporate group could have taken had they known that the Minister would apply the GAAR to the series of transactions.[216] As stated in this Court's decision in *Fiducie financière Satoma v Canada*[217] (affirmed by the Federal Court of Appeal):

> As for the appellant's arguments that a different course of action could have achieved the same result, as shown by the examples provided, they do not change my conclusion. On the one hand, as the Federal Court of Appeal pointed out in *Perrault v. The Queen*, [1979] 1 F.C. 155, page 163, cited by

[214] Respondent's written submissions, para 94. Brian J. Arnold, "The Federal Court of Appeal Decisions in *Univar* and *Oxford Properties*", *The Arnold Report*, Posting: 126, February 27, 2018.
[215] Respondent's written submissions, paras 164–65.
[216] *Ibid*, paras 166–69.
[217] *Fiducie financière Satoma v Canada*, 2017 TCC 84, paras 70–73.

> the appellant, the tax obligation must be determined in the context of what was actually done and not on the basis of various other methods that could have allowed the appellant to avoid being taxed. On the other hand, the examples given of cases where funds were invested directly in a corporation, instead of going through a trust, are not valid comparisons. The tax system differs depending on whether the transactions are between corporations or with individuals (including trusts). Once the evidence shows that the trust was an essential part of the plan, it cannot be shown that the result would have been the same without the use of a trust. A valid comparison could have been an investment made directly by Fiducie familiale Louis Pilon, without paying the dividends received from Gennium to 9134. In that case, the results would not have been the same since that family trust would have been taxed on the dividends it did not distribute to its beneficiaries, as it was not a reversionary trust.[218]

v. The alternative transaction presented by Wuswig is neither relevant nor informative for the analysis that this Court must undertake in determining whether the avoidance transactions carried out by Wuswig result in an abuse of subsection 93(2) of the ITA.

vi. In summary, the alternative transaction submitted by Wuswig does not put at issue subsection 93(2) of the ITA, nor does it provide any indication on the object, spirit and purpose of that provision. Rather, the alternative transaction relies on another provision of the ITA, subsection 50(1) of the ITA, which deals with the deemed disposition of a bad debt owing to a taxpayer, a provision that has its own underlying rationale, unrelated to subsection 93(2), and engages other schemes of the ITA.[219]

vii. Additionally, the alternative transaction raised by Wuswig is irrelevant because it would not have resulted in the same tax consequences. First, this would have meant that Wuswig would have earned even more dividend income than it did, and it is unclear whether this additional dividend could benefit from the deduction under subsection 113(1) of the ITA or would have been taxable. Second, additional U.S. withholding tax required under the *Canada–U.S. Tax Convention (1980)* would have applied to those dividends. Third, the hypothetical loan between Wuswig and the U.S. foreign subsidiary in need of funds would have borne interest, which would have resulted in additional interest income for Wuswig. Fourth, additional U.S. withholding

[218] Respondent's written submissions, paras 169–70. *Fiducie financière Satoma v Canada*, 2017 TCC 84, paras 70–73.

[219] Respondent's Supplementary Submissions, para 35.

tax as required under the *Canada–U.S. Tax Convention (1980)* would have applied to those interest payments. Finally, while the loans between Detroit Marine Terminals and other U.S. subsidiaries were settled by respective creditors for no consideration based on a consolidated approach of the U.S. group, the U.S. tax consequences are unknown if the creditors were outside of the U.S. consolidated group.[220]

viii. Lastly, this alternative transaction does not accord with what Wuswig wanted at the time of the transactions. As per the testimony of Wuswig's representative, Southridge was created in 1999 to provide greater flexibility in the payments of dividends to Noro Holdings' shareholders because the group did not want to "send the money up to Canada and then bring it all the way back down". Indeed, they "wanted to keep the capital...in the United States" and "to leave the money in the United States simply because it was easier and avoided cross-border transactions".[221]

[125] In conclusion, counsel for HMTK submits that the alternative transaction raised by the Appellant is not relevant for the task that this Court has to do, which is to determine whether the admitted avoidance transactions circumvented the underlying rationale of subsection 93(2) in an abusive manner.

b) The 2007 Taxation Year

(1) Did a Tax Benefit Arise from the Series of Transactions?

[126] At trial, counsel submitted that the first condition necessary for the GAAR to apply to the 2007 taxation year is met. Counsel submitted that the tax benefit for the 2007 taxation year arose from Wuswig's using a portion ($79,114) of the $5,086,039 capital loss resulting from the series of transactions against its capital gain for the year to reduce its taxable income. Therefore, Wuswig materialized a portion of the capital loss in that year, which constitutes a tax benefit.[222]

[127] Counsel further submitted that the Minister must determine the tax consequences that are reasonable in the circumstances in order to deny the tax benefit under subsection 245(2) of the ITA.[223] According to counsel, the Minister issued a notice of determination as a reasonable consequence arising from the application of

[220] Respondent's Supplementary Submissions, para 39.
[221] Respondent's Supplementary Submissions, para 40.
[222] Respondent's written submissions, paras 69 and 71.
[223] *Ibid*, para 172.

the GAAR to reduce the available capital loss balance by the amount of $4,463,307 ($5,086,039 minus the losses already claimed in statute-barred taxation years 2007, 2010 and 2011).

[128] Additionally, counsel submitted that the Minister did not deny the $79,114 of capital losses claimed in the 2007 taxation year (and other amounts claimed in 2010 and 2011) because these years were statute-barred. Reassessing Wuswig to deny portions of the capital loss of $5,086,039 realized by Wuswig from the disposition of its shares of Wuswig Holdings 2007 in statute-barred years would not constitute reasonable tax consequences resulting from the application of the GAAR.[224]

[129] As previously mentioned, at the hearing, this Court asked for additional submissions. In the submissions, counsel clarifies HMTK's position and submits that, by issuing a notice of determination for the 2007 taxation year, the Minister is simply stating what the reasonable tax consequences of the application of the GAAR should be for the 2007 taxation year. The Minister is not retroactively reassessing a statute-barred year, nor is he creating a tax benefit. The Minister is not trying to do indirectly what he cannot do directly. Counsel submits that the reasonable tax consequences of the application of the GAAR to the taxation year 2007 is not to deny the portion of the losses that were used in statute-barred taxation years, but to adjust the capital loss balance accordingly.[225]

(a) The Reasonable Tax Consequence Argument

[130] Counsel's submissions on this topic can be summarized as follows:

i. When a tax benefit is claimed and it results from an abusive avoidance transaction, the Minister must, in accordance with subsection 245(2) of the ITA, determine the tax consequences that are reasonable in the circumstances in order to deny the tax benefit. Subsection 152(1.11) of the ITA is the procedure by which the Minister is allowed to ascertain the tax consequences under subsection 245(2).[226]

ii. In this case, the Minister determined that the reasonable tax consequences to deny Wuswig's tax benefit were to issue a determination under subsection 152(1.11) to reduce the loss carry-forward balance from

[224] *Ibid*, para 175.
[225] Respondent's additional written submissions, July 8, 2022, page 3.
[226] Respondent's written submissions, paras 172–73.

> $4,463,407 to nil. According to counsel, the loss carry-forward balance of $4,463,407 represents the disallowed capital loss of $5,086,039, less the amounts already claimed by Wuswig in statute-barred taxation years ($79,114 in 2007, $396,958 in 2010 and $146,660 in 2011). The Minister did not reassess Wuswig to refuse the portions of the loss claimed in the 2007, 2010 and 2011 taxation years because these years were statute-barred and this would not constitute a reasonable tax consequence in the circumstances.[227]

(2) Was the Series of Transactions an Avoidance Transaction?

[131] Counsel submits that the transactions were part of a series because they were preordained to produce a result, which is to realize the capital loss on the disposition of the shares.[228] Counsel submits that the series is composed of transactions, all of which are avoidance transactions because they were undertaken to obtain a tax benefit.[229]

(3) Was the Avoidance Transaction Abusive?

[132] Counsel submits that the series of transactions was abusive within the meaning of subsection 245(4) of the ITA because the series of transactions circumvented the application of subsection 93(2) of the ITA. Counsel submits that once the object, spirit and purpose of the provision have been identified, the next task for this Court is to determine whether the transaction falls within or frustrates the purpose of a provision. Counsel submits that this part of the analysis requires this Court to closely examine the facts to determine whether allowing a tax benefit would be within the object, sprit or purpose of the provisions relied on by the taxpayer, when those provisions are interpreted textually, contextually and purposively.[230]

C. The Parties' Positions with Respect to *Deans Knight*

[133] Following the hearing of this case, on May 26, 2023, the Supreme Court of Canada rendered the *Deans Knight Income Corp v Canada*[231] decision in which the GAAR was at issue. On February 28, 2024, this Court requested submissions from

[227] *Ibid*, paras 174–75.
[228] *Ibid*, para 84.
[229] *Ibid.*
[230] *Ibid*, para 148.
[231] *Deans Knight*, above, footnote 67.

the parties on the impact of this decision on the analysis that must be conducted by this CourtWuswig's Submissions.

[134] Counsel for Wuswig submits that *Deans Knight* has no special relevance to this appeal. Counsel has made in part the same submissions that had already been made during the course of the proceedings. Counsel's new submissions can be summarized as follows:

i. In *Trustco*, the Supreme Court of Canada established the analytical framework for the application of the GAAR. In subsequent decisions, the Supreme Court of Canada has applied the framework established in *Trustco* without disturbing it, and *Deans Knight* is no exception. The *Deans Knight* decision has no relevance to this appeal except insofar as it confirms the analytical framework already set forth by Wuswig in its written submissions.[232]

ii. As clearly acknowledged by this Court in *Husky Energy Inc v The King*,[233] the majority in *Deans Knight* is not introducing new interpretive principles. Rather, the majority is elaborating on the Supreme Court of Canada's approach to the GAAR in its earlier decisions. Crucially, it remains the case after *Deans Knight* that, to apply the GAAR, HMTK must demonstrate a clear misuse or abuse of specific provisions of the ITA, as affirmed by this Court in *Québecor Inc v The King*.[234]

iii. Given that this appeal does not involve loss trading or a question of control, it is difficult to see how *Deans Knight* could have any relevance beyond its restatement of the *Trustco* analytical framework.

iv. Wuswig submits that subsection 93(2) of the ITA is intended to limit the artificial creation of losses on the disposition of shares in foreign affiliates (the why) by operating to reduce the resulting capital loss on the disposition of foreign affiliate shares by the aggregate amount of dividends paid on such shares and subject to a deduction under section 113 of the ITA (the how).

1. HMTK's Submissions

[232] Appellant's Supplementary Submissions, paras 1–2.
[233] *Husky Energy Inc v The King*, 2023 TCC 167.
[234] *Québecor Inc v The King*, 2023 TCC 142.

[135] Counsel for HMTK also submits that *Deans Knight* has no special relevance to this appeal. Similarly to counsel for Wuswig, counsel's submissions repeat in part what has already been submitted during the proceedings. Counsel's new submissions with respect to the impact of *Deans Knight* can be summarized as follows:

a) The First Step of the Abuse Inquiry: Identifying Why the Provision Was Adopted

[136] In *Deans Knight*, the Supreme Court of Canada clarified that, when determining the underlying rationale or the object, spirit and purpose of a provision, it is critical to distinguish its rationale (the why) from the means (the how) chosen by Parliament to give effect to this rationale.[235]

[137] In *Deans Knight*, the Supreme Court reaffirmed that, even where Parliament has legislated with precision, such as in enacting a specific anti-avoidance provision, there is no bar to applying the GAAR. Abusive tax avoidance can occur when transactions circumvent the application of a specific anti-avoidance rule in a manner that frustrates or defeats the object, spirit and purpose of those provisions.[236]

b) The Second Step of the Abuse Inquiry Is a Comparative Analysis

[138] In *Deans Knight,* the Supreme Court of Canada confirmed that, at this stage of the inquiry, the analysis is comparative: the result that the transactions achieved is assessed against the provision's rationale to determine whether this rationale is frustrated. Therefore, the determination of whether the admitted avoidance transactions result in an abuse of the provision relied upon to obtain a tax benefit is necessarily based on specific facts and must be anchored in the overall effect of the transactions at issue in each given case compared to the specific statutory scheme at play.[237]

c) The Underlying Rationale of Subsection 93(2) of the ITA Reflects the Reason Why this Provision Was Adopted

[139] Counsel submits that Wuswig's position leads to a result that is not consistent with the analysis mandated by *Deans Knight* and by the previous decisions of the

[235] Respondent's Supplementary Submissions, para 6.
[236] *Ibid,* para 8.
[237] *Ibid,* para 12.

Supreme Court of Canada on the application of the GAAR. Rather than describing the rationale of the provision or the reasons why it was enacted, Wuswig's position overly focuses on the *means* chosen to give effect to the provision.

d) The Reliance by Wuswig on a Hypothetical Alternative Scenario Is of No Relevance in the Abuse Inquiry as Mandated by the Supreme Court of Canada in *Deans Knight*

[140] As stated in *Deans Knight*, the abuse inquiry under the GAAR is a comparative analysis between the underlying rationale of the provision that gave rise to the tax benefit and the result of the avoidance transactions that gave rise to the tax benefit. It is a two-step process, the purpose of which is to determine whether the outcome of an avoidance transaction achieves a result that the provision sought to prevent and whether it defeats or circumvents its underlying rationale in any manner.[238] The examination of a hypothetical alternative transaction has no place in this exercise. This is especially true in this case because the hypothetical alternative transaction is one that is conceived after the fact; that is based on a different factual basis; that puts at play different provisions of the ITA, namely, the application of subsection 50(1) of the ITA; that engages different schemes of the ITA; and that may not even produce the same result. These are indications that the reliance on this hypothetical alternative scenario has no place in the analysis that this Court must conduct and is not helpful in determining whether the underlying rationale of subsection 93(2) was abused because of the avoidance transactions undertaken by Wuswig.[239]

[141] This Court should therefore follow the framework for the GAAR, as reaffirmed in *Deans Knight* and compare the result of the actual transactions against the underlying rationale of subsection 93(2) of the ITA.[240]

D. The Parties' Positions with Respect to *3295940 Canada Inc*

[142] Following the hearing of this case, on March 7, 2024, the Federal Court of Appeal rendered the *3295940 Canada Inc v Canada*[241] decision, in which the GAAR was at issue. More specifically, the decision addressed situations where an alternative transaction can be used to assess misuse of the GAAR or abuse of the

[238] *Ibid,* para 21.
[239] *Ibid,* paras 22–23.
[240] *Ibid,* para 25.
[241] *3295940 Canada Inc v Canada*, 2024 FCA 42 [*3295940 Canada Inc*].

ITA. Notably, in the decision, the Court set out a list of elements to be used to determine when alternative transactions are relevant to the GAAR analysis. On July 16, 2024, this Court requested written submissions from the parties on the impact of the *3295940 Canada Inc* decision on the analysis that must be conducted by this Court.



[143] This Court held several case management conferences to address the impact of *3295940 Canada Inc* and Wuswig's possible failure to prove some material facts in light of that decision. Counsel for Wuswig sought to reopen the hearing to introduce new evidence to admit a portion of Mr. Davidson's discovery testimony, which counsel argued was relevant considering *3295940 Canada Inc.* Counsel for HMTK opposed this suggestion and the parties could not agree on how to proceed.

[144] Consequently, counsel for Wuswig filed a Motion Record on November 1, 2024, requesting that the hearing be reopened for the purpose of permitting the parties to submit additional evidence in connection with Wuswig's alternative transaction argument. Following the motion, to expedite the resolution of this matter, the parties agreed that additional evidence be presented to this Court and put on the record through HMTK filing the additional evidence pursuant to section 100 of the *Tax Court of Canada Rules (General Procedure)*. To this end, this Court allowed Wuswig to withdraw its Motion Record requesting the reopening of the hearing, without costs. This Court further allowed HMTK to file additional evidence pursuant to section 100.

[145] As a result, HMTK read into evidence extracts from the transcript of the continuation of the examination for discovery of Mr. Davidson as well as an answer given by Wuswig to an undertaking taken during the examination.

1. Wuswig's Submissions

[146] Counsel for Wuswig submits that *3295940 Canada Inc* identifies two new factors that may be considered when determining the relevance of alternative transactions in a GAAR analysis. Therefore, new evidence should be introduced and considered by this Court to fill in the evidentiary gaps that *3295940 Canada Inc* created and to allow this Court to consider these two new factors. Counsel's submissions with respect to the impact of the *3295940 Canada Inc* decision can be summarized as follows:

i. Prior to the release of *3295940 Canada Inc*, the principal decision dealing explicitly with an alternative transaction argument in the context of the misuse

or abuse analysis was *Univar*. However, it provided little guidance in determining when an alternative transaction is relevant in deciding whether a particular transaction was abusive under the GAAR analysis;[242]

ii. In *3295940 Canada Inc*, the Federal Court of Appeal confirmed the finding in *Univar* that courts must consider relevant alternative transactions when determining whether avoidance transactions are abusive;[243]

iii. Applying this approach, the Federal Court of Appeal held that the alternative transactions submitted by the taxpayer, each clearly inoffensive, provided a strong argument that the impugned transactions were not abusive, since the same overall result of the impugned transactions could have easily been achieved under these relevant and realistic alternative scenarios;[244]

iv. For the first time, the Federal Court of Appeal established five factors that can be assessed in determining whether a proposed alternative transaction provides a relevant benchmark in determining whether a particular series of transactions is abusive under the GAAR;[245]

v. Relevant alternative transactions must be considered in determining whether the overall result sought by a series of transactions is abusive;[246]

vi. The Federal Court of Appeal did not establish a stringent test requiring that five conditions each be met. Indeed, the Federal Court of Appeal treats these five factors as indicia that show that the alternative transaction is relevant and at no point mentions that all five factors must be present as conditions to establish such relevance;[247]

vii. *3295940 Canada Inc* is novel because, prior to its release, *Univar* considered (explicitly or implicitly) only three of the five factors mentioned in *3295940 Canada Inc*:[248]

[242] Appellant's Supplementary Submissions, paras 20, 23.
[243] *Ibid*, para 26.
[244] *Ibid*, para 27.
[245] *Ibid*, para 30.
[246] *bid*, para 32.
[247] *Ibid*, para 33.
[248] *Ibid*, para 34.

- The alternative transactions are available under the ITA;

- The alternative transactions generate tax consequences approximately as favourable as the series at issue; and

- The alternative transactions are not abusive under the GAAR.

viii. In *3295940 Canada Inc*, the Federal Court of Appeal sets out two new factors that can be used to determine the relevance of alternative transactions in a GAAR analysis:

- They are not so remote as to be practically infeasible; and

- They have a high degree of commercial and economic similarity to the series at issue.

ix. Had the Federal Court of Appeal in *3295940 Canada Inc* intended to depart from its approach in *Univar*, it presumably would have done so explicitly. The fact that *3295940 Canada Inc* did not signal a departure from *Univar* suggests the decisions must be read harmoniously, which requires that the five factors be treated as indicia and not conditions to establish relevance;[249]

x. Regardless of whether the Federal Court of Appeal set out a list of factors or conditions, the qualification is ultimately irrelevant because each of these five considerations are met in respect of the alternative transaction argument;[250]

xi. Wuswig's alternative transactions are relevant and must be considered by this Court in determining whether the Reorganization was abusive for purposes of the GAAR.[251]

2. HMTK's Submissions

[147] Counsel for HMTK submits that the Federal Court of Appeal's reasoning on the issue of alternative transactions in *3295940 Canada Inc* continues from the previous decision of the Federal Court of Appeal in *Univar*, which held that reliance on an alternative transaction in the abuse inquiry under the GAAR may be helpful

[249] *Ibid*, para 35.
[250] *Ibid*, para 36.
[251] *Ibid*, para 37.

in informing the Court on the scope of the provision that gave rise to the tax benefit and in determining whether the transactions undertaken resulted in abusive tax avoidance. Counsel's submissions with respect to the impact of *3295940 Canada Inc* can be summarized as follows:

i. In examining the alternative transactions in *3295940 Canada Inc*, the Federal Court of Appeal relied on *Univar* and stated that "[a]lternative transactions are helpful in determining the object, spirit and purpose of the relevant provisions and, correspondingly, what the Act seeks to allow and prevent";[252]

ii. *3295940 Canada Inc* is aligned with alternative transactions and *Univar*, as it considers their existence as a useful but limited factor in the initial step of the GAAR abuse analysis, which involves determining, as a matter of law, the object, spirit and purpose of the provisions under review in a given series of transactions. In other words, the alternative transaction becomes a tool to look at the series of transactions from another angle and to provide some guidance as to the object, spirit and purpose of the provisions at play;[253]

iii. In its reasons, the Federal Court of Appeal identified a number of considerations that rendered the alternative transactions submitted by the appellant helpful in the specific context of that case because the taxpayer presented evidence at trial demonstrating that the alternative transactions were actually considered, studied, formalized, submitted and refused by the counterparties of the appellant's transactions before the actual transactions were carried out;[254]

iv. The principle remains, as it was the case in *Univar*, that an alternative transaction may be considered only when such an alternative helps in informing the Court of the scope of the provision that gave rise to the tax benefit and ultimately assists in determining whether the transactions undertaken resulted in abusive tax avoidance;[255]

v. The alternative transaction argument raised by Wuswig is not relevant for the task that this Court must do, which is to determine whether the admitted

[252] Respondent's Supplementary Submissions, para 30.
[253] *Ibid*, para 31.
[254] *Ibid*, para 32.
[255] *Ibid*, para 33.

avoidance transactions circumvented the underlying rationale of subsection 93(2) of the ITA in an abusive manner.[256]

## VI. DISCUSSION

### A. The Law

#### 1. The Origin and Role of the GAAR

[148] In *Deans Knight Income Corp v Canada*,[257] the Supreme Court of Canada provides an extensive review of the GAAR. The review includes a summary of the origins and role of the GAAR within the ITA. The summary reads as follows:

> [41] In 1988, Parliament enacted the GAAR in s. 245 of the Act, partially in response to this Court's decision in *Stubart Investments Ltd. v. The Queen*, [1984] 1 S.C.R. 536. In *Stubart*, this Court rejected a literal approach to interpreting the Act. At the same time, it also rejected an interpretation of a precursor to the GAAR that would have required transactions to have a *bona fide* business purpose. Instead, it offered guidelines to limit unacceptable tax avoidance arrangements. Parliament viewed the decision in *Stubart* as an inadequate approach to the problem of tax avoidance (*Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54, [2005] 2 S.C.R. 601, at para. 14).
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> [42] Moreover, abusive tax avoidance had become a problem of significant concern for Parliament. Taxpayers, aided by expert advice, increasingly devised complex legal transactions to avoid tax in ways unintended by Parliament. Once the avoidance mechanisms relied on became evident, either from advance ruling requests or tax assessments, Parliament would react to "plug" the loopholes in the Act to prevent future use. The problem was that increasingly convoluted rules were vulnerable, creating new loopholes to exploit. This Court described this cycle in *Stubart* as "the action and reaction endlessly produced by complex, specific tax measures aimed at sophisticated business practices, and the inevitable, professionally-guided and equally specialized taxpayer reaction" (p. 580; see also D. A. Dodge, "A New and More Coherent Approach to Tax Avoidance" (1988), 36 *Can. Tax J.* 1, at p. 4). As this "cycle of action and reaction" between creative tax planners and Parliament continued, the Act grew in size and complexity (Department of Finance, *Guidelines for Tax Reform in Canada* (1986), at p. 7).
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> [43] Despite these efforts, Parliament was unable to curb the proliferation of tax avoidance schemes. Corporate tax revenues in 1985-86 "were $1.2 billion lower than the initial budgetary forecasts", a shortfall which "was considered to be caused

[256] *Ibid*, para 44.
[257] *Deans Knight*, above, footnote 67.

largely by the unexpected application of loss carry forwards" (Dodge, at p. 3; see also W. J. Strain, D. A. Dodge and V. Peters, "Tax Simplification: The Elusive Goal", in *Report of Proceedings of the Fortieth Tax Conference* (1989), 4:1, at pp. 4:43 and 4:52-53).

[44] The GAAR was Parliament's chosen mechanism to interrupt this cycle. In the 1987 White Paper on Tax Reform, the government recognized that specific anti-avoidance rules are "not always desirable" because they "make the tax system more complex; they sometimes create additional unintended loopholes, and they do not deal with transactions completed before the amendments become effective" (see Department of Finance, *The White Paper: Tax Reform 1987* (1987), at p. 57; see also B. J. Arnold and J. R. Wilson, "The General Anti-Avoidance Rule — Part 2" (1988), 36 *Can. Tax J.* 1123, at p. 1140). A new general anti-avoidance rule was meant to overcome some of these disadvantages. The novel approach found within the GAAR explains why, upon its enactment, Parliament was able to remove certain specific anti-avoidance rules that it felt were sufficiently addressed by a general rule (*White Paper*, at p. 57; *Triad Gestco Ltd. v. Canada*, 2012 FCA 258, [2014] 2 F.C.R. 199, at paras. 52-53; Department of Finance, *Tax Reform 1987: Income Tax Reform* (1987), at p. 129; Dodge, at p. 8; Department of Finance, *Modernizing and Strengthening the General Anti-Avoidance Rule: Consultation Paper*, 2022 (online), at pp. 16 and 19-20; see also Arnold and Wilson, at p. 1148).

[45] In light of the foregoing, the GAAR is best understood as a way to overcome the disadvantages of a system based solely on specific rules (*White Paper*, at p. 57; Dodge, at p. 8). The GAAR was a choice, made by Parliament, to complement its specific anti-avoidance efforts with the enactment of a general rule. To achieve this aim, the GAAR "draws a line between legitimate tax minimization and abusive tax avoidance" (*Trustco*, at para. 16). Abusive tax avoidance can involve unforeseen tax strategies (*Canada v. Alta Energy Luxembourg S.A.R.L.*, 2021 SCC 49, at para. 80). For example, in *Alta Energy*, this Court treated evidence of Parliament's knowledge and acceptance of the tax strategy at issue as a relevant consideration when ascertaining its intent. However, the GAAR is not limited to unforeseen situations; as this Court has explained, it is designed to capture situations that undermine the integrity of the tax system by frustrating the object, spirit and purpose of the provisions relied on by the taxpayer (*Lipson v. Canada*, 2009 SCC 1, [2009] 1 S.C.R. 3, at para. 2; *Copthorne Holdings Ltd. v. Canada*, 2011 SCC 63, [2011] 3 S.C.R. 721, at paras. 71-72; see also *The Gladwin Realty Corporation v. The Queen*, 2020 FCA 142, [2020] 6 C.T.C. 185, at para. 85; D. G. Duff, "General Anti-Avoidance Rules Revisited: Reflections on Tim Edgar's 'Building a Better GAAR'" (2020), 68 *Can. Tax J.* 579, at p. 591).[258]

[258] *Ibid*, paras 41–45.

## 2. The Relationship Between the GAAR and the *Duke of Westminster* Principle

[149] In *Deans Knight*, the Supreme Court of Canada also provided a summary of the relationship between the GAAR and the *Duke of Westminster* principle. This summary reads as follows:

> [46] The GAAR must also be understood in light of its relationship to the *Duke of Westminster* principle. In *Commissioners of Inland Revenue v. Duke of Westminster*, [1936] A.C. 1 (H.L.), Lord Tomlin recognized the foundational principle that "[e]very man is entitled if he can to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be" (p. 19). The principle that taxpayers can order their affairs to minimize the amount of tax payable has been affirmed by this Court on numerous occasions (see, e.g., *Stubart*, at p. 552; *Trustco*, at para. 11; *Copthorne*, at para. 65).
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> [47] The *Duke of Westminster* principle, however, has "never been absolute" (*Lipson*, at para. 21) and it is open to Parliament to derogate from it. Parliament has done so through the GAAR. The GAAR does not displace the *Duke of Westminster* principle for legitimate tax planning. Rather, it recognizes a difference between legitimate tax planning — which represents the vast majority of transactions and remains unaffected, consistent with the *Duke of Westminster* principle — and tax planning that operates to abuse the rules of the tax system — in which case the integrity of the tax system is preserved by denying the tax benefit, notwithstanding the transactions' compliance with the provisions relied upon. Even where the purpose of a transaction is to minimize tax, taxpayers are allowed to carry it out unless it results in an abuse of the provisions of the Act (*Lipson*, at para. 25). Where the transaction is shown to be abusive, the *Duke of Westminster* principle is "attenuated" by the GAAR (*Trustco*, at para. 13).
>
> [48] In establishing a general anti-avoidance rule that operated to deny tax benefits on a case-specific basis, Parliament was cognizant of the GAAR's implications for the level of certainty in tax planning. Parliament sought to balance "the protection of the tax base and the need for certainty for taxpayers" (Department of Finance, *Explanatory Notes to Legislation Relating to Income Tax* (1988), at p. 461). The GAAR was enacted to be "a provision of last resort" to address abusive tax avoidance only and was therefore not designed to create more generalized uncertainty in tax planning (*Trustco*, at para. 21; *Copthorne*, at para. 66). Some uncertainty is unavoidable when a general rule is adopted (Dodge, at p. 21; *Copthorne*, at para. 123). However, a reasonable degree of certainty is achieved by the balance struck within the GAAR itself.
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> [49] First, as Professor Jinyan Li noted, "the GAAR cases generally involve situations that do not concern the majority of taxpayers, and the transactions are well planned and executed on the basis of professional tax advice" ("'Economic

> Substance': Drawing the Line Between Legitimate Tax Minimization and Abusive Tax Avoidance" (2006), 54 *Can. Tax J.* 23, at p. 40). The GAAR only scrutinizes transactions motivated by tax avoidance, and even a tax-motivated transaction that is consistent with the object, spirit and purpose of the provisions of the Act is unaffected by the GAAR (see *Explanatory Notes*, at p. 461). By virtue of the rigorous analysis required by s. 245, the GAAR only affects a small subset of transactions, largely conducted by sophisticated parties with the ability to properly evaluate the risks inherent in a GAAR reassessment. Indeed, this is precisely what occurred in the present case: the prospectus relating to the appellant's IPO expressly recognized the risk of a successful challenge to the use of the Tax Attributes.
>
> [50] Second, a proper application of the GAAR methodology serves to ensure reasonable certainty in tax planning (P. Samtani and J. Kutyan, "GAAR Revisited: From Instinctive Reaction to Intellectual Rigour" (2014), 62 *Can. Tax J.* 401, at p. 403). The GAAR is not a tool to sanction conduct that courts find immoral (*Copthorne*, at para. 65; *Alta Energy*, at para. 48). Rather, courts must conduct an "objective, thorough and step-by-step analysis" (*Copthorne*, at para. 68). Within this analysis, the principles of certainty, predictability and fairness do not play an independent role; rather, they are reflected in the carefully calibrated test that Parliament crafted in s. 245 of the Act and in its interpretation by this Court. It is to this test that I now turn.[259]

[150] Indeed, it is well recognized in Canadian law that taxpayers have the right to organize their affairs to minimize the amount of tax payable.[260] However, as the Supreme Court of Canada has stated, this principle is not absolute, and it is open to Parliament to derogate from it. Parliament has done so through the GAAR,[261] which should not, however, be interpreted as undermining this basic tenet of tax law.[262] Parliament intends taxpayers to take full advantage of the provisions of the ITA that confer tax benefits.[263] Achieving the various policies that the ITA seeks to promote is dependent on taxpayers' doing so. Therefore, in the absence of contrary provisions in the ITA, the courts cannot prevent taxpayers from using complex strategies to minimize the tax they must pay if the strategies comply with the relevant provisions of the ITA.[264] Taxpayers are therefore entitled to enter into a series of transactions

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[259] *Ibid*, paras 46–50.
[260] *Deans Knight*, above, footnote 67, at para 46; *Copthorne*, above, footnote 40, at para 49*; Inland Revenue Commissioners v Duke of Westminster* (1935), 19 TC 490 (UK HL).
[261] *Deans Knight*, above, footnote 67, at para 47.
[262] *Canada Trustco*, above, footnote 63, at para 61.
[263] *Ibid*, para 31.
[264] *Ibid*, para 62.

that will minimize their tax liability.[265] The GAAR can only be applied to deny a tax benefit when the abusive nature of the transaction is clear.[266]

[151] The GAAR's purpose is to deny the tax benefits of certain arrangements that comply with a literal interpretation of the provisions of the ITA, but amount to an abuse of some of these provisions.[267] The Court's role, therefore, is to conduct an objective, thorough and step-by-step analysis and explain the reasons for its conclusion.[268] The Minister may apply the GAAR to deny a tax benefit when the abusive nature of the transaction is clear.[269] Abusive tax avoidance can involve unforeseen tax strategies that undermine the integrity of the tax system by frustrating the object, spirit and purpose of the provisions relied on by the taxpayer.[270]

[152] An avoidance transaction may operate alone to produce a tax benefit, but it may also operate as part of a series of transactions that results in the tax benefit. While the focus must be on the transaction, where it is part of a series, it must be viewed in the context of the series to enable the Court to determine whether abusive tax avoidance has occurred.[271] In such a case, whether a transaction is abusive will only become apparent when it is considered in the context of the series of which it is a part and the overall result that is achieved.[272]

[153] The object, spirit or purpose can be identified by applying the same interpretive approach employed in all questions of statutory interpretation—a "unified textual, contextual and purposive approach" to establish the object, spirit or purpose of the provisions at issue.[273] However, as the Supreme Court pointed out in *Copthorne*, determining the rationale of the relevant provisions of the ITA 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.[274]

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[265] *Copthorne,* above, footnote 40, at para 65.
[266] *Canada Trustco,* above, footnote 63, at para 50.
[267] *Ibid*, para 16.
[268] *Copthorne,* above, footnote 40, at para 68.
[269] *Ibid*.
[270] *Deans Knight,* above, footnote 67, at para 45 (*Canada v Alta Energy Luxembourg SARL*, 2021 SCC 49 at para 80).
[271] *Copthorne,* above, footnote 40, at para 71.
[272] *Ibid,* para 71.
[273] *Canada Trustco,* above, footnote 63, at para 47; *Lipson,* 2009 SCC 1 at para 26 [*Lipson*].
[274] *Copthorne,* above, footnote 40, at para 70.

[154] The purpose of the GAAR is not to imply moral opprobrium regarding the actions of a taxpayer to minimize tax liability utilizing the provisions of the ITA in a creative way.[275] It is a provision of last resort enacted to address abusive tax avoidance.[276]

### 3. The GAAR Test

[155] For the GAAR to apply, the courts must determine whether the tax benefit obtained by a taxpayer constitutes an abuse of certain provisions of the ITA. In doing so, as the Court stated in *Copthorne*, the courts have the duty to look behind the words of the legislation to make this determination.[277]

[156] To this end, an analysis involving a three-step test should be performed.[278] The test has been the subject of thorough guidance by the Supreme Court of Canada. The Court must answer a question at each step. Each question includes a requirement that must be met in order for the GAAR to apply.[279] The three questions that this Court must answer are:

1- Whether there is a tax benefit arising from a transaction or series of transactions under subsections 245(1) and (2) of the ITA;

2- Whether the transaction or series of transactions is an avoidance transaction within the meaning of subsection 245(3) of the ITA; and

3- Whether the avoidance transaction is abusive within the meaning of subsection 245(4) of the ITA.[280]

[157] The Minister may only apply the GAAR to deny a tax benefit when these three requirements have been fulfilled.[281] Consequently, as part of its analysis, this Court must determine whether the three requirements have been fulfilled.[282]

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[275] *Ibid*, para 65.
[276] *Canada Trustco*, above, footnote 63, at para 21.
[277] *Copthorne*, above, footnote 40, at para 66.
[278] *Deans Knight*, above, footnote 67, at para 51.
[279] *Canada Trustco*, above, footnote 63, at para 17.
[280] *Ibid*, para 66.
[281] *Ibid.*
[282] *Canada Trustco*, above, footnote 63, at para 17.

[158] On this subject, it should be noted that the taxpayer bears the burden of demonstrating that the first two requirements have not been fulfilled. The Minister bears the burden of proving that the "avoidance transaction" is abusive within the meaning of subsection 245(4) of the ITA.[283]

a) Did a Tax Benefit Arise from the Series of Transactions?

[159] The definition of "tax benefit" is provided in subsection 245(1) of the ITA and it reads as follows:

> ***tax benefit*** means a reduction, avoidance or deferral of tax or other amount payable under this Act or an increase in a refund of tax or other amount under this Act, and includes a reduction, avoidance or deferral of tax or other amount that would be payable under this Act but for a tax treaty or an increase in a refund of tax or other amount under this Act as a result of a tax; (*avantage fiscal*)

[160] Whether a tax benefit exists is a factual determination that has to be made by the Court. In order for a tax benefit to exist, pursuant to subsection 245(1) of the ITA, the taxpayer must have reduced, avoided or deferred tax payable under the ITA.[284] The tax benefit must have been realized.[285] This means that an increase of a tax attribute is not considered to be a "tax benefit" for the application of the GAAR, and a "tax benefit" cannot be the result of a notice of determination issued under the GAAR.[286] In *Gladwin*, the Federal Court of Appeal stated the following on this issue:

> 47 The appellant for its part contends that the tax benefit results from the CDA increase in the amount of $12,155,827 (Memorandum of the Appellant, para. 1). However, it is now established that the modification of tax attributes, such as an increase in a taxpayer's CDA, does not give rise to a tax benefit unless and until a capital dividend is paid out of that account to a recipient capable of benefiting from its tax-free character (see *1245989 Alberta Ltd. v. Canada (Attorney General)*, 2018 FCA 114 (F.C.A.) [*Perry Wild*]). Although distributions have been made from the appellant's CDA, the recipients so far are all related corporations which can otherwise receive inter-corporate dividends on a tax-free basis (subsection 112(1)).
>
> 48 The tax benefit identified by the Tax Court judge, and agreed to by the Crown, no more qualifies as a tax benefit. The GAAR may only be used to deny a tax benefit that results from an avoidance transaction. The tax benefit in the form of

[283] *Deans Knight*, above, footnote 67, at para 52.
[284] *Deans Knight*, above, footnote 67, at para 53; *Canada Trustco*, above, footnote 63, at para 20.
[285] *Gladwin Realty Corporation v Canada*, 2020 FCA 142, at paras 48–49 [*Gladwin*].
[286] *1245989 Alberta Ltd v Canada*, 2018 FCA 114 at paras 30–34 [*1245989*]; see also *Gladwin*, above, footnote 286, at para 47.

> the avoidance of the additional tax on excessive elections provided for under subsection 184(2) would result from the Notice of determination itself which reduced the appellant's CDA by half of the second capital gain in order to deny the tax benefit. A tax benefit cannot be the result of a Notice of determination issued under the GAAR as the purpose of such a determination is to deny the tax benefit, not to bring the benefit into existence.



### b) Was the Series of Transactions an Avoidance Transaction?

[161] In the second step, pursuant to subsection 245(3) of the ITA, the Court must determine whether the transaction or series of transactions was made primarily for the purpose of obtaining a tax benefit.[287] The definition of an avoidance transaction is provided in subsection 245(3). Subsection 245(3) of the ITA reads as follows:

> **(3)** An avoidance transaction means any transaction
>
> > **(a)** that, but for this section, would result, directly or indirectly, in a tax benefit, unless the transaction may reasonably be considered to have been undertaken or arranged primarily for bona fide purposes other than to obtain the tax benefit; or
> >
> > **(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.

[162] A transaction may have both tax and non-tax purposes. In such a case, the taxpayer must prove to the Court that it is reasonable to conclude that the non-tax purpose was primary.[288]

[163] An avoidance transaction may consist of a single transaction or be part of a series of transactions.[289] Under subsection 245(3) of the ITA, obtaining the tax benefit cannot constitute a *bona fide* purpose.[290] Therefore, a series of transactions is an avoidance transaction if it is reasonable to consider that it was not primarily undertaken for a *bona fide* non-tax purpose. In a series of transactions, if at least one

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[287] *Deans Knight*, above, footnote 67, at para 54 and *Canada Trustco*, above, footnote 63, at paras 17, 21, 66.
[288] *Deans Knight*, above, footnote 67, at para 54 and *Canada Trustco*, above, footnote 63, at paras 27, 29.
[289] *Deans Knight*, above, footnote 67, at para 54.
[290] *Copthorne*, above, footnote 40, at para 40.

transaction in the series is an avoidance transaction, the second step has been satisfied.[291]

[164] A series of transactions also includes related transactions or events in contemplation of the series per subsection 248(10) of the ITA, which refers to transactions or events before or after the series that were undertaken "'in relation to' or 'because of' the series".[292] In *Copthorne*, the Court stated the following on the issue:

> 55 In *Trustco*, the Chief Justice and Major J. explained that it is likely more consonant with the Parliamentary intention, to read s. 248(10) both prospectively and retrospectively. And *Trustco* adopted and expanded the application of s. 248(10) as interpreted in *OSFC*, which itself involved the retrospective application of the provision. The Court in *Trustco* said,
>
> 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*" (2003), 57 I.B.F.D. Bulletin 278, at p. 287) [para. 26]

### c) Was the Avoidance Transaction Abusive?

[165] In the third step, pursuant to subsection 245(4) of the ITA, the Court must determine whether the transaction is abusive.

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[291] *Deans Knight*, above, footnote 67, at para 55, *Copthorne*, above, footnote 40, at para 60.
[292] *Deans Knight*, above, footnote 67, at para 55, *Copthorne*, above, footnote 40, at para 46 and *Canada Trustco*, above, footnote 63, at para 26.

[166] An avoidance transaction is abusive within the meaning of subsection 245(2) of the ITA in the cases listed in subsection 245(4) of the ITA. Subsection 245(4) reads as follows:

> **(4)** Subsection (2) applies to a transaction only if it may reasonably be considered that the transaction
>
> > **(a)** would, if this Act were read without reference to this section, result directly or indirectly in a misuse of the provisions of any one or more of
> >
> > > **(i)** this Act,
> > > **(ii)** the *Income Tax Regulations*,
> > > **(iii**) the *Income Tax Application Rules*,
> > > **(iv)** a tax treaty, or
> > > **(v)** any other enactment that is relevant in computing tax or any other amount payable by or refundable to a person under this Act or in determining any amount that is relevant for the purposes of that computation; or
> >
> > **(b)** would result directly or indirectly in an abuse having regard to those provisions, other than this section, read as a whole.

[167] In *Canada Trustco*, the Supreme Court of Canada described the analysis that the Court must perform to determine whether an avoidance transaction is abusive as follows:

> 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.
>
> . . .
>
> 47 The first part of the inquiry under s. 245(4) requires the court to look beyond the mere text of the provisions and undertake a contextual and purposive approach to interpretation in order to find meaning that harmonizes the wording, object, spirit and purpose of the provisions of the *Income Tax Act*. There is nothing novel in this. Even where the meaning of particular provisions may not appear to be ambiguous at first glance, statutory context and purpose may reveal or resolve latent ambiguities.

> 55 The second step is to examine the factual context of a case in order to determine whether the avoidance transaction defeated or frustrated the object, spirit or purpose of the provisions in issue.

[168] In *Deans Knight*, the Supreme Court of Canada summarized the third step of the analysis as follows:

> [56] … Analyzing whether the transactions are abusive involves, first, determining the object, spirit and purpose of the relevant provisions and, second, determining whether the result of the transactions frustrated that object, spirit and purpose (*Trustco*, at para. 44; *Copthorne*, at paras. 69-71).
>
> [57] The object, spirit and purpose "[reflect]" the rationale of the provision. The provision's text, context and purpose help to shed light on this rationale. Once the object, spirit and purpose has been ascertained, the abuse analysis focuses on whether the result of the transactions frustrates the provision's rationale. I provide guidance on these aspects below.[293]

[169] Consequently, to determine whether an avoidance transaction or transactions are abusive within the meaning of subsection 245(4) of the ITA, the Court must perform an analysis that includes the following two steps:

1- The first step is to determine the object, spirit and purpose of the provisions of the ITA that are relied on for the tax benefit, having regard to the scheme of the ITA, the relevant provisions and permissible extrinsic aids.

2- The second step is to determine whether the avoidance transaction defeated or frustrated the object, spirit or purpose of the provisions in issue.

### (1) What Is the Object, Spirit and Purpose of the Relevant Provisions?

[170] The Court must look into the underlying rationale of the provisions relied upon in order to obtain the tax benefit.[294] The Court must look beyond the mere text of the provisions.[295] The object, spirit and purpose of a provision reflect the rationale of the provision, and have been referred to as a description of the legislative rationale that underlies specific or interrelated provisions of the ITA.[296] The object, spirit and

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[293] *Deans Knight*, above, footnote 67, at paras 56–57.
[294] *Canada v Oxford Properties Group Inc*, 2018 FCA 30 at para 45 [*Oxford Properties*].
[295] *Canada Trustco*, above, footnote 63, at para 47.
[296] *Ibid*, para 58 and *Deans Knight*, above, footnote 67, at para 73.

purpose of a provision represent its reason for being. The text of the provision, its context and its purpose help to shed light on its rationale.[297]

[171] In *Deans Knight*, the Court provided the following guidance with respect to the determination of the object, spirit and purpose of a provision:

> [60] The object, spirit and purpose of a provision must be worded as a description of its rationale (*Copthorne*, at para. 69). When articulating the object, spirit and purpose of a provision, a court is not repeating the test for the provision, nor is it crafting a new, secondary test that will apply to avoidance transactions. Discerning the object, spirit and purpose does not rewrite the provision; rather, the court merely takes a step back to formulate a concise description of the rationale underlying the provision, against which a textually compliant transaction must be scrutinized (*Trustco*, at para. 57; *Copthorne*, at para. 69).[298]

[172] As previously stated, the courts must look to the provisions themselves and to the scheme of the ITA. In doing so, the courts must remember that the legislative drafting process reflects the task of translating government aims into legislative form in order to create intelligible, legally effective rules, but it does not necessarily provide a full answer as to *why* the provision was adopted.[299] Even the most carefully drafted provision can be abused, which is why the GAAR exists to protect the provision's underlying rationale.[300]

[173] The courts have set out several principles to be followed when determining the object, spirit and purpose of provisions in the context of the GAAR. Those principles are:

- The courts are not authorized to search for an overriding policy of the ITA that is not based on a unified textual, contextual and purposive interpretation of the specific provisions in issue to obtain a tax benefit.[301]

- Parliament's overall policy is to ensure that tax law is certain, predictable and fair so that taxpayers can intelligently organize their affairs. To search for an overriding policy of the ITA that is not anchored in a textual, contextual and

[297] *Deans Knight,* above, footnote 67, at para 57.
[298] *Ibid,* para 60.
[299] *Ibid,* para 59, *Oxford Properties,* above, footnote 296, at para 101.
[300] *Ibid,* para 59.
[301] *Canada Trustco,* above, footnote 63, at para 41.

purposive interpretation of the provisions at issue would run counter to this policy.[302]

- The courts must exercise caution when deciding whether to apply the GAAR to the paid-up capital (PUC) or adjusted cost base (ACB) of a class of shares because such a decision may have implications for innumerable "everyday" transactions carried out by taxpayers every year.[303]

- If Parliament has not been clear and unambiguous as to the general policy it was contemplating, the Court cannot make a finding of abuse, and compliance with the ITA must govern.[304]

[174] When determining the object, spirit and purpose of the provisions at issue, the courts must take a "unified textual, contextual and purposive" approach to statutory interpretation.[305]

[175] This method of statutory interpretation is not unique to questions relating to the application of the GAAR or the provisions of the ITA: it is the same as for any other act.[306] However, when applying the GAAR, the analysis seeks to identify a different aspect of the ITA compared to regular statutory interpretation.

[176] In *Deans Knight*, the Supreme Court of Canada described the analysis that has to be performed by the courts as follows:

> [62] Although the GAAR analysis involves a consideration of the provision's text, context and purpose, the use of these elements differs from "traditional" statutory interpretation (*Copthorne*, at para. 70; *Alta Energy*, at para. 30, per Côté J., and at para. 116, per Rowe and Martin JJ., dissenting but not on this point; *Oxford Properties Group*, at paras. 40-44). It must be recalled that the GAAR is a provision of last resort (*Trustco*, at para. 21; *Copthorne*, at para. 66). There is a distinction between the application of a provision in general and the application of the GAAR to a transaction motivated by tax avoidance. If a court is performing a GAAR analysis, the impugned transactions necessarily comply with the provisions of the Act, properly interpreted and applied (see *Copthorne*, at para. 88; D. G. Duff, "The Interpretive Exercise Under the General Anti-Avoidance Rule", in B. J. Arnold, ed., *The General Anti-Avoidance Rule — Past, Present, and Future* (2021), 383, at

[302] *Ibid*, para 42.
[303] *Copthorne*, above, footnote 40, at para 67.
[304] *OSFC Holdings Ltd v Canada*, 2001 FCA 260 at para 70.
[305] *Canada Trustco*, above, footnote 63, at para 47; *Copthorne*, above, footnote 40, at para 70.
[306] *Lipson*, above, footnote 274, at para 26.

> p. 391). This is self-evident: if there is a specific provision with which the taxpayer has not complied, the Minister need not resort to the GAAR.
>
> [63] … A consideration of the text, context and purpose gives structure to this analysis. Indeed, the object, spirit and purpose analysis should not turn into a "value judgment of what is right or wrong nor . . . what tax law ought to be or ought to do" (*Copthorne,* at para. 70). Nor should it become a "search for an overriding policy of the Act" that is not founded in the text, context and purpose of the provisions (*Canada Trustco,* at para. 41; *Alta Energy,* at para. 49). Rather, a focus on the provision's text, context and purpose ensures that the intrinsic and extrinsic evidence used to discern a provision's rationale remains tied to the provision itself. To that end, a brief discussion on how to conduct this analysis is useful. [307]

[177] In traditional statutory interpretation, the courts consider a provision's text, context and purpose to determine what the words of the statute mean.[308] The analysis begins by reading the words of the act in their entire context, in their grammatical and ordinary sense harmoniously with the scheme of the act, the object of the act, and the intention of Parliament.[309] Even if the meaning of the words of the statute is clear, it is possible that the rationale for the provision may not be captured within these words.[310] Therefore, it is necessary to look into the context and purpose of the provision as well.

[178] In the GAAR analysis, however, the search is for the rationale that underlies the words that may not be captured by the bare meaning of the words themselves.[311]

[179] Because the three elements of statutory interpretation are often intertwined, it is difficult to evaluate them separately. In *Mathew v Canada*,[312] the Supreme Court of Canada stated:

> 43 We add this. While it is useful to consider the three elements of statutory interpretation separately to ensure each has received its due, they inevitably intertwine. For example, the statutory context involves consideration of the purposes and policy of the provisions examined. And while factors indicating

[307] *Deans Knight,* above, footnote 67, at paras 62–63.
[308] *Ibid.*
[309] *Ibid*; see also *Canada Trustco*, above, footnote 63, at para 10.
[310] *Copthorne,* above, footnote 40, at para 70.
[311] *Ibid*.
[312] *Mathew*, above, footnote 153.

> legislative purpose are usefully examined individually, legislative purpose is at the same time the ultimate issue — what the legislator intended.[313]

[180] During the analysis, the courts can use several useful sources to determine the object, spirit and purpose of the provisions of the ITA at issue. The courts may have recourse to Department of Finance explanatory notes and studies; the description of the object, spirit and purpose of the provision in previous decisions; and the manuals and articles in legal journals taken into consideration by the courts. They may also monitor the development of the statute from its creation to its current form, considering the successive amendments that it may have undergone.[314]



### (a) Textual Analysis

[181] The textual analysis has been summarized in *Deans Knight* as follows:

> [64] The text of the provision is relevant to the analysis of a provision's object, spirit and purpose (*Alta Energy*, at para. 58). Bearing in mind the search for the provision's underlying rationale, courts may ask how the text sheds light on what the provision was designed to achieve. Put differently, what was the provision intended to do? (*Copthorne*, at para. 88). This includes considering what the text of the provision expressly permits or restricts. Similarly, the language and structure of the provision can sometimes be evocative of Parliament's underlying concerns. The text can also help to identify the nature (or "type") of provision at issue, which can be relevant to understanding the rationale underlying it.
>
> [65] There may be circumstances where the provision's underlying rationale is no broader than its text because, having regard to its context and purpose, the provision's text "fully explains its underlying rationale" (*Copthorne*, at para. 110). A court, however, must not lose sight of the goal of the exercise — to discern the underlying rationale of the provision — and the reality that this rationale "may not be captured by the bare meaning of the words themselves" (*Copthorne*, at para. 70). As explained by Noël C.J. of the Federal Court of Appeal, "[w]hile one cannot rule out the possibility that the underlying rationale for a provision will be fully captured by the words, this must still be demonstrated by inquiring into the provision's reason for being" (*Oxford Properties Group*, at para. 88, citing *Copthorne*, at paras. 110-11).[315]

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[313] *Ibid*, para 43; see also *Copthorne*, above, footnote 40, at para 87.
[314] Ruth Sullivan, *Sullivan and Driedger on the Construction of Statutes*, 4th ed., Markham: Butterworths, 2002, pages 209, 210.
[315] *Deans Knight*, above, footnote 67, at paras 64–65.

[182] The text must be analyzed using a so-called "grammatical" method. When using this method, the Court must do the following:

1- Give the words the meaning they have in everyday language;

2- Give the words the meaning they had on the day the Act was adopted; and

3- Avoid adding to the words of the act or depriving them of effect.[316]

[183] The Court must therefore give the words used in the provision their ordinary and grammatical meaning. In *Pharmascience Inc v Binet*, the Supreme Court of Canada stated:

> 30 Although the weight to be given to the ordinary meaning of words varies enormously depending on their context, in the instant case, a textual interpretation supports a comprehensive analysis based on the purpose of the Act. Most often, "ordinary meaning" refers "to the reader's first impression meaning, the understanding that spontaneously emerges when words are read in their immediate context" (R. Sullivan, *Sullivan and Driedger on the Construction of Statutes* (4th ed. 2002), at p. 21, *Marche v. Halifax Insurance Co.*, [2005] 1 S.C.R. 47, 2005 SCC 6, at para. 59). In *Canadian Pacific Air Lines Ltd. v. Canadian Air Line Pilots Assn.* [1993] 3 S.C.R. 724, at p. 735, Gonthier J. spoke of the "natural meaning which appears when the provision is simply read through".[317]

[184] When the Court performs this analysis, certain assumptions recognized by the Supreme Court of Canada may be useful. Here are a few examples:

1- Parliament is well informed and competent in drafting legislation;[318]

2- Parliament avoids using superfluous or meaningless words;[319] and

[316] Pierre-André Côté, *Interprétation des lois*, 4th ed, Montréal: Thémis, 2009, page 295.
[317] *Pharmascience Inc v Binet,* 2006 SCC 48 at para 30.
[318] *ATCO Gas & Pipelines Ltd v Alberta (Energy & Utilities Board)*, 2006 SCC 4 at para 59; see also *Triad Gestco (FCA)*, above, footnote 168, at para 56 citing with approval *1207192 Ontario Ltd v Canada*, 2012 FCA 259 at paras 73–83; *Syndicat de la fonction publique du Québec v Quebec (Attorney General)*, 2010 SCC 28 at paras 36–37.
[319] See for example *British Columbia v Philip Morris International, Inc*, 2018 SCC 36 at para 29.

3- Parliament uses language carefully and consistently so that, in a statute or other legislative instrument, the same words have the same meaning and different words have different meanings.[320]

[185] The Court must look beyond the words of the provision because words that appear clear and unambiguous may in fact prove to be ambiguous once placed in their context.[321] The possibility of the context revealing a latent ambiguity, such as this, is a logical result of the modern approach to interpretation.[322]



### (b) Contextual Analysis

[186] The contextual analysis focuses on determining the statutory context of a provision. In *Copthorne*, the Supreme Court of Canada stated:

> [91] The consideration of context involves an examination of other sections of the Act, as well as permissible extrinsic aids (*Trustco*, at para. 55). However, not every other section of the Act will be relevant in understanding the context of the provision at issue. Rather, relevant provisions are related "because they are grouped together" or because they "work together to give effect to a plausible and coherent plan" (R. Sullivan, *Sullivan on the Construction of Statutes* (5th ed. 2008), at pp. 361 and 364).[323]

[187] In a GAAR case, the contextual analysis involves an examination of other relevant provisions of the ITA, that is, those that interact and have an effect on the provision at issue.[324] Of course, this does not involve considering every other section of the ITA.[325] The focus is on the relationship between the provision alleged to have been abused and the particular scheme within which it operates.[326] Although the ITA

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[320] Ruth Sullivan, *The Construction of Statutes*, 7th ed., Markham: LexisNexis Canada, 2022, ch. 8 – Presumption about how legislation is drafted; see also *Grenon v The Queen*, 2021 TCC 30 at paras 192–95; *Orphan Well Association v Grant Thornton Ltd*, 2019 SCC 5 at paras 82–84.
[321] *Canada Trustco*, above, footnote 63, at para 47; *Montréal (City) v 2952-1366 Québec Inc*, 2005 SCC 62 at para 10.
[322] *Montréal (City) v 2952-1366 Québec Inc*, above, footnote 323, at para 10; see also *Iberville Developments Limited v The Queen*, 2018 TCC 102 at para 60, affirmed by 2020 FCA 115, leave to appeal to the SCC denied, 39392 (April 1, 2021).
[323] *Copthorne*, above, footnote 40, at para 91; see also *Gladwin*, above, footnote 286, at para 55.
[324] *Deans Knight*, above, footnote 67, at para 66.
[325] *Ibid.*
[326] *Ibid*, para 67.

is lengthy and detailed, an understanding of its structure can help to identify the function of the provision at issue.[327]

[188] In *Deans Knight*, the Supreme Court of Canada said:

> [66] Beyond the provision's text, a court must consider the provision's context. The contextual analysis "involves an examination of other sections of the Act, as well as permissible extrinsic aids" (*Copthorne*, at para. 91; *Trustco*, at para. 55). Of course, this does not involve considering every other section of the Act. Rather, "relevant provisions are related 'because they are grouped together' or because they 'work together to give effect to a plausible and coherent plan'" (*Copthorne*, at para. 91, citing R. Sullivan, *Sullivan on the Construction of Statutes* (5th ed. 2008), at pp. 361 and 364).
>
> [67] The focus is on the relationship between the provision alleged to have been abused and the particular scheme within which it operates (*Triad Gestco*, at paras. 26 et seq.). Although the Act is lengthy and detailed, an understanding of its structure can help to identify the function of the provision at issue. For example, a specific restriction may shed light on the rationale of a general benefit-conferring rule, and vice versa.[328]

[189] Ultimately, the contextual analysis seeks a harmonious whole to ensure that a provision interacts logically and consistently with the ITA as a whole.

### (c) Purposive Analysis

[190] The purposive analysis aims to determine the object of the legislation or legislative scheme in which the provision appears. However, acts often have several purposes, and the analysis seeks to ascertain the outcome that Parliament intended the provision at issue to achieve. In *Copthorne*, the Court stated:

> [113] Tax provisions are intended to "promote purposes related to specific activities" (*Trustco*, at para. 52). This step seeks to ascertain what outcome Parliament intended a provision or provisions to achieve, amidst the myriad of purposes promoted by the Act.[329]

[191] In *Deans Knight*, the Court also stated:

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[327] *Ibid*.
[328] *Ibid*, paras 66–67.
[329] *Copthorne*, above, footnote 40, at para 113.

> [68] Finally, understanding the provision's purpose is central to the GAAR analysis. A purposive analysis permits courts to consider legislative history and extrinsic evidence (see R. Sullivan, *The Construction of Statutes* (7th ed. 2022), at § 9.03, at paras. 7-8). These materials provide insight into the rationale for specific provisions. Of course, tax provisions can serve a variety of independent and interlocking purposes (*Trustco*, at para. 53). Nevertheless, such provisions are intended to promote particular aims, and courts must therefore determine *what outcome Parliament sought to achieve* through the specific provision or provisions (*Copthorne*, at para. 113).[330]

[192] The purposive analysis is most useful when the purpose of a provision is not clearly stated in the ITA, because the purpose can be determined by looking at the said provision and its relationship to one or more closely related provisions.[331] Tax provisions can serve a variety of independent and interlocking purposes.[332] Because of this, often, the purpose of a provision can be discerned from related provisions in the ITA.[333] Where the purpose of the statute is not apparent, legislative history and extrinsic evidence may be used.[334] Explanatory notes can also be used to determine the purpose.[335]

(2) Did the Avoidance Transaction Defeat or Frustrate the Object, Spirit or Purpose of the Relevant Provisions?

(a) Applicable Principles

[193] In *Deans Knight*, the Court said that an avoidance transaction will be abusive if the courts conclude that the outcome or the result of the transaction:

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[330] *Deans Knight*, above, footnote 67, at para 68.
[331] *Bell ExpressVu Limited Partnership v Rex*, 2002 SCC 42 at paras 44–46.
[332] *Ibid. Canada Trustco*, above, footnote 65, at para 53.
[333] *Hillier v Canada (Attorney General)*, 2019 FCA 44, at para 27.
[334] *Deans Knight*, above, footnote 67, at para 68. Ruth Sullivan, above, footnote 322, at section 23.03 – Legislative History (this includes reports from royal commissions, law reform commissions and other similar bodies; ministerial studies; proposals and memoranda submitted to Cabinet; the observations of the Minister responsible for a bill; documents tabled or otherwise brought to the attention of the legislature during the legislative process, including explanatory notes; documents published by government during the legislative process, such as briefing material or press releases; records of legislative debates and committee hearings; the record of motions to amend the bill; and regulatory impact analysis statements); see for example *Tele-Mobile Co v Ontario*, 2008 SCC 12, at paras 29–40.
[335] *Lawyers' Professional Indemnity Company v Canada*, 2020 FCA 90 at paras 74–79.

1- Is an outcome that the provisions relied on seek to prevent;

2- Defeats the underlying rationale of the provisions relied on; or

3- Circumvents certain provisions in a manner that frustrates the object, spirit and purpose of those provisions.[336]

[194] The context of the transaction must be considered. This means that all the transactions that are part of the series of transactions and their overall effects must be taken into consideration. In *Lipson*, the Supreme Court of Canada stated the following on this subject:

> [34] It is true, as the appellants argue, that in assessing a series of transactions, the misuse and abuse must be related to the specific transactions forming part of the series. However, the entire series of transactions should be considered in order to determine whether the individual transactions within the series abuse one or more provisions of the Act. Individual transactions must be viewed in the context of the series. Consideration of this context will enable a reviewing court to assess and understand the nature of the individual parts of the series when analysing whether abusive tax avoidance has occurred. At the same time, care should be taken not to shift the focus of the analysis to the "overall purpose" of the transactions. Such an approach might incorrectly imply that the taxpayer's motivation or the purpose of the transaction is determinative. In such a context, it may be preferable to refer to the "overall result", which more accurately reflects the wording of s. 245(4) and this Court's judgment in Canada Trustco. …[337]

[195] The Supreme Court of Canada also stated that the considerations listed above are not independent of one another and frequently overlap.[338] It also said that, ultimately, the analysis remains squarely focused on abuse and that the courts must go beyond the legal form and technical compliance of the transactions; they must compare the result of the transactions to the underlying rationale of the provision and determine whether that rationale has been frustrated.[339]

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[336] *Deans Knight*, above, footnote 67, at para 69. See also *Lipson*, above, footnote 274, at para 40, citing *Canada Trustco* at para 45. *Copthorne,* above, footnote 40, at para 72.
[337] *Lipson*, above, footnote 274, at para 34.
[338] *Deans Knight*, above, footnote 67, at para 69. See also *Copthorne*, above, footnote 40, at para 72.
[339] *Deans Knight*, above, footnote 67, at para 69.

[196] The courts can conclude that the underlying rationale of the provision has been frustrated only if the abusive nature of the transaction is clear.[340]

[197] Examples of the types of circumstances that rise to the level of abuse are the following:

1- If the rationale underlying the provision is to encourage particular relationships or activities, abusive tax avoidance may be found where the relationships and transactions are "wholly dissimilar to the relationships or transactions that are contemplated by the provisions".[341]

2- Where a specific anti-avoidance rule is flipped on its head to enable tax avoidance, there is likely to be a finding of abuse.[342]

3- An abuse may also be found in certain circumstances where a series of transactions "achieved a result the section was intended to prevent" while narrowly avoiding application of the provision.[343]

4- When an arrangement 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.[344]

[198] Moreover, the Supreme Court of Canada, in *Copthorne*, largely rejected the argument that, where Parliament has drafted detailed provisions, a taxpayer that has technically complied with these provisions cannot frustrate their rationale.Simply put, specific and carefully drafted provisions are not immune to abuse. As with any other provision, the GAAR ensures that the rationale behind such provisions is not frustrated by abusive tax strategies.

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[340] *Ibid*. See also *Canada Trustco*, above, footnote 63, at paras 62, 66; *Copthorne*, above, footnote 40, at para 68; *Alta Energy*, above, footnote 271, at para 33.
[341] *Deans Knight*, above, footnote 67, at para 70, *Mathew*, above, footnote 153, at para 57, citing *Canada Trustco*, at para 60.
[342] *Deans Knight*, above, footnote 67, at para 70; *Lipson*, above, footnote 274, at para 42; see also *Fiducie Financière Satoma v The Queen*, 2018 FCA 74, 2018 DTC 5052 at para 52.
[343] *Deans Knight*, above, footnote 67, at para 70, as in *Copthorne*, above, footnote 40, at paras 124–27.
[344] *Deans Knight*, above, footnote 67, at para 69; *Alta Energy*, above, footnote 271, at para 32 [emphasis added], citing *Canada Trustco*, at para 45.

[199] The purpose of a transaction should not be the focus of the analysis to determine whether the avoidance transaction is abusive:[345]

> [45] While this is sufficient to dispose of this appeal, I note that the Tax Court's conclusion that section 84.1 was abused appears to have been influenced by Mr. Wild's inability to explain the purpose of certain transactions or why the transactions were structured as they were. The purpose of the transaction is relevant when considering whether the transaction giving rise to the taxable benefit was an avoidance transaction (*Copthorne*, paragraph 40). The purpose of a transaction should not be the focus of the abuse analysis where the question is whether a transaction abused the object, spirit or purpose of the provisions relied on.

[200] In coming to such a conclusion, the abusive nature of the transaction "must be clear".[346]

### (b) The Role of Alternative Transactions

[201] An alternative transaction has been defined as an alternative means (transaction) by which a taxpayer, should he or she enter into it, could achieve the same result as the one obtained from the series of transactions under review.[347]

[202] In a GAAR analysis, alternative transactions serve the following two purposes:

1 - Alternative transactions can demonstrate the existence of a tax benefit by comparing the tax consequences of the transaction or series of transactions carried out by a taxpayer with the tax consequences of alternative transactions that might have been carried out but were not.[348]

2 - Alternative transactions are a relevant factor in determining whether an avoidance transaction is abusive.[349]

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[345] *1245989*, above, footnote 287, at para 45.
[346] *Deans Knight*, above, footnote 67, at para 69.
[347] *3295940 Canada Inc*, above, footnote 242, at para 58, *Univar*, above, footnote 118, at paras 19–20.
[348] *3295940 Canada Inc*, above, footnote 242, at para 57, citing *Canada Trustco* at para 20 and *Copthorne* at para 35.
[349] *Univar*, above, footnote 118, at paras 19–20. *3295940 Canada Inc*, above, footnote 242, at para 58.

[203] In *Univar Holdco Canada ULC v. Canada*,[350] a case in which alternative transactions were submitted to the Court as a relevant consideration to determine whether an avoidance transaction was abusive, the Federal Court of Appeal stated that only alternative transactions that produce the same result should be taken into consideration. The Court stated:

> [19] … If the taxpayer can illustrate that there are other transactions that could have achieved the same result without triggering any tax, then, in my view, this would be a relevant consideration in determining whether or not the avoidance transaction is abusive.
>
> [20] … In my view, the alternative means by which the same result could have been realized is a relevant consideration in determining whether or not the avoidance transaction was abusive.[351]

[204] In *Univar*, alternative transactions were described as transactions that achieve "the same result without triggering any tax". The expression "without triggering any tax" was used by the Court because, in that case, the purpose of the avoidance transaction was to allow an arm's length purchaser of a Canadian corporation (Univar Canada) to extract the surplus that had accumulated prior to the acquisition without triggering any tax under Part XIII of the ITA.[352] The same result could have been achieved with the alternative transaction according to the Court in that case.[353]

[205] Consequently, following *Univar*, for alternative transactions to be a relevant factor in a GAAR analysis, it is imperative that the transactions, had they been entered into by the taxpayer, would have allowed the taxpayer to achieve "the same result" as the one achieved through the avoidance transaction. Therefore, not all alternative transactions are useful in a GAAR analysis.

[206] This Court notes that in *Univar*, the alternative transactions were not only a relevant consideration to determining whether an avoidance transaction was abusive, they were also the determinative consideration for the Court.[354]

[207] This Court also notes that, while the series of transactions and the avoidance transaction achieved the same result, they were very different transactions and were both complex. The series of transactions entered into by the taxpayer are described

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[350] *Univar*, above, footnote 118.
[351] *Ibid*, paras 19–20.
[352] *Univar*, above, footnote 118, at para 22.
[353] *Univar*, above, footnote 118, at para 31.
[354] *Univar*, above, footnote 118, at para 31.

at paragraphs 27 to 41 of this Court's reasons for judgment, while the alternative transactions are described at paragraphs 17 to 18 of the Federal Court of Appeal's decision. This Court also notes that, even though the avoidance transaction involved the application of sections 89 and 212.1 of the ITA, other provisions could also have been applied, but the judgment did not identify them. As for the alternative transactions, they involved the application of sections 82, 87, 88, 89 and 112 and subsection 84(4) of the ITA.[355] Since in *Univar* the provisions of the ITA applicable to the alternative transactions were different from those that applied to the avoidance transactions and because the transactions themselves were fundamentally different, this Court concludes that it is not necessary for alternative transactions to rely on the same provisions of the ITA or to be similar in nature to the avoidance transactions, as long as both achieve the same result.

[208] Until very recently, *Univar* was the only case from the Federal Court of Appeal in which a court had explicitly accepted that alternative transactions could have a role to play in the analysis that the courts must undertake to determine whether transactions were abusive under the GAAR.[356]

[209] In March 2024, the Federal Court of Appeal rendered the *3295940 Canada Inc v Canada* decision.[357] In that decision, the Court reaffirmed *Univar* and clearly stated that alternative transactions are helpful in determining the object, spirit and purpose of the relevant provisions when applying the GAAR.[358] What was new with *3295940 Canada Inc* was that the Court listed the reasons why it found that the alternative transactions proposed by the taxpayer were relevant in that case. The relevant passage of the decision is the following:[359]

> [61] More fundamentally, in deciding not to consider the alternative transactions, the Tax Court failed to take into account the series' overall result: Micsau used its high ACB, and a capital gain was realized, which was roughly equal to the capital gain Micsau would have realized from selling 3295 directly. In my opinion, the alternative transactions 3295 submitted are relevant because:

[355] *Univar*, above, footnote 118, at paras 17–18.
[356] See Shaw D. Porter, "The Misuse and Abuse Exception: The Role of Alternative Transactions" in *The General Anti-Avoidance Rule: Past, Present and Future*, ed. Brian J. Arnold (Toronto: Canadian Tax Foundation, 2021), 269, at page 269.
[357] *Univar*, above, footnote 118, at para 19.
[358] *3295940 Canada Inc*, above, footnote 242, at para 58.
[359] *Ibid*, para 61.

> a) *They are available under the Act*. The fact that they were not presented to Novartis or that Novartis may have refused to proceed with them does not detract from the fact that the Act allowed for these transactions;
>
> b) *They are not so remote as to be practically infeasible*. The alternative transactions 3295 submitted could realistically have been carried out. Had Novartis or RoundTable agreed, carrying out these alternatives would have been relatively easy;
>
> c) *They have a high degree of commercial and economic similarity to the series at issue*: Porter at 270. The alternative transactions would have resulted in Novartis acquiring shares of a corporation whose underlying asset would be the generic drug business—exactly what Novartis in fact acquired;
>
> d) *They generate tax consequences approximately as favourable as the series at issue*: The proposed alternatives would have enabled Micsau to use its ACB in the 3295 shares. This would have generated a capital gain of $53.7M—roughly the same gain that 3295 realized in our case; and
>
> e) *They are not abusive of the GAAR*: *Univar* at para. 20; Porter at 277–279. The various alternative transactions would have enabled Micsau to realize its high ACB without attracting the application of the GAAR.
>
> [Emphasis added.]

[210] While it might be argued that these five reasons were case specific and therefore need not be strictly satisfied by alternative transactions in other cases to be considered a relevant consideration for the purposes of the GAAR analysis, upon closer examination, this Court finds that they are indeed conditions that must be met in all cases.

[211] It is this Court's view that, with respect to the first, second and fifth reasons, it would not make sense for a court to conclude that an alternative transaction is a relevant consideration for the GAAR analysis if it is not available under the ITA, if it is so remote as to be practically infeasible or if it is abusive of the GAAR itself. Therefore, this Court concludes that these three reasons are clearly conditions that must be met by the proposed alternative transactions. With respect to the fourth condition, it was already made a condition by *Univar*. Following *3295940 Canada Inc*, not only must an alternative transaction now achieve the same result as the avoidance transaction, it must also generate tax consequences that are approximately as favourable as the series of transactions in issue.

[212] As for the final reason, namely that the alternative transaction has a high degree of commercial and economic similarity with the series of transactions, this Court concludes that it is a condition, given that it is expressly listed by the Federal Court of Appeal alongside other conditions.

[213] Finally, this Court will add that the GAAR analysis framework itself does not change because a party submits that an alternative transaction could have been entered into by a taxpayer. Alternative transactions are helpful when it is time to determine whether a series of transactions abused the provisions of the ITA. It is therefore at the second stage of the GAAR analysis that it is appropriate to consider alternative transactions, and they are only a relevant consideration that may or may not be determinative.[360]



## B. Analysis

### 1. The 2018 Taxation Year

#### a) Did a Tax Benefit Arise from the Series of Transactions?

[214] To determine whether Wuswig has obtained a tax benefit from the series of transactions, the Court must determine whether the series allowed Wuswig to reduce, avoid or defer an amount of tax payable under the ITA. The parties have submitted to the Court that the series of transactions consists of the transactions described in paragraphs 40 to 42 above.

[215] During the trial, counsel for Wuswig admitted that Wuswig obtained a tax benefit from the series of transactions. According to counsel, pursuant to subsection 111(1) of the ITA, Wuswig used a portion ($334,176) of the capital loss ($5,086,039) realized from the series of transactions against the capital gains realized in its 2018 taxation year. As a result, Wuswig's taxable capital gain for that year was reduced by $334,176, which led to a reduction of the tax payable under the ITA. This is the tax benefit obtained by Wuswig.

[216] Based on the admission of counsel and the facts presented to the Court, the Court concludes that Wuswig has obtained a reduction of its tax payable under the ITA for its 2018 taxation year. Consequently, the Court concludes that Wuswig has obtained a tax benefit resulting from a series of transactions within the meaning of

[360] *Univar*, above, footnote 118, at para 19.

subsection 245(1) of the ITA. The first condition for the application of the GAAR is met.

b) Was the Series of Transactions an Avoidance Transaction?

[217] In order to determine whether the series of transactions constitutes an avoidance transaction within the meaning of subsection 245(3) of the ITA, the Court must determine whether it is reasonable to consider that the series of transactions was entered into or arranged primarily for a *bona fide* purpose. If it was not, the Court must conclude that the series constitutes an avoidance transaction within the meaning of subsection 245(3) of the ITA. Importantly, under subsection 245(3) of the ITA, obtaining a tax benefit cannot constitute a *bona fide* purpose.

[218] Counsel for Wuswig admitted that the series of transactions was not carried out primarily for a *bona fide* purpose.[361] In the present case, the evidence shows that the series of transactions was made to obtain a tax benefit and for that reason alone. The evidence shows that in December 2005, Wuswig requested from its tax advisors, KPMG, a review of the Canadian tax consequences of a liquidation of its foreign affiliates located in the U.S.A. into Wuswig. In doing so, Wuswig would dispose of its shares of Southridge Holdings.

[219] After their review of the Canadian tax consequences of such a liquidation, KPMG proposed a reorganization to dissolve Wuswig's U.S. structure. The proposed reorganization would allow Wuswig to claim the loss on the shares of Southridge Holdings in accordance with the ITA with the best tax consequences possible. Wuswig went ahead with the proposed reorganization by entering into the series of transactions. The evidence shows that the series of transactions was entered into for tax purposes.

[220] Consequently, the Court concludes that the series of transactions was not carried out primarily for a *bona fide* purpose, and therefore the second condition for the application of the GAAR is met.

[361] Appellant's plan of argument, para 10.

c) Was the Avoidance Transaction Abusive?

(1) The Object, Spirit and Purpose of Subsections 93(2) and (2.01) of the ITA

(a) Textual Analysis

[221] The text of the provision is relevant to the analysis of a provision's object, spirit and purpose. Obviously, the courts must take into consideration what the text of the provision expressly permits or restricts. Using the "grammatical" method, the courts must give the words the meaning they have in everyday language and the meaning they had on the day the provision was adopted and avoid adding to them or depriving them of effect. The courts must also give the words used in the provision their ordinary and grammatical meaning.

[222] The relevant provisions of the ITA for the purpose of the analysis are subsections 93(2) and (2.01). Subsection 93(2) defines the losses to which the loss limitation rule applies while subsection 93(2.01) sets out a limit on these losses. More specifically, subsection 93(2) of the ITA deals with the situation where a corporation residing in Canada suffers a "particular loss" from the disposition of a share of the capital stock of its foreign affiliate. It also deals with the situation where a foreign affiliate of a corporation resident in Canada suffers a "particular loss" from the disposition of a share of the capital stock of another foreign affiliate of the corporation resident in Canada. In those situations, subsection 93(2) triggers the application of subsection 93(2.01). Subsection 93(2.01) deals with the limitation of a loss on the disposition of a share of a foreign affiliate contemplated in subsection 93(2).

[223] Read together, subsections 93(2) and (2.01) set out what is referred to as a "stop-loss rule". This rule limits the loss resulting from the disposition of a share of a foreign affiliate by a corporation resident in Canada, by the amount of exempt dividends received on that share or on a share for which it was substituted. The rule also limits the loss realized by a foreign affiliate on the disposition of a share of another foreign affiliate of the corporation resident in Canada in the same way.

[224] The definition of the term "exempt dividends" is found in subsection 93(3) of the ITA. According to this definition, "exempt dividends" are dividends received by a Canadian corporation that are deductible from the income of the corporation, for the purpose of computing its taxable income under paragraphs 113(1)(a) to (c) of the ITA. Pursuant to paragraphs 113(1)(a) to (c), a corporation resident in Canada that

receives a dividend on a share of a foreign affiliate can make deductions in respect of such dividends, to the extent that they are prescribed to be paid out of certain surplus balances maintained in respect of that foreign affiliate, or that the foreign affiliate was taxed in its home jurisdiction on its earnings.[362]

[225] Under subsections 93(2) and 93(2.01), there are no requirements to prove that the payment of the exempt dividends created or triggered the loss on the disposition of shares of the foreign affiliate. As long as tax-free dividends have been paid on the shares and these shares have been sold at a loss, subsections 93(2) and 93(2.01) apply to limit the loss by the amount of tax-free dividends that were paid on said shares. While there are exceptions in respect of certain dividends, which are found in subsection 93(3), generally, tax-free dividends limit the loss on the disposition of shares of a foreign affiliate regardless of whether they created the loss in the value of the shares.

[226] Based on the textual analysis, the Court concludes the following:

i. The stop-loss rule contained in subsections 93(2) and (2.01) applies to situations involving the disposition of a share of a foreign affiliate of a Canadian corporation or the disposition of a share of a foreign affiliate of another foreign affiliate of a Canadian corporation.

ii. Subsections 93(2) and (2.01) do not distinguish between real and artificial economic losses. The stop-loss rule is triggered if a dividend is paid on a share that is later sold at a loss, whether the taxpayer has suffered a real economic loss or the loss was artificial.

iii. Subsections 93(2) and (2.01) do not expressly exclude from their prescribed calculations dividends paid by a foreign affiliate to a Canadian taxpayer prior to the affiliate's immigration to Canada.

iv. Based on the text of subsections 93(2) and (2.01) alone, the Court cannot determine if subsections 93(2) and (2.01) can be applied to limit the loss on the disposition of a share of the capital stock of a Canadian corporation that

[362] Note that paragraph 113(1)(d), which provides a deduction in respect of a dividend prescribed to be paid out of the foreign affiliate's pre-acquisition surplus, is not an exempt dividend for the purposes of subsection 93(3).

was a foreign affiliate of a Canadian corporation before it immigrated to Canada, if the loss was incurred after the immigration.

(b) Contextual Analysis

[227] As explained above, the Court must consider the provision's context. The contextual analysis involves an examination of other relevant provisions of the ITA, which are those that interact with the provision(s) at issue. This might be because they are grouped together or because they work together to give effect to a plausible and coherent plan. The Court must focus on the relationship between the provision(s) that was or were allegedly abused and the scheme within which it or they operate. The ITA's structure can help to identify the function of the provision at issue.

(i) The ITA's Structure

[228] The relevant part of the ITA in this case is Part 1. Part 1 contains the rules applicable to income tax. Division B of Part 1 contains the rules applicable to the computation of the income of a taxpayer. Subdivisions A and B of Division B contain the rules applicable to the income or loss from an office or employment and to the income or loss from a business or property respectively.

[229] Section 3 and paragraph 3(b) of the ITA are found in Part 1. They are found in Division B but are located before Subdivisions A and B and therefore are not part of Subdivision A or B. They contain the fundamental rules applicable to the calculation of a taxpayer's income for a taxation year. Pursuant to section 3, a capital gain is a source of income that is subject to tax in the year in which it was realized. Section 3 constitutes the legislative basis for the taxation of capital gains and losses and their inclusion in the computation of the taxable income of a taxpayer.

[230] Subsections 93(2) and (2.01) are part of the foreign affiliate regime of the ITA. The regime includes the rules that apply to the computation of income of shareholders of corporations not resident in Canada. The Supreme Court of Canada described the foreign affiliate regime as among the most complex regimes in Canadian law.[363]

[231] Subsections 93(2) and (2.01) are also found in Part 1, Division B. They are found in Subdivision I. Subdivision I contains the specific rules applicable to

[363] *Canada v Loblaw Financial Holdings Inc*, 2021 SCC 51 at para 2 [*Loblaw SCC*]; *Loblaw Financial Holdings Inc v Canada*, 2020 FCA 79 at para 20.

computing the income of shareholders of corporations that are not resident in Canada. It contains numerous stop-loss rules aiming to limit a taxpayer's losses when they receive certain types of dividends. It also contains a series of rules that ensure the application of the stop-loss rule where a corporation directly or indirectly holds affiliate shares through a partnership.[364]

[232] Subsections 93(2) and (2.01) apply to limit capital losses, but only in particular circumstances. The capital loss on the disposition of shares of a foreign affiliate is calculated in accordance with the ordinary principles of the capital gains regime, such as section 38 and subsections 39(1) and 40(1) of the ITA, which are found in Subdivision C, so not in subdivision I but in the same Division, Division B.

(ii) The Capital Gains Regime

[233] Subdivision C of Division B deals with the determination, for income tax purposes, of the taxable capital gains and allowable capital losses on the disposition of property.

[234] Sections 38, 39, 40, 53 and 54 of the ITA are found in Subdivision C of Division B. These provisions are the key provisions for the determination of the taxable capital gains and allowable capital losses. Section 38 and subsections 39(1) and 40(1) prescribe the method of calculating the gain or loss. Sections 53 and 54 define the terms "proceeds of disposition" and "adjusted cost base" respectively.

[235] A capital loss, such as the one the taxpayer sustained in this case, generally arises when the proceeds of the disposition of a share are less than its adjusted cost base, in accordance with paragraphs 39(1)(b) and 40(1)(b) of the ITA.[365]

[236] The ITA's capital gains regime seeks to recognize a capital loss where there are underlying economic losses and to deny a capital loss where there are no underlying economic losses. This principle dates back to the Carter Commission, which established that, where a taxpayer realizes a gain or loss on a disposition of capital property, it should, generally, be subject to a related income inclusion or deduction, as the gain or loss represents a real increase or decrease in the taxpayer's economic power.[366] The purpose of the deduction in respect of capital losses is thus to give tax relief where a taxpayer has suffered an economic loss on the disposition

[364] Subsections 93(2.1), (2.11), (2.2), (2.21), (2.3) and (2.31).
[365] *Ibid*, para 30.
[366] *1207192 Ontario Limited v The Queen*, 2011 TCC 383 at paras 85–86 [*1207192 Ontario Ltd (TCC)*]; *Triad Gestco (FCA)*, above, footnote 168, at paras 41–42.

of property. Conversely, where a taxpayer does not suffer an economic loss on the disposition of capital property, they should not be entitled to a deduction in respect of allowable capital losses.[367] This principle was established in a trilogy of Federal Court of Appeal decisions dealing with the application of the GAAR to various loss-generating transactions. Although these cases dealt with different sets of stop-loss rules, these decisions are nevertheless instructive because they explain the general policy underlying stop-loss rules and how they are supposed to interact with the capital gains system.

[237] The first such decision is *Landrus (TCC)*,[368] which dealt with the fair-market-value transfer of a building with a latent loss from a partnership to another non-arm's length partnership, allowing the transferor to recognize a significant capital loss on the building. This Court allowed the taxpayer's appeal, noting it "does not involve a scheme whereby the [taxpayer] is trying to claim a loss incurred by some other taxpayer" and that the taxpayer had "suffered a real economic loss".[369]

[238] *Landrus* was followed by the companion decisions in *Triad Gestco (TCC)* and *1207192 Ontario Ltd*, which both dealt with the use of stock dividends to shift value across share classes and to create artificial losses. The taxpayers in both cases had transferred property to a newly incorporated corporation in exchange for common shares with an ACB and FMV equal to the FMV of the transferred property. Each corporation then declared a stock dividend on the common shares, payable by the issuance of high-value preferred shares to the taxpayer. The preferred shares soaked up the value in the corporation, and the common shares, now of nominal value, were sold by the taxpayer to a related trust at a substantial loss. The transfer of common shares to the trusts was not subject to any stop-loss rule, since the definition of "affiliated person" did not at the time capture trusts.

[239] Contrary to the finding in *Landrus (TCC)*, this Court concluded that the GAAR applied in both *Triad Gestco (TCC)* and *1207192 Ontario Ltd* but did so for different reasons. In *Triad Gestco (TCC)*, the Court concluded that the recognition of a capital loss pursuant to a transfer within the same economic unit was contrary to the object, spirit and purpose of the various stop-loss provisions.

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[367] *1207192 Ontario Ltd (TCC)*, above, footnote 368, at paras 85, 90; *Triad Gestco (FCA)*, above, footnote 168, at paras 41–42.
[368] *Landrus v The Queen*, 2008 TCC 274 [*Landrus (TCC)*]; aff'd 2009 FCA 113 [*Landrus (FCA)*].
[369] *Ibid*, para 67.

[240] This reasoning was rejected in *1207192 Ontario Ltd*, in which this Court, echoing its finding in *Landrus (TCC)*, held that there was no general policy in the ITA to disallow losses on a transfer of property between persons within the same economic unit. However, the Court, relying on the Carter Commission reports, held that the underlying rationale of the general capital loss deduction provision is to allow for a tax deduction where a taxpayer has suffered an economic loss. Accordingly, the deduction by the taxpayer in respect of an artificial loss was held to frustrate that rationale:

> [85] I agree with the Respondent that the purpose of paragraph 38(*b*) is to give tax relief (to the extent of an offset against capital gains) in circumstances where a taxpayer has suffered an economic loss on the disposition of property. This is apparent from the manner in which a loss is calculated, by determining the excess of the cost of the property over the proceeds from the disposition of the property. Furthermore, capital gains are recognized as income under the *Act* because they represent an addition to a taxpayer's economic power. *The Report of the Royal Commission on Taxation*, proposed that capital gains be taxed for the following reasons:
>
> Rights to and interests in property can produce increases in economic power, whether held or disposed of. These increases take two basic forms: rents, dividends, royalties, interest, and other returns derived from holding property rights; and gains derived from increases in the market value of property rights. The first form is already taxed as income in Canada, while the second is normally exempt as a "capital gain". While the changes we propose in the taxation of returns from holding property are minor, we suggest a major change in the tax treatment of gains on the disposal of property. We have emphasized in this Report that the only equitable basis for taxation is to include in the comprehensive tax base the value of all additions to economic power, including so-called capital gains.
>
> It is logical to infer that capital losses are allowed under the *Act* as an offset to capital gains because they represent a decrease to a taxpayer's economic power.
>
> …
>
> [90] I find that the Respondent has shown that the purpose of paragraph 38(*b*) is to recognize economic losses suffered by a taxpayer on the disposition of property. …[370]
>
> [Emphasis added.]

[241] The Federal Court of Appeal dismissed both *1207192 Ontario Ltd (TCC)* and *Triad Gestco (TCC)*, adopting the reasons of this Court in *1207192 Ontario Ltd*

[370] *1207192 Ontario Ltd (TCC)*, above, footnote 368, at paras 85–86, 90.

*(TCC)* and rejecting those in *Triad Gestco (TCC)*. More generally, the Federal Court of Appeal held that the underlying rationale of the capital loss deduction rule was frustrated where a capital loss was claimed where there was no corresponding economic loss:

> [39] It is common ground that the loss generated by the appellant as a result of the value shift is a loss on paper only in the sense that no economic loss was suffered (the term "paper loss" is used in that sense throughout these reasons). All that happened is that the high inherent value of the common shares was moved to the preferred shares—because they are paid in priority—with the result that the common shares were left with a nominal value and a high cost, thereby allowing for the loss to be realized on the disposition of these shares to the Peter Cohen Trust. The appellant was neither richer nor poorer after this disposition.
>
> [40] According to the appellant, the loss should be given effect to despite the fact that no economic loss was suffered. It maintains that the application of the provisions of the Act on which it relied to trigger this loss gives rise to a mechanical exercise and that their effect, when so applied, is to recognize the claimed loss despite the fact that no economic loss was suffered and no dollars were lost.
>
> [41] The result proposed by the appellant is fundamentally counter-intuitive as the capital gain system is generally understood to apply to real gains and real losses. In this regard, the comment of the House of Lords in *W.T. Ramsay Ltd. v. Inland Revenue Commissioners*, [1981] UKHL 1 (BAILII), [1981] 1 All E.R. 865, although it was made by reference to capital gain under U.K. Law, is entirely apposite (page 873):
>
> > The capital gains tax was created to operate in the real world, not that of make-believe. As I said in *Aberdeen Construction Ltd. v. Inland Revenue Comrs*, [1978] 1 All ER 962 at 996, [1978] AC 885 at 893, [1978] STC 127 at 131, it is a tax on gains (or, I might have added, gains less losses), it is not a tax on arithmetical differences.
>
> [42] In Canada, the capital gain system has been understood, since a time that pre-dates its creation, to be aimed at taxing increases in "economic power" (Carter Commission Report, 1966 [*Report of the Royal Commission on Taxation*], page 325) and "economic power" is unaffected by paper losses.[371]
>
> [Emphasis added.]

[242] Counsel for Wuswig submits that, taken together, these cases demonstrate that it may be appropriate to apply the GAAR to deny benefits that result from schemes

[371] *Triad Gestco (FCA)*, above, footnote 168, at paras 39–42.

to generate artificial capital losses, but that it should not apply where there is a real underlying economic loss. While it is true these cases support counsel's view that it may by appropriate to apply the GAAR to deny benefits that result from schemes to generate artificial capital losses, it does not mean that real economic losses cannot and should not be limited in specific circumstances. These cases do not say this expressly nor do they imply it. It is this Court's view that there is no basis in these cases to allow the Court to conclude that the underlying rationale of subsections 93(2) and (2.01) is to limit capital losses only in situations where the losses were artificially created and that therefore they are not applicable to real economic losses.[372]

[243] Counsel for Wuswig also relies on a comment made by the Federal Court of Appeal in *Landrus* in support of his submission that it may be appropriate to only apply the GAAR to deny benefits that result from schemes to generate artificial capital losses. In *Landrus*, the Federal Court of Appeal stated that, where it can be shown that an anti-avoidance provision has been carefully crafted to include some situations and exclude others, it is reasonable to infer that Parliament chose to limit their scope accordingly.[373]

[244] This Court is of the view that this comment goes both ways and cannot agree with counsel. Anti-avoidance provisions have indeed been carefully crafted by Parliament. While the comment was made in respect of domestic anti-avoidance provisions in *Landrus*, it also applies to other anti-avoidance provisions, such as subsections 93(2) and 93(2.01). Also, these provisions do not specifically include or exclude situations where a taxpayer suffers a real economic loss.

(iii) The Immigration Regime for Foreign Affiliates

[245] Division F of the ITA is titled "Special Rules Applicable in Certain Circumstances". Section 128.1 of the ITA is in Division F, and it contains the special rules applicable to a change in residency. These rules apply when at a particular time, a taxpayer becomes resident in Canada, which is also referred to as a corporate "immigration". As such, they are part of the rules governing foreign affiliates and, for that reason, are relevant to the analysis at hand.

[246] Division F of the ITA does not contain an equivalent to Subdivision I of Division B (Shareholders of Corporations Not Resident in Canada), and it does not

[372] See Appellant's Submissions, para 76.
[373] *Landrus (FCA)*, above, footnote 371, at para 47.

contain provisions equivalent to subsections 93(2) and (2.01) of Division B. In Division F, there is also no reference to subsections 93(2) and (2.01). In Division F, there are no provisions that deal specifically with how pre-immigration dividends should be treated if a share of the corporation is disposed of after the immigration of the foreign affiliate is carried out. Further, in Division F, it is not mentioned anywhere that subsections 93(2) and (2.01) of Division B do not apply to foreign affiliates after they have immigrated to Canada.

[247] Counsel for Wuswig submits that subsections 93(2) and (2.01) are applicable only where there is a disposition of shares of a foreign affiliate. Once a foreign affiliate becomes resident in Canada, it is no longer a foreign affiliate and therefore no longer subject to the foreign affiliate regime and to subsection 93(2.01). According to counsel, the immigration regime is a complete regime, and there are no rules in it to ensure the continuity of stop-loss attributes where a foreign affiliate becomes resident in Canada. In other words, according to counsel, because there are no rules bridging domestic and foreign affiliate dividend stop-loss rules together, none of these rules apply to a foreign affiliate upon immigration to Canada and therefore subsections 93(2) and 93(2.01) do not apply to the avoidance transaction. This is also because, according to counsel, Division F includes all the rules applicable to foreign affiliates that immigrate to Canada and form a complete and exhaustive code. Consequently, the Court should not look outside this division for other applicable rules with respect to corporations that become residents of Canada. Counsel further submits that the omission of a stop-loss rule within the foreign affiliate immigration rules suggests a deliberate choice by Parliament not to extend the application of subsections 93(2) and (2.01) to foreign affiliates' immigration to Canada.

[248] To consider this argument, this Court must look at the broader context of the immigration rules for foreign affiliates in Canada. The Court must look at their interaction with the dividend stop-loss rules that are alleged to have been abused.

[249] The Court does not agree with counsel for Wuswig. Indeed, the rules that apply to corporations that have immigrated are not all exclusively found in Division F. Corporations that have immigrated become subject to the application of other rules, such as the basic rules found in section 3, which contains the fundamental rules applicable to the calculation of a taxpayer's income for a taxation year. Corporations that have immigrated become resident in Canada and consequently subject to the application of the ITA as a whole. As for Division F, it is entitled "Special Rules Applicable in Certain Circumstances". The immigration of a taxpayer to Canada is one of those circumstances for which special rules apply.

However, common sense dictates that this does not mean that other rules found in Divisions B or C, if applicable, do not apply to a taxpayer that has immigrated to Canada. Divisions B, C and F are all found in Part 1 of the ITA and are not mutually exclusive; therefore, Division F simply creates a set of special rules within the existing Canadian income tax system.



(iv) Other Provisions of the ITA

[250] The contextual analysis involves an examination of other relevant provisions of the ITA, which might be because they are grouped together or because they work together to give effect to a plausible and coherent plan. Capital losses may be applied to offset taxable capital gains, but the ITA contains numerous stop-loss provisions that preclude a taxpayer from applying losses to offset capital gains. As such, dividend stop-loss rules interact with the provisions of the capital gains regime.

[251] Multiple rules found in the ITA generally apply to deny, reduce or defer a loss on a disposition of property, including shares, in certain specific circumstances. These numerous specific anti-avoidance provisions in the ITA preclude a taxpayer from claiming relief for a capital loss and are colloquially referred to as "stop-loss rules".[374]

[252] There are two types of stop-loss rules scattered throughout the ITA.[375] These types of rules serve the following two purposes:

- Rules that deny the immediate recognition of a loss on transactions involving related or affiliated persons and typically defer the recognition of the loss to some future time;[376] and

- Rules that permanently deny all or a portion of the loss otherwise arising from a transaction under certain conditions, whether or not the transaction involves related or affiliated persons.[377]

[253] Divisions B and C contain several of these rules, scattered throughout their respective subdivisions.

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[374] *Triad Gesco (FCA)*, above, footnote 168, at para 33.
[375] *Kaulius v Canada*, 2003 FCA 371 at para 17.
[376] For example, paragraph 40(2)(e.1), subparagraph 40(2)(g)(i), subsections 13(21.2), 18(15), 40(3.4), 40(3.6) and 93(4).
[377] For example, subsections 93(2) and 112(3) and subparagraphs 40(2)(g)(ii) and (iii).

[254] Consequently, it is relevant for the purposes of the analysis to examine the stop-loss rules found in the ITA. One stop-loss rule that is of interest is in subsection 112(3) of the ITA, which is like the one contained in subsections 93(2) and 93(2.01) but applies in the domestic context (for Canadian shareholders of a Canadian corporation). Both parties agree that, except for some specific exceptions, subsections 112(3) and (3.01) are equivalent to subsections 93(2) and 93(2.01). As such, the stop-loss rule they contain is relevant to the analysis.

[255] Subsections 112(3) and (3.01) limit a loss incurred by a corporation on the disposition of any shares to the extent that the corporation has received certain tax-free dividends on those shares, such as capital dividends or deductible inter-corporate dividends.[378] As in the foreign affiliate context, there are companion provisions that ensure the application of the rule when a corporation holds shares through a partnership or trust.[379]

(a) Paragraph 92(2)(c) of the ITA

[256] Paragraph 92(2)(c) is found in Subdivision I of Division B. Under paragraph 92(2)(c), a dividend paid out of an affiliate's surplus accumulated before the acquisition by the corporation of the affiliate's shares (referred to as a pre-acquisition surplus) reduces the ACB of the relevant shares. Dividends paid out of pre-acquisition surpluses of a foreign affiliate will not be taxed in the hands of the Canadian corporation. However, instead of reducing the loss when those shares are disposed of, they will reduce the ACB of those shares, pursuant to the application of paragraph 92(2)(c).

(b) Paragraph 93(2.01)(b) of the ITA

[257] In June 2013, the ITA was amended to add a new loss preservation rule found in paragraph 93(2.01)(b), Subdivision I, Division B.[380] This rule aims to preserve the portion of a loss on the disposition of shares of a foreign affiliate that is attributable to a fluctuation in the value of foreign currency relative to Canadian currency.[381] This preservation rule is very restrictive and applies only in certain limited circumstances. It is essentially limited to the portion of such loss that is offset by a corresponding gain realized by the taxpayer in respect of certain indebtedness or

[378] Paragraph 112(3)(b).
[379] Subsections 112(3.1), (3.2) and (4).
[380] A new subsection 93(2.02) was also added to define the term "specified gain" for the purposes of subparagraph 93(2.01)(b)(ii).
[381] Technical Notes of the Department of Finance for 93(2), October 24, 2012.

hedges that are closely tied to the acquisition of the foreign affiliate shares in respect of which the loss was realized. In addition, the offsetting gain must be a gain made within 30 days before or after the disposition of a foreign affiliate share. Outside these limited circumstances, a taxpayer's capital loss on shares of a foreign affiliate that is incurred due to fluctuations of foreign currency exchange rates will be reduced by the exempt or tax-free dividends received on those shares.



(c) Subsection 112(3) of the ITA

[258] Subsection 112(3) is found in Division C. It applies to the disposition of a share that is capital property and not the property of a partnership.

[259] The stop-loss rule contained in subsections 112(3) and (3.01) is very similar to the stop-loss rule contained in subsections 93(2) and 93(2.01) with the difference being that one rule applies in the domestic context (112(3) and (3.01)) and the other one in the foreign affiliate context (93(2) and 93(2.01)). There is no equivalent to paragraph 93(2.01)(b) in subsection 112(3), and, consequently, certain dividends are not excluded from reducing the loss like they are in subsection 93(2). Like subsections 93(2) and (2.01), subsections 112(3) and (3.01) do not distinguish between real and artificial losses and are triggered as soon as a dividend is paid on a share and that share is sold at a loss.

[260] Based on the contextual analysis, the Court concludes the following:

i. Section 3 and paragraph 3(b) are found in Part 1, Division B of the ITA. These provisions contain the fundamental rule applicable to capital gains and capital losses. They constitute the legislative basis for the taxation of capital gains and losses. They are located before Subdivisions A and B in Division B, under the title "Basic Rules" and the subtitle "Income for taxation year". They are not part of Subdivisions A or B. As such, they apply to all taxpayers, subject to any exceptions specifically mentioned in the ITA, including Canadian shareholders of non-resident corporations, such as foreign affiliates. Therefore, they apply to Canadian shareholders of a non-resident corporation after the corporation immigrates to Canada.

ii. Paragraph 92(2)(c) is found in Part 1, Division B, subdivision I. Under paragraph 92(2)(c), a dividend paid out of an affiliate's surplus accumulated before the acquisition by the corporation of the affiliate's shares (referred to as a pre-acquisition surplus) reduces the ACB of the relevant shares. Since it affects capital losses on the disposition of those shares, it is an exception to

the basic rule found in section 3 and paragraph 3(b) according to which, the full amount of a capital gain is taxable, and the full amount of a capital loss is deductible.

iii. Subsections 93(2) and (2.01) are found in Part 1, Division B, Subdivision I of the ITA, which contains the specific rules applicable to the computing of income of shareholders of corporations that are not resident in Canada. Subsections 93(2) and (2.01) are part of the foreign affiliate regime of the ITA. The regime includes the rules that apply to the computation of income of shareholders of corporations not resident in Canada. Together, they form a stop-loss rule that limits a taxpayer's ability to use a capital loss to offset a capital gain. Therefore, they are an exception to the basic rule applicable to capital gains and capital losses found in section 3 and paragraph 3(b), according to which the full amount of a capital gain is taxable and the full amount of a capital loss is deductible.

iv. Paragraph 93(2.01)(b) is found in Subdivision I, Division B and it contains a specific rule. This rule aims to preserve the portion of a loss on the disposition of shares of a foreign affiliate even if exempt or tax-free dividends were received. It is an exception to the exception to the general principle applicable to capital losses found in section 3 and paragraph 3(b).

v. Subsections 112(3) and (3.01) are found in Part 1, Division C. These provisions contain a similar rule to the one contained in subsections 93(2) and (2.01). The rule contained in subsections 112(3) and (3.01) applies in the domestic context (for Canadian shareholders of a Canadian corporation), while the rule contained in subsections 93(2) and (2.01) applies to foreign affiliates of a Canadian corporation. Both sets of rules limit the use of capital losses by subtracting from these losses exempt tax-free dividends received by a taxpayer on the shares that incurred the capital loss. It is therefore an exception to the general principle applicable to capital losses found in section 3 and paragraph 3(b), according to which the full amount of a capital gain is taxable and the full amount of a capital loss is deductible.

vi. Division F of Part 1 is titled "Special Rules Applicable in Certain Circumstances". The immigration of a taxpayer to Canada is one of those circumstances for which special rules apply. Division F does not contain a stop-loss rule such as the one found in subsections 93(2) and (2.01).

vii. Subsections 93(2) and (2.01) do not operate independently of other provisions of the ITA. There is a close link between the basic rules for the calculation of income found in section 3 and in paragraph 3(b) since they both contain rules applicable to capital gains and capital losses. They are all found in Part 1, Division B.

viii. Division F of the ITA contains the special rules applicable to a change in residency. Division F does not contain provisions equivalent to subsections 93(2) and (2.01) of Division B. In Division F, there is also no reference to subsections 93(2) and (2.01). In Division F, there are no provisions that specifically deal with how pre-immigration dividends should be treated if a share of the corporation is disposed of after the immigration of the foreign affiliate.



### (c) Purposive Analysis

[261] The purposive analysis or object analysis seeks to ascertain what outcome Parliament intended a provision or provisions to achieve amidst the myriads of purposes promoted by the ITA.

[262] A purposive analysis allows the courts to consider legislative history and extrinsic evidence. Therefore, the purposive analysis aims to uncover the object of the legislation or legislative scheme in which the provision operates to determine the outcome that Parliament intended the provision to achieve. Sometimes, the purpose is clearly stated in the ITA, and in other cases the purpose is determined in relation to one or more closely related provisions. Where the purpose of the provision is not apparent, legislative history may be used. Explanatory notes can also be used to help determine the purpose of the provision.

#### (i) Subsection 93(2) of the ITA

[263] On December 23, 1971, subsection 93(2) of the ITA was enacted.[382] In its initial form, this dividend stop-loss rule constituted a relatively straightforward version of the calculation currently found in paragraph 93(2.01)(a) of the ITA. At that time, the wording of subsection 93(2) was simple, and it clearly stated that, where a corporation resident in Canada disposed of a share of the capital stock of a foreign affiliate, all exempt dividends received by the disposing corporation on the share had to be deducted from the amount of capital loss realized by the corporation

[382] *An Act to Amend the Income Tax Act*, SC 1970-71-72, c 63.

on the shares. However, subsequent amendments have added significant complexity to the rule.

[264] On December 17, 1991, subsection 93(2) of the ITA was amended for the first time to introduce the notion of a substituted share.[383] The amendment was made to ensure that subsection 93(2) applied when shares of a foreign affiliate were transferred within a corporate group. This was necessary to ensure that the application of subsection 93(2) could not be bypassed by simply exchanging the class of affiliate shares on which dividends were declared for another class of shares or for shares of another affiliate prior to a disposition.[384]

[265] On June 14, 2001, subsection 93(2) of the ITA was amended for the second time to add subsections 93(2.1), (2.2) and (2.3). These apply to the disposition of shares by a partnership, by a corporation of a partnership interest and by a partnership of an interest in another partnership.[385] The explanatory notes with respect to the amendment and to the new version of subsection 93(2) specify that it is an anti-avoidance provision.[386]

[266] Counsel for Wuswig submits that, at their core, subsections 93(2) and 93(2.01) are a mechanical loss computation rule. According to counsel, in that sense, it can be described as a technical counting or reconciliation rule in the ITA. Moreover, it does not share any of the hallmarks of a traditional specific anti-avoidance rule. For instance, unlike the safe-income rules found in subsection 55(2), which are designed to limit surplus-stripping transactions that reduce capital gains on a disposition of shares, subsections 93(2) and (2.01) apply mechanically and do not possess the classic hallmarks of anti-avoidance rules, such as a purpose test or a concept of a "series of transactions".[387] For this reason, it is not readily apparent that subsections 93(2) and (2.01) should be characterized as a specific anti-avoidance rule, and counsel for Wuswig prefers to take the view that it is a counting or reconciliation rule.

[267] This proposition is in complete contradiction with the Explanatory Notes and cannot be accepted by the Court.

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[383] *Income Tax Amendments Revision*, 1994, c 7, Sch II.
[384] Department of Finance, *Explanatory Notes on Subsection 93(2)*, May 1991.
[385] *Income Tax Amendments Act, 2000,* SC 2001, c 17. See also *Technical Tax Amendments Act, 2012,* SC 2013, c 34.
[386] Department of Finance, *Explanatory Notes on Subsection 93(2)*, March 2001.
[387] Written submissions, para 53.

[268] On June 26, 2013, subsection 93(2) of the ITA was amended yet again. That amendment is the last to date.[388] The amendment has divided subsection 93(2) into two subsections. Subsection 93(2) defines the losses to which the loss limitation rule applies, and subsection 93(2.01) sets out the loss limitation rules themselves. Subsection 93(2.02) was also added to define the term "specified gain" for the purposes of the application of subsection 93(2.01). A loss preservation rule was also introduced in paragraph 93(2.01)(b).

[269] Tax provisions are intended to "promote purposes related to specific activities".[389] More specifically, specific anti-avoidance provisions might have a rationale that relates to the specific result, or mischief, that Parliament sought to prevent.[390] This step of the analysis seeks to ascertain what outcome Parliament intended a provision or provisions to achieve, among the many purposes promoted by the ITA.[391]

[270] Extrinsic aids can be used when determining the object, spirit and purpose of a particular provision.[392] Therefore, the *Proposals for Tax Reform* [the "White Paper"][393] can be used to ascertain the purpose of a provision among the foreign affiliate rules.[394]

[271] In the present case, the White Paper reveals that subsections 93(2) and (2.01) of the ITA have a clearly defined objective. The objective is to limit the recognition of losses where such losses were created through the extraction of corporate value on a tax-free basis, in this case, tax-free dividends.[395]

[272] Subsection 93(2) of the ITA was enacted during the 1972 tax reform, which enacted substantive changes to foreign affiliate taxation in Canada. In the White Paper, which preceded the 1972 reform, it is stated that Parliament wanted the general capital gains provisions to apply to the shares of controlled foreign

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[388] *Technical Tax Amendments Act, 2012,* SC 2013, c 34.
[389] *Canada Trustco*, above, footnote 63, at para 52.
[390] *Deans Knight,* above, footnote 67, at para 61.
[391] *Copthorne*, above, footnote 40, at para 113.
[392] *Canada Trustco*, above, footnote 63, at para 55. In *Loblaw SCC*, above, footnote 365, at para 54, the Supreme Court of Canada recently relied on the White Paper to ascertain the purpose of a provision in the foreign affiliate rules.
[393] *Proposals for Tax Reform* (1969) (E.J. Benson, Minister of Finance) [White Paper].
[394] *Loblaw SCC,* above, footnote 365, at para 54.
[395] White Paper, above, footnote 396, at para 6.19.

corporations. Therefore, gains realized on the disposal of those shares would be fully taxable and losses fully deductible.[396]

[273] However, Parliament stated that, because the general capital gains provisions would not allow for full corporate tax to be collected on dividends from controlled foreign corporations, it was necessary to place a limit on the deductibility of losses for the system as a whole to be effective.[397] Otherwise, Canadian corporations could purchase control of foreign corporations, arrange to receive most of the assets of the company as a special dividend and then sell the shares for the value of the remaining assets.[398] In this situation, the dividend received by a Canadian corporation would bear little or no Canadian tax because of the foreign tax credit or the exemption, but the loss would reduce taxable income and save Canadian tax.[399] Such a tax result would be clearly inappropriate since the Canadian corporation would not, in fact, have suffered an overall loss on its investment. Therefore, to avoid this consequence, it was proposed to reduce the deductible loss on such shares by reference to the dividends received from the corporation that did not bear full Canadian corporation tax[400] with the introduction of subsection 93(2) of the ITA.

[274] Counsel for HMTK submits that this rule demonstrates that, even in situations where a loss is attributable to real economic circumstances, Parliament's intent was that subsections 93(2) and (2.01) apply to the extent that the taxpayer has already benefitted from exempt or tax-free dividends on those shares.

[275] According to counsel, paragraph 93(2.01)(b) also supports this conclusion. Pursuant to subsection 93(2.01), a portion of the loss resulting from the disposition of a share of a foreign affiliate by a corporation resident in Canada is limited by exempt dividends received on that share or on a share for which it was substituted. In some circumstances, the portion of the loss on the disposition of a share attributable to a fluctuation in the value of foreign currency relative to the Canadian currency is not impacted by dividends received and such loss is a real economic loss.

[276] The Court agrees with this proposition. Subsections 93(2) and (2.01) apply to situations where the taxpayer has suffered a real economic loss because it has been demonstrated that Parliament wanted full corporate tax to be collected on dividends from controlled foreign corporations and that, in order to achieve this objective, it

[396] *Ibid.*
[397] *Ibid.*
[398] *Ibid.*
[399] *Ibid.*
[400] *Ibid.*

was necessary to place a limit on the deductibility of losses for the system as a whole to be effective.

(ii) Paragraph 92(2)(c) of the ITA

[277] Counsel for HMTK also submits that the dividend stop-loss rules are not concerned with the source of the loss, nor do they contemplate or provide a distinction based on the source of the loss. According to counsel, the policy intent behind the dividend stop-loss rules is strengthened by the existence of paragraph 92(2)(c), which contains another rule found in Subdivision I of Division B.

[278] Counsel for HMTK submits that some commentators have argued that paragraph 92(2)(c) fully addresses the mischief associated with artificial capital losses in a foreign affiliate context and thus subsection 93(2) is not warranted. Despite these comments, subsection 93(2) was never repealed. Counsel contends that the fact that both subsection 93(2) and paragraph 92(2)(c) are included within the ITA suggests that paragraph 92(2)(c) must encompass other situations, otherwise, it would serve no purpose. Common sense dictates that it is most probably the case, but there is no need for the Court to inquire further.

[279] Counsel for Wuswig seems to agree since they submit that it is not accurate to say that paragraph 92(2)(c) is a complete response to artificial losses in a foreign affiliate context and therefore subsection 93(2) must address something other than artificial losses—that is, it must apply to all dividends. Counsel submits that, while paragraph 92(2)(c) applies to prevent value stripping in the context of pre-acquisition surpluses, subsection 93(2) applies to prevent value stripping in the context of other dividends (e.g., exempt surplus, hybrid surplus, taxable surplus).

[280] The Court agrees with counsel for Wuswig on this point. There is more than one way to generate artificial losses from foreign affiliates. It seems clear that paragraph 92(2)(c) addresses one method (i.e., pre-acquisition surplus) and subsection 93(2) addresses another (e.g., exempt surplus); that is all.

(iii) Subsections 112(3) and (3.01) of the ITA

[281] The purpose of domestic dividend stop-loss rules, such as subsection 112(3), has been described by some as follows:

> The general purpose of all these [domestic dividend stop-loss rules (found in subsections 112(3), (3.1), (4), (4.1), (4.2), (4.3) and (7))] is to ensure that a corporation does not strip value out of an investor corporation by paying tax-deductible dividends and then selling the shares. In addition, section 112 is intended to avoid the realization of a loss if a share is bought shortly before a dividend is paid and then sold after the dividend is received, and an economic loss is realized on the share equal to the tax-deductible dividend. The provisions are worded so broadly, however, that they clearly will eliminate losses even if the dividend recipient has no control over the payment of dividends, and even if the payment itself has little or no effect on the value of the shares. These provisions can merely reduce or eliminate a loss on shares. They have no effect if a dividend reduces a gain without creating a loss.[401]
>
> [Emphasis added.]



[282] Based on the purposive analysis, the Court concludes the following:

i. Parliament objective with respect to subsections 93(2) and (2.01) is to limit the recognition of losses where such losses were created through the extraction of corporate value on a tax-free basis, in this case, tax-free dividends.

ii. With subsections 93(2) and (2.01), Parliament intended to ensure that the general capital gains regime applied to the shares of controlled foreign corporations and that the capital gains realized on the disposal of foreign shares were fully taxable in Canada.

iii. With subsections 93(2) and (2.01), Parliament intended for full corporate tax to be collected on dividends from controlled foreign corporations by placing a limit on the deductibility of capital losses on shares of foreign affiliates.

iv. There are no indications that Parliament intended to limit the application of subsections 93(2) and (2.01) and, consequently, for them not to apply in cases where taxpayers have sustained a real economic loss.

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[401] J.A. Boultbee, "Minimizing the Taxation Effects of Dividends", in *Report of Proceedings of the Thirty-Seventh Tax Conference, 1985 Conference Report*, (Toronto: Canadian Tax Foundation, 1986, 7:1-20).

v. There are no indications that Parliament intended to limit the application of subsections 93(2) and (2.01) in cases where payments of dividends had no effect on the value of shares.

(d) Conclusion on the Object, Spirit and Purpose of Subsections 93(2) and (2.01) of the ITA

[283] The object, spirit and purpose of a provision reflect the rationale of the provision and have been referred to as a description of the legislative rationale that underlies specific or interrelated provisions of the ITA. The rationale of the provision under review must be harmonious with the ITA.

[284] The Court has considered the three elements of statutory interpretation individually because it is useful to do so even if, as stated by the Supreme Court of Canada, these elements are inevitably intertwined. The Court must consider all three elements of statutory interpretation even when the text of a provision is clear, as it is the case for subsections 93(2) and (2.01), because they are intertwined and need to be considered together.

[285] Through the textual analysis, this Court has concluded that subsections 93(2) and (2.01) do not distinguish between real and artificial economic losses. The stop-loss rule is triggered if a dividend is paid on a share that is later sold at a loss, whether the taxpayer has suffered a real economic loss or the loss was artificial. Also, subsections 93(2) and (2.01) do not specifically exclude dividends received prior to the immigration of a taxpayer.

[286] Following the contextual analysis, the Court has stated that section 3 and paragraph 3(b) contain the fundamental rules applicable to the calculation of a taxpayer's income for a taxation year and, pursuant to them, a capital gain is a source of income. Section 3 constitutes the legislative basis for the taxation of capital gains and losses. Section 3 and paragraph 3(b) are located before Subdivisions A and B and are not part of those subdivisions. Subsections 93(2) and (2.01) are found in Part 1, Division B, Subdivision I of the ITA, which contains the specific rules applicable to computing the income of shareholders of corporations that are not resident in Canada. Subsections 93(2) and (2.01) are part of the foreign affiliate regime of the ITA. The regime includes the rules that apply to the computation of income of shareholders of corporations not resident in Canada. As a stop-loss rule, the regime limits a taxpayer's ability to use a capital loss to offset a capital gain. Consequently, it can be concluded that subsections 93(2) and (2.01) do not operate independently of the capital gains regime as they are closely linked with it and their application

must be harmonious with the rule found in section 3 and paragraph 3(b) of the ITA, that is, with the fundamental rule applicable to all capital gains and losses.

[287] Section 3 and paragraph 3(b) contain the fundamental rules applicable to the calculation of a taxpayer's income, pursuant to which capital gains are a source of income that must be subject to tax. It is logical to conclude that Parliament intended to ensure that the general capital gains regime applied to the shares of controlled foreign corporations, and that the capital gains realized on the disposal of foreign shares were fully taxable in Canada. The rules found in subsections 93(2) and (2.01) and in subsections 112(3) and (3.01) ensure that losses on the disposition of a share of an affiliate created through the extraction of corporate value on a tax-free basis by the payment of tax-free dividends would be limited whether the affiliate is Canadian or foreign, subject to some exceptions found in the ITA.

[288] Furthermore, the capital gains regime seeks to allow a capital loss where there are underlying economic losses. Since it is this Court’s view that subsections 93(2) and (2.01) do not operate independently of the capital gains regime and the text of the provisions does not say otherwise, it is reasonable to conclude that they apply in situations where a taxpayer suffered a real economic loss. If Parliament had wanted to limit the application of the rule found in subsections 93(2) and (2.01), it would have specifically said so. It is this Court’s view that concluding that the provisions do not apply if a taxpayer suffered a real economic loss would limit their application without justification.

[289] With this in mind, the key source of information for this Court’s analysis in determining the object, spirit and purpose of subsections 93(2) and (2.01) is the Department of Finance’s explanatory notes. In these notes, it is specified that subsection 93(2) is an anti-avoidance provision. As stated in *Deans Knight*, when the explanatory notes state that a provision is an anti-avoidance provision, this usually means that the rationale behind the provision might relate to the specific result that Parliament sought to prevent.

[290] Based on these explanatory notes, this Court has concluded that Parliament’s objective with respect to subsections 93(2) and (2.01) is to limit the recognition of losses where such losses were created through the extraction of corporate value on a tax-free basis by the payment of tax-free dividends without limitations, unless specifically provided for by the ITA. Consequently, this Court concludes that the objective of subsections 93(2) and (2.01) is to create an exception to the basic rule of the ITA found in section 3 and also to the capital gains regime by limiting the

allowable capital loss applicable to the calculation of a taxpayer's income for a taxation year.

(2) Does the Avoidance Transaction Frustrate the Object, Spirit or Purpose of Subsections 93(2) and 93(2.01) of the ITA?

(a) Is There a Valid Alternative Transaction?

[291] As previously explained, this Court has concluded that, in *3295940*, the Federal Court of Appeal listed conditions that have to be met for a transaction or series of transactions to be qualified as an alternative transaction or an alternative series of transactions for the purposes of the application of the GAAR. These conditions are the following:

1- The transaction or series of transactions must be available under the ITA;

2- The transaction or series of transaction must not be so remote as to be practically not feasible;

3- The transaction or series of transactions must have a high degree of commercial and economic similarity to the transaction or series of transactions under review;

4- The transaction or series of transactions must generate tax consequences approximately as favourable as the transaction or series of transaction under review; and

5- The transaction or series of transactions must not be abusive of the GAAR.

[292] Since it is Wuswig that submits that there were alternative transactions that could have been made instead of the series of transactions and that these transactions would have achieved the same result as the series, Wuswig had the onus of demonstrating to the Court that the conditions listed above were met.

[293] Counsel for Wuswig submits that Detroit Marine Terminals' operations were financed by loans totalling 3,309,765 USD. Detroit Marine Terminals received advances totalling 3,309,765 USD from Southridge 2007, Noro Holdings and PBI-Kinmont between 2000 and 2006. These advances were never repaid. This internal financing led to a loss of 3,309,675 USD sustained in the corporate group.

[294] Counsel for Wuswig submits that, instead of providing these loans, Wuswig could have directly financed Detroit Marine Terminals' activities by loaning it money using its own liquidities. The liquidities would have come from the payment of dividends to Wuswig by Southridge 2007, which Southridge 2007 would have paid with the money received from the Noro Holdings subsidiary's profitable real estate activities. The dividends received by Wuswig would have been deducted from its taxable income by Wuswig under section 113 of the ITA, less a 5% withholding tax.

[295] Counsel for Wuswig submits that Wuswig would then have been able to provide loans to Detroit Marine Terminals to finance its operations. Counsel submits that subsection 50(1) of the ITA allows a creditor to recognize capital losses on bad debt when the debtor becomes insolvent. In this case, because Detroit Marine Terminals became insolvent, that would have allowed Wuswig to have incurred capital losses on these loans. Consequently, the alternative transaction would have led to the same result as the avoidance transaction, which is a capital loss.

(i) The Transaction or Series of Transactions Must Be Available under the ITA

[296] According to Wuswig's counsel, the alternative transactions were available to Wuswig because Detroit Marine Terminals' operations were financed by loans totalling 3,309,765 USD. The funds for the loans were coming out of the profitable real estate activities from affiliates located in the U.S.A. These loans were never repaid by Detroit Marine Terminals. Counsel submits that, instead of providing these loans, Wuswig could have directly financed Detroit Marine Terminals' activities by loaning it money using its own liquidities. These loans could have been granted under the ITA.

[297] Counsel for HMTK did not submit or demonstrate that the dividends received by Wuswig would not have been deducted from its taxable income by Wuswig under section 113 of the ITA, less a 5% withholding tax, or that, pursuant to subsection 50(1) of the ITA, Wuswig would not have realized capital losses on the loans when Detroit Marine Terminals became insolvent.

[298] Consequently, this Court has concluded that the alternative transactions were available under the ITA and, because of this, the first condition is met.

(ii) The Transaction or Series of Transactions Must Not Be so Remote as to Be Practically Infeasible

[299] There are no indications or evidence to demonstrate that it would not have been practical to carry out the alternative translations. The transactions are quite simple and feasible.

[300] Consequently, this Court has concluded that the alternative transactions were not so remote as to be practically not feasible. The second condition is met.

(iii) The Transaction or Series of Transactions Must Have a High Degree of Commercial and Economic Similarity to the Transaction or Series of Transactions under Review

[301] In this case, counsel for Wuswig asked this Court to conclude that loan agreements have a high degree of commercial and economic similarity to the transaction or series of transactions. As for the series of transactions, it is comprised of the following transactions:

1- Wuswig incorporated a new wholly owned subsidiary in 2007 under the laws of Delaware, Southridge 2007.

2- Southridge Holdings and Southridge 2007 merged.

3- The entity resulting from the merger, Southridge 2007, was continued into Canada.

4- Wuswig Holdings 2007 issued 100,000 preferred shares to Windsor, a shareholder of Wuswig.

5- Wuswig Holdings 2007 was wound up.

6- Wuswig's American subsidiaries were dissolved, and Noro Holdings was wound up into Wuswig.

[302] It is obvious that the loan agreements as described by Wuswig in paragraph 79 above do not have a high degree of commercial and economic similarity to the transactions that took place. Indeed, this Court finds that Wuswig has not satisfied its burden of persuasion. Consequently, the third condition is not met.

(iv) The Transaction or Series of Transactions Must Generate Tax Consequences Approximately As Favourable as the Transaction or Series of Transactions Under Review

[303] Counsel for Wuswig submitted that earnings from the U.S. group's profitable U.S. activities could have been distributed by Southridge Holdings to Wuswig as dividends. These dividends would be subject to a 5% U.S. withholding tax pursuant to Article X of the *Convention Between Canada and the United States of America*[402], which reduces the withholding tax rate to 5% where the beneficial owner is a company that owns at least 10% of the voting stock of the company paying the dividends. These dividends would be included in Wuswig's income pursuant to subsection 90(1) of the ITA, but a corresponding deduction would be granted under subsection 113(1) of the ITA. Assuming the earnings of the U.S. group totalled $4,548,640.88, the net amount received by Wuswig, after subtracting the U.S. withholding tax, would be $4,321,208.84.

[304] Wuswig could have lent the $4,321,208.84 to Detroit Marine Terminals as a cross-border loan to finance its activities during its winding-up. Pursuant to section 247 of the ITA, this loan would be deemed to be interest-bearing.

[305] Given that the debt owing by Detroit Marine Terminals was not collectible, Wuswig could have elected to dispose of this "bad debt" for nil proceeds pursuant to subsection 50(1) of the ITA. As a result, Wuswig could have incurred a capital loss under section 38 of the ITA equal to the face value of the debt (minimally $4,321,208.84, which represents the capital value of the loan).

[306] In the case at hand, because of the series of transactions, Wuswig realized a capital loss of $5,086,039 on the disposition of its shares of Wuswig Holdings 2007.

[307] This Court must determine if the capital losses resulting from the actual series of transactions and the proposed alternative transactions are approximately as favourable to the taxpayer. In the present case, the alternative transaction results in a total capital loss that is around 15% lower than the one incurred through the original series of transactions. This difference between both capital losses amounts

[402] *Convention Between Canada and the United States of America ith Respect to Taxes on Income and on Capital*, 26 September 1980, as amended.

to roughly $764,830.16. This Court finds this discrepancy sufficiently significant to conclude that the tax consequences are not "approximately as favourable".

[308] Therefore, the fourth condition is not met.

(v) The Transaction or Series of Transactions Must Not Be Abusive of the GAAR

[309] . There is nothing to suggest that the transactions or series of transactions would have frustrated the object, spirit or purpose of the relevant provisions that would have applied had the alternative transactions been carried out.

[310] Consequently, this Court has concluded that the alternative transactions were not abusive of the GAAR. The fifth condition is met.

(vi) Conclusion

[311] Because the alternative transactions did not have a high degree of commercial and economic similarity to the series of transactions and because they did not generate tax consequences approximately as favourable as the series of transactions, the alternative transaction is not a relevant factor in determining whether the avoidance transaction is abusive.

(3) Conclusion on Whether the Transaction Was Abusive

[312] As previously mentioned, subsections 93(2) and 93(2.01) are anti-avoidance provisions. Read together, these provisions are a "dividend-stop loss rule". The objective that Parliament seeks to achieve with these provisions is to limit the recognition of a loss where such a loss was created through the extraction of corporate value with dividends received by a taxpayer on a tax-free basis, that is, by way of payment of tax-free dividends.

[313] More specifically, subsections 93(2) and (2.01) are meant to limit the recognition of a capital loss on shares of a foreign affiliate of a Canadian taxpayer where the Canadian taxpayer has received tax-free dividends from the foreign affiliate.

[314] In this case, this Court must determine whether Wuswig's avoidance transaction defeats the rationale of subsections 93(2) and (2.01) and circumvents the

application of these provisions in a manner that frustrates the object, spirit and purpose of those provisions, as described above.[403]

[315] The evidence shows that, had Southridge 2007 not immigrated to Canada, it would have been subject to subsections 93(2) and 93(2.01). As a result, on the disposition of the shares, this stop-loss rule would have prevented the loss from being overstated. The exempt or tax-free dividends totalling $19,430,329 received by Wuswig from Noro Holdings and Southridge Holdings before 2007 would have been subtracted from the capital loss realized from the disposition of its shares of Wuswig Holdings 2007.

[316] Considering that this Court has concluded that subsections 93(2) and (2.01) are meant to limit the realization of a capital loss on shares of a foreign affiliate of a Canadian taxpayer when the latter has received tax-free dividends from the foreign affiliate, clearly, the avoidance transaction defeats the rationale of subsections 93(2) and (2.01).

[317] The transaction allowed Wuswig to circumvent the application of subsections 93(2) and (2.01) in a manner that frustrates their object, spirit and purpose because the exempt or tax-free dividends of $19,430,329 received by Wuswig before 2007 were not subtracted from the capital loss realized from the disposition of its shares of Wuswig Holdings 2007 following the transaction. It allowed Wuswig to extract corporate value on a tax-free basis by the payment of tax-free dividends.

[318] Consequently, the avoidance transaction is abusive because the overall result of the series of transactions frustrated and defeated the underlying rationale of the provisions, as identified by this Court, and it allowed Wuswig to achieve an outcome that the provisions seek to prevent.

### 2. The 2007 Taxation Year

[319] Counsel for Wuswig submits that the notice of determination for the 2007 taxation year should be vacated for two reasons. Counsel's submissions on each of them can be summarized as follows:

[403] *Deans Knight,* above, footnote 67, at para 69. See also *Lipson*, above, footnote 274, at para 40, citing *Canada Trustco*, at para 45.

1 - Under subsection 152(1.11) of the ITA, a notice of determination may be issued by the Minister to correct an abuse where the GAAR applies. Consequently, the issuance of such notice is conditional on the three conditions for the application of the GAAR being met. Because Wuswig did not receive a tax benefit in the 2007 taxation year, the first condition necessary for the application of the GAAR is not met and a notice of determination could not be issued for that 2007 taxation year.

2 - The Minister cannot rely only on a notice of determination under section 152(1.11) of the ITA to deny a tax benefit and apply the GAAR to a statute-barred year. By doing so, the Minister is trying to reassess a statute-barred taxation year with a notice of determination. To issue a notice of determination under subsection 152(1.11) for a taxation year, the Minister must deny a tax benefit for that taxation year under the GAAR. In this case, the Minister could not deny a tax benefit for the 2007 taxation year because the year was statute-barred.

a) Did a Tax Benefit Arise from the Avoidance Transaction in the 2007 Taxation Year?

[320] Pursuant to subsection 152(1.11) of the ITA, when the Minister ascertains the tax consequences of a transaction by reason of subsection 245(2) of the ITA, the Minister shall determine any amount that is relevant for the purposes of computing the income, the taxable income or the taxable income earned in Canada of, the tax or other amount payable by, or amount refundable to, a taxpayer under the ITA. Subsection 152(1.11) reads as follows:

> **152 (1.11)** Where at any time the Minister ascertains the tax consequences to a taxpayer by reason of subsection 245(2) with respect to a transaction, the Minister
>
> **(a)** shall, in the case of a determination pursuant to subsection 245(8), or
>
> **(b)** may, in any other case,
>
> determine any amount that is relevant for the purposes of computing the income, taxable income or taxable income earned in Canada of, tax or other amount payable by, or amount refundable to, the taxpayer under this Act and, where such a determination is made, the Minister shall send to the taxpayer, with all due dispatch, a notice of determination stating the amount so determined.

[321] Where such a determination is made, the Minister sends the taxpayer a notice of determination stating the said amount by way of an adjustment. Subsection 245(2) reads as follows:

> Where a transaction is an avoidance transaction, the tax consequences to a person shall be determined as is reasonable in the circumstances in order to deny a tax benefit that, but for this section, would result, directly or indirectly, from that transaction or from a series of transactions that includes that transaction.

[322] It is clear from the text of subsection 152(1.11) that, for it to apply, the GAAR must have been applied by the Minister since there is a direct reference to subsection 245(2) in the provision. Once the Minister concludes that the three conditions necessary for the application of the GAAR have been met, a notice of determination under subsection 152(1.11) can be sent to a taxpayer. Therefore, the Minister had to have concluded that Wuswig received a tax benefit from an avoidance transaction before the notice was sent.

[323] The question becomes whether Wuswig has obtained a tax benefit and, if so, what it was.

### (1) What Is the Difference Between a Tax Benefit and Tax Attribute?

[324] The definition of a "tax benefit" can be found in subsection 245(1) of the ITA. The relevant version of the provision reads as follows:

> **245 (1)** In this section,
>
> **tax benefit** means a reduction, avoidance or deferral of tax or other amount payable under this Act or an increase in a refund of tax or other amount under this Act, and includes a reduction, avoidance or deferral of tax or other amount that would be payable under this Act but for a tax treaty or an increase in a refund of tax or other amount under this Act as a result of a tax treaty; (*avantage fiscal*)

[325] The term "tax attribute" is defined in two places in the ITA. However, the definitions are only for the purposes of the application of specific provisions.[404] For instance, the definition of "tax attribute" found in subsection 160.01(1) of the ITA reads as follows:

[404] See Section 80 and section 160 of the ITA.

> **tax attribute** means a balance, pool or other amount determined under this Act that is or may be relevant in computing income or in determining a taxpayer's liability for tax under this Act in any taxation year and includes
>
> (a) a capital loss, non-capital loss, restricted farm loss, farm loss and limited partnership loss;
>
> (b) an amount that is deductible in computing a person's income;
>
> (c) any balance of undeducted outlays, expenses or other amounts;
>
> (d) paid-up capital in respect of a share of any class of the capital stock of a corporation;
>
> (e) cost or capital cost of a property;
>
> (f) an amount deductible from an amount otherwise payable under this Act; and
>
> (g) an amount that is deemed to have been remitted as an amount payable under this Act. (*attribut fiscal*)

[326] This provision was enacted in 2022 and is only applicable to transactions that occurred after April 2021. Nonetheless, it gives an example of what is considered a "tax attribute" under the ITA.

[327] Examples of tax attributes can be found in the jurisprudence. In *1245989*,[405] the Federal Court of Appeal made the distinction between a tax benefit and a tax attribute, establishing in the process that the paid-up capital of shares was a tax attribute.[406] In *Gladwin*,[407] the Federal Court of Appeal stated that an increase in a taxpayer's capital dividend account is a modification of a tax attribute.[408] Therefore, the balance of a capital dividend account is a tax attribute. In *Rogers Enterprise (2015) Inc v The Queen*, this Court stated that a tax attribute can be the paid-up capital of shares or the ACB of a capital property.[409]

[328] Additionally, the known tax attributes, such as the paid-up capital of shares, the ACB of a property, the capital dividend account or the stated tax attributes in

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[405] *1245989*, above, footnote 287.
[406] *Ibid*, para 39.
[407] *Gladwin*, above, footnote 286.
[408] *Ibid*, para 47.
[409] *Rogers Enterprise (2015) Inc v The Queen*, 2020 TCC 92 at para 37.

section 160 are generally amounts that are distributed tax-free or are amounts used to reduce a taxpayer's tax liability. The "tax-free" character of tax attributes has been confirmed by the Federal Court of Appeal in *Gladwin*.[410]

[329] Based on what is said above, a tax benefit is different than a tax attribute. Pursuant to subsection 245(1), this Court concludes that a tax attribute, when it becomes relevant in computing income or in determining a taxpayer's liability for tax under the ITA, can be qualified as a tax benefit when it is used to reduce, avoid or defer tax or other amount payable under ITA or allows a taxpayer to increase a refund of tax or other amount under the ITA, including a reduction, avoidance or deferral of tax or other amount that would be payable under the ITA but for a tax treaty or an increase in a refund of tax or other amount under the ITA as a result of a tax treaty.

[330] In this case, to find that Wuswig obtained a tax benefit in the 2007 taxation year, this Court must determine whether the capital loss incurred from the avoidance transaction was used by Wuswig to reduce its tax liability in one of the ways described in subsection 245(1). More specifically, in this case, this Court must determine whether Wuswig reduced the tax payable under the ITA. If it did, this Court will conclude that Wuswig obtained a tax benefit in the 2007 taxation year from the avoidance transaction.

[331] Counsel for Wuswig submitted that Wuswig had a capital loss balance available from previous years that could be used and that it was sufficient to offset its capital gains of $79,114 realized in the 2007 taxation year without using a portion of the loss realized with the avoidance transaction. Therefore, Wuswig did not realize a tax benefit in that year. This Court cannot accept the reasoning since it is not accurate. This Court will explain below how it comes to this conclusion.

(2) When Does an Amount Contained in a Capital Loss Balance Become a Tax Benefit?

(a) What Is a Capital Loss Balance?

[332] While the terms "capital loss balance", "capital loss pool" and "capital loss account" are commonly used when capital losses are discussed, none of these terms are defined in the ITA. The ITA only refers to "net capital losses" from preceding years or following years, such as in section 111 of the ITA. The ITA sometimes

[410] *Gladwin,* above, footnote 286, at para 47.

explicitly refers to a "balance", such as an "exempt capital gains balance" in subsection 39.1(1) of the ITA or to an "account" such as a "capital dividend account" in subsection 89(1) of the ITA. The word "capital loss balance" is used in paragraph 111(1.1)(b) as follows:

> **(1.1)** Notwithstanding paragraph 111(1)(b), the amount that may be deducted under that paragraph in computing a taxpayer's taxable income for a particular taxation year is the total of
>
> …
>
> **(b)** where the taxpayer is an individual, the least of
>
> **(i)** $2,000,
> **(ii)** the taxpayer's pre-1986 capital loss balance for the particular year, and

[333] Subsection 111(8) of the ITA, which defines terms for the purposes of the application of section 111, reads as follows:

> ***Pre-1986 capital loss balance*** of an individual for a particular taxation year means the amount determined by the formula
>
> (A + B) - (C + D + E + E.1)

[334] However, as specified by this definition, this is the capital loss balance of an individual.

[335] The CRA, in some of its administrative positions, refers to a "capital loss balance" or a "capital loss pool" without defining the terms.[411] In these documents, it appears that the "capital loss balance" is the remaining amount that is left after capital losses are used against capital gains for a year (the unused capital loss balance).[412]

[336] Based on what is said above, this Court concludes that the term "capital loss balance" is the amount of capital losses left after they were used against capital gains for a taxation year. Because these net capital losses can be used in other taxation years, it makes sense that a taxpayer (and the Minister) would keep track of the

[411] CRA Views, February 1991-5, "Determination of adjusted capital losses for minimum tax purposes", February 1991.
[412] See Canada Revenue Agency, Views document 2023-0961311C6, "STEP 2023—Question 2—Worthless property", June 20, 2023.

amounts left or used over the years. Hence, the terms "capital loss balance" or "capital loss pool" refer to the sum of the amounts of capital losses available to a taxpayer to use against future capital gains.

(b) When Does an Amount Contained in a Capital Loss Balance Become a Tax Benefit?

[337] The capital gains regime is based on paragraph 3(b) of the ITA. This provision recognizes capital gains as a source of income and subjects them to tax in the year in which the gains were realized following the disposition of the property on which they were incurred.[413] Section 3 of the ITA reads as follows:

> **3** The income of a taxpayer for a taxation year for the purposes of this Part is the taxpayer's income for the year determined by the following rules:
>
> **(a)** determine the total of all amounts each of which is the taxpayer's income for the year (other than a taxable capital gain from the disposition of a property) from a source inside or outside Canada, including, without restricting the generality of the foregoing, the taxpayer's income for the year from each office, employment, business and property,
>
> **(b)** determine the amount, if any, by which
>
> **(i)** the total of
>
> **(A)** all of the taxpayer's taxable capital gains for the year from dispositions of property other than listed personal property, and
>
> **(B)** the taxpayer's taxable net gain for the year from dispositions of listed personal property,
>
> exceeds
>
> **(ii)** the amount, if any, by which the taxpayer's allowable capital losses for the year from dispositions of property other than listed personal property exceed the taxpayer's allowable business investment losses for the year.

[338] Consequently, pursuant to subsection 245(1) of the ITA, when a capital loss is used by a taxpayer to reduce its tax payable for a taxation year, it is considered a tax benefit under the ITA. Since, pursuant to paragraph 39(1)(b) of the ITA, a capital loss from the disposition of any property can be deducted by a taxpayer in computing

[413] *2763478 Canada Inc v Canada*, 2018 FCA 209 at para 54.

its income in the year of the disposition or in any taxation year, a capital loss is considered a tax benefit if and when it is used by a taxpayer to reduce its capital gain for a taxation year. Paragraph 39(1)(b) reads as follows:

> (b) a taxpayer's capital loss for a taxation year from the disposition of any property is the taxpayer's loss for the year determined under this Subdivision (to the extent of the amount thereof that would not, if section 3 were read in the manner described in paragraph (a) of this subsection and without reference to the expression "or the taxpayer's allowable business investment loss for the year" in paragraph 3(d), be deductible in computing the taxpayer's income for the year or any other taxation year) from the disposition of any property of the taxpayer other than
>
> …

[339] Therefore, if this Court finds that Wuswig used a portion of the capital loss it realized from the avoidance transaction in the 2007 taxation year, this Court will have to conclude that Wuswig received a tax benefit for that year.

[340] Pursuant to section 3 of the ITA, the amount of a capital gain that is taxable in a taxation year is the amount, if any, that exceeds the taxpayer's allowable capital losses for the year the property was disposed of. Pursuant to subsection 111(1) of the ITA, for the purpose of computing its taxable income for a taxation year and, more specifically, its taxable capital gain, a taxpayer can deduct its net capital losses realized in the taxation years preceding and the three taxation years immediately following the year it realized the capital gain. The net capital losses are defined in subsection 111(8) of the ITA and are essentially the result of the calculation in paragraph 3(b) of the ITA for a year. Subsection 111(1) reads as follows:

> 111 (1) For the purpose of computing the taxable income of a taxpayer for a taxation year, there may be deducted such portion as the taxpayer may claim of the taxpayer's
>
> …
>
> Net capital losses
>
> (b) net capital losses for taxation years preceding and the three taxation years immediately following the year;

[341] To determine whether a taxpayer has used a portion of its capital loss balance to reduce its capital gain for a taxation year, where a taxpayer has realized a capital gain and a capital loss in that year, it is necessary to calculate the net capital gain first. This is because, pursuant to subparagraph 111(1.1)(a)(i) of the ITA, the capital

loss realized in a taxation year will always be deducted first from the capital gain for that year since the net capital loss is used against a net capital gain only. Therefore, it is only when a taxpayer has a net capital gain for a taxation year that it can use a portion of the capital loss found in its capital loss balance. Subsection 111(1.1) reads as follows:



**Net capital losses**

**(1.1)** Notwithstanding paragraph 111(1)(b), the amount that may be deducted under that paragraph in computing a taxpayer's taxable income for a particular taxation year is the total of

**(a)** the lesser of

**(i)** the amount, if any, determined under paragraph 3(b) in respect of the taxpayer for the particular year, and

**(ii)** the total of all amounts each of which is an amount determined by the formula

$$A \times B/C$$

where

A is the amount claimed under paragraph 111(1)(b) for the particular year by the taxpayer in respect of a net capital loss for a taxation year (in this paragraph referred to as the "loss year"),

B is the fraction that would be used for the particular year under section 38 in respect of the taxpayer if the taxpayer had a capital loss for the particular year, and

C is the fraction required to be used under section 38 in respect of the taxpayer for the loss year;

**(b)** where the taxpayer is an individual, the least of

**(i)** $2,000,
**(ii)** the taxpayer's pre-1986 capital loss balance for the particular year, and
**(iii)** the amount, if any, by which

**(A)** the amount claimed under paragraph 111(1)(b) in respect of the taxpayer's net capital losses for the particular year

exceeds

**(B)** the total of the amounts in respect of the taxpayer's net capital losses that, using the formula in subparagraph 111(1.1)(a)(ii), would be required to be

> claimed under paragraph 111(1)(b) for the particular year to produce the amount determined under paragraph 111(1.1)(a) for the particular year; and
>
> **(c)** the amount, if any, that the Minister determines to be reasonable in the circumstances for the particular year and after considering the application to the taxpayer of subsections 104(21.6), 130.1(4), 131(1) and 138.1(3.2) as they read in their application to the taxpayer's last taxation year that began before November 2011.

(3) Conclusion on Whether a Tax Benefit Arose from the Avoidance Transaction in the 2007 Taxation Year

[342] As a result of the avoidance transaction, Wuswig realized a capital loss of $5,086,039 on the disposition of its shares of Wuswig Holdings 2007 in the 2007 taxation year. Pursuant to subparagraph 111(1.1)(a)(i) of the ITA, a capital loss realized in a taxation year is always deducted first from the capital gain for that year. In the 2007 taxation year, the amount of $5,086,039 was available to Wuswig, and it had to be used first to reduce the capital gain of $79,114 realized in that year. It was sufficient to reduce Wuswig's capital gain for the year to $0. A portion of the capital loss of $5,086,039 was therefore used by Wuswig to reduce the tax payable for that year, and Wuswig did not need and could not have used losses from its capital loss balance at the start of the 2007 taxation year. Consequently, in applying subsection 245(1) of the ITA, this Court concludes that Wuswig received a tax benefit from the avoidance transaction in the 2007 taxation year.

b) Was the Series of Transactions an Avoidance Transaction?

[343] This Court found that the series of transactions was an avoidance transaction, as explained in paragraphs 217 to 220 above.

c) Was the Avoidance Transaction Abusive?

[344] This Court found that the avoidance transaction was abusive, as explained in paragraphs 312 to 318 above.

d) Can the Minister Issue a Notice of Determination under Subsection 152(1.11) of the ITA to Adjust a Tax Attribute and Apply the GAAR to a Statute-Barred Year?

[345] Pursuant to subsection 152(1.11) of the ITA, the Minister can ascertain the tax consequences imputable to a taxpayer by reason of subsection 245(2) with respect to a transaction. In the case of an avoidance transaction, the adjusted amount may not have any effect on the taxpayer's income tax return(s) until a number of years after the avoidance transaction. Therefore, according to comments made by the Department of Finance, in many cases, these adjustments cannot be made through an immediate assessment or reassessment, and that is the reason why a notice of determination is sent out by the Minister.[414]

[346] These comments are relevant to the present case. It was only on April 2, 2015, that the Minister issued the notice of determination with respect to Wuswig's 2007 taxation year, the year the avoidance transaction was entered into by Wuswig. The reason why it happened in 2015 was not explained to this Court, but it does not seem to be uncommon in these circumstances, based on the technical notes from the Department of Finance referred to above.

[347] In 2015, Wuswig's 2007 taxation year was statute-barred. In application of the GAAR, with the notice of determination, the Minister reduced Wuswig's capital loss carry-forward balance by $4,463,307. The amount represented the capital loss realized by Wuswig from the disposition of its shares of Wuswig Holdings 2007, less the portions of the capital loss used by Wuswig against its capital gains in the 2007, 2010 and 2011 taxation years. The Minister did not deny the portions of the capital loss that were used by Wuswig in the 2007, 2010 and 2011 taxation years, which means Wuswig was allowed to deduct the capital loss realized from the disposition of its shares of Wuswig Holdings 2007 in the 2007 taxation year from the capital gain it realized that year. No tax had to be paid by Wuswig for the 2007 taxation year because of the issuance of the notice.

[348] As previously stated, this Court concludes that, in application of subparagraph 111(1.1)(a)(i) of the ITA, the capital loss realized in a taxation year is always deducted first from the capital gain for that year. Because the 2007, 2010 and 2011 taxation years were statute-barred, pursuant to subsection 152(4) of the ITA, the Minister could not reassess those years. Consequently and pursaunt to subparagraph 111(1.1)(a)(i), the Minister allowed Wuswig to deduct from the capital gain it realized in that year a portion of the capital loss realized in that year from the disposition of its shares of Wuswig Holdings 2007. The Minister then adjusted

[414] Canada, Department of Finance, "Technical Notes – 152(1.11)", 1988.

Wuswig's capital loss balance accordingly, with the issuance of the notice of determination.

[349] Because in 2015, the Minister reduced Wuswig's capital loss carry-forward balance by $4,463,307, the question this Court has to answer is whether the Minister can make an adjustment to a tax attribute if it does not increase the tax, interest or penalties payable under the ITA, after the normal reassessment period in a statute-barred year, more precisely, whether the Minister could reduced Wuswig's capital loss carry-forward balance by $4,463,307.

[350] In *New St James Limited v Minister of National Revenue*, the Exchequer Court of Canada held that loss balances do not become statute-barred until they are carried over and deducted in another taxation year in which tax is payable.[415] The Court concluded that the Minister could reassess a taxpayer's loss balance even after the normal reassessment period.

[351] In *Coastal Construction and Excavating Limited v The Queen*,[416] this Court applied the conclusion of the Court in *New St James* to investment tax credits (ITCs). The Court wrote:

> This interpretation would involve a conclusion that a determination of the balance of a carry-forward of investment tax credits for a statute-barred year was tantamount to an assessment. I do not read section 152 of the *Income Tax Act* as supporting such a conclusion. The Minister is obliged to assess in accordance with the law. If he assesses a prior year incorrectly and that year becomes statute-barred this will prevent his reassessing tax for that year, but it does not prevent his correcting the error in a year that is not statute-barred, even though it involves adjusting carry-forward balances from previous years, whether they be loss carry-forwards or balances of investment tax credits.

[352] More recently, in *Papiers Cascades Cabano Inc v The Queen*,[417] this Court allowed an appeal of an assessment by which the Minister assessed statute-barred taxation years to make adjustments to the taxpayer's ITC carry-forward balances, without modifying its tax payable. The Federal Court of Appeal allowed the appeal and adopted the conclusions of this Court in *Coastal Construction*. The Federal Court of Appeal said the following on the matter:[418]

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[415] *New St James Ltd v Minister of National Revenue,* 66 DTC 5241.
[416] *Coastal Construction and Excavating Limited v The Queen,* 97 DTC 27.
[417] *Papiers Cascades Cabano Inc v The Queen,* 2005 TCC 396.
[418] *Canada v Papiers Cascades Cabano Inc,* 2006 FCA 419 at para 23.

> … for the 1993 to 1995 taxation years, readjusting the qualified or certified property that the respondent claimed does not imply or require or constitute a new assessment of the tax payable for those years in question. The readjustment merely establishes the ITC balance that legally qualifies for a deduction at the end of each taxation year in which the property was acquired. That was the conclusion reached by Mr. Justice Bowman (now Chief Justice) of the Tax Court of Canada in *Coastal Construction and Excavating Limited v. The Queen*, 97 DTC 27. I adopt the following statements that he wrote at page 31:
>
> > Finally, the appellant contends that because the Minister, in prior years, had treated the operation as a "facility" as defined in the RDIA he was not entitled to change the investment tax credit carry-forward from those admittedly statute-barred years to affect the taxable income of a year that was not statute-barred to conform to his view that the property was qualified and not certified. This interpretation would involve a conclusion that a determination of the balance of a carry-forward of investment tax credits for a statute-barred year was tantamount to an assessment. I do not read section 152 of the *Income Tax Act* as supporting such a conclusion. The Minister is obliged to assess in accordance with the law. If he assesses a prior year incorrectly and that year becomes statute-barred this will prevent his reassessing tax for that year, but it does not prevent his correcting the error in a year that is not statute-barred, even though it involves adjusting carry-forward balances from previous years, whether they be loss carry-forwards or balances of investment tax credits. *New St. James Limited v. M.N.R.*, 66 DTC 5241; *Allcann Wood Suppliers Inc. v. The Queen*, 943 DTC 1475. No question of estoppel arises: *Goldstein v. The Queen*, 96 DTC 1029.
>
> [Emphasis added.]

[353] On the same topic, in *Leola Purdy, Sons Ltd v Canada*, this Court made the following comments:[419]

> … We are not dealing with an adjustment request. Nobody is saying that a statute-barred year can be reassessed. The tax the taxpayer has been assessed for the statute-barred year cannot be changed. … But it is valid and binding only for the year assessed. If an error was made in the assessment of the statute-barred year which affects another year, the Minister, in assessing the other year, must follow the *Act* and if there was an error in law in a previous year, including a statute-barred year, that error ought to be corrected so that the assessment for the current year is correct. *New St. James, supra, Coastal Construction, supra* …

[419] *Leola Purdy, Sons Ltd v The Queen*, 2009 TCC 21 at para 28.

[354] Based on these decisions, this Court concludes that the Minister can issue a notice of determination under subsection 152(1.11) of the ITA to adjust a taxpayer's capital loss balance in a statute-barred year. In doing so, the Minister did not assess Wuswig's tax or penalty for the year that was statue-barred. The Minister allowed Wuswig to use the capital losses realized from the series of transactions in 2007. Therefore, the notice of determination did not affect the tax payable for a statute-barred year.

## VII. CONCLUSION

### A. The 2018 Taxation Year

[355] For the reasons set out above, this Court concludes that the avoidance transaction entered into by Wuswig was abusive of subsections 93(2) and 93(2.01) of the ITA, within the meaning of subsection 245(4) of the ITA.

[356] HMTK had the burden of establishing that the avoidance transaction carried out by Wuswig was abusive within the meaning of subsection 245(4) of the ITA. Based on the arguments put forward, this Court concludes that HMTK has demonstrated, following a textual, contextual and purposive analysis of subsections 93(2) and (2.01), that it is reasonable to consider that the avoidance transaction produced a result that these provisions seek to prevent and defeated their underlying rationale.

[357] Consequently, this Court concludes that, for the 2018 taxation year, the Minister correctly denied Wuswig's capital loss carryover of $334,176 from its 2007 taxation year.

### B. The 2007 Taxation Year

[358] Having concluded that Wuswig received a tax benefit from the series of transactions in the 2007 taxation year, that the avoidance transaction is abusive and that the Minister can rely on a notice of determination under subsection 152(1.11) to deny a tax benefit to a statute-barred year, this Court concludes that the Minister can issue a notice of determination under subsection 152(1.11) of the ITA to adjust a taxpayer's capital loss balance in a statute-barred year.

[359] Consequently, this Court concludes that, for the 2007 taxation year, the Minister correctly reduced Wuswig's capital loss balance by $4,463,307.

[360] The appeal is dismissed with costs.

Signed at Ottawa, Canada, this 14th day of October 2025.

"Sylvain Ouimet"

Ouimet J.

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