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Tax Policy Branch
Department of Finance Canada
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Via email GAAR-RGAE@fin.gc.ca

Dear Sir or Madam:

Re: GAAR Consultation – Deloitte's Comments

We are writing to provide our comments on the consultation paper entitled "Modernizing and Strengthening the General-Anti-Avoidance Rule" released on August 9, 2022 (the "GAAR Consultation Paper"). We appreciate the fact that the Government has released a consultation paper to gather feedback on this topic and believe that this affords stakeholders with the opportunity to provide input based on their experience and practical insights. We believe this approach will foster a greater understanding of the issues being addressed and will ultimately help to develop tax policy that will contribute towards a competitive Canadian economy.

Deloitte and its affiliated entities constitute one of the largest professional services firms in Canada. We work with many taxpayers, ranging from individuals and private businesses to Canadian and global multinationals, to advise and support them in their compliance obligations under the Income Tax Act (the "Act").

General observations

The General Anti-Avoidance Rule ("GAAR") is and has been an important part of the Act since its introduction in 1988, and further developed through jurisprudence over many decades. In our experience, taxpayers place a high degree of value on tax certainty – particularly in the context of budgeting economic outflows in relation to business activities and for financial reporting purposes. This requires having tax legislation that is easily interpreted by both taxpayers and the Canada Revenue Agency ("CRA").

While tax certainty and predictability are among primary desires for taxpayers, which in turn contributes to a competitive Canadian economy, these cannot be at the expense of tax fairness. Tax fairness, in our view, should be focused on ensuring that all taxpayers – small and large – have equal access to arranging their affairs within the context of the Act in a predictable manner that is consistent with the policy intent behind the legislation relied on. This is especially important in a self-assessment system where the dispute resolution process can often be protracted.

The concept of tax fairness is not new. The 1987 Tax Reform White Paper, which introduced the GAAR, noted that "[t]he fundamental principle that the tax system should be, and should be seen to be, fair is essential to

the integrity of our self-assessment system."[1] We highlight that the increased complexity through the evolution of the Act, as well as the changing economic paradigm in which business operates, has inherently resulted in a tax system that is perceived by many as unfair. More specifically, the complexity of the tax system has increased as a result of the enactment of successive measures including specific anti-avoidance rules ("SAARs") as well as measures to address commercial, technological, and global developments. The manner in which these measures interact and overlap has contributed to a tax system that is becoming increasingly burdensome for all stakeholders, particularly those with fewer resources. While such complexity may be perceived, in some instances, as providing opportunities to obtain tax benefits, it also makes it much more difficult for all taxpayers to ensure that they have not inadvertently run afoul of particular rules or interactions of rules. A significant, if not central, part of compliance with the Act is now focused on this latter element.

In this light, Deloitte continues to be of the view that a comprehensive review of the Canadian tax system is a crucial next step in the path to having a tax system that is fair to all stakeholders and that has a reasonable cost structure for compliance and administration. A substantial modification to the GAAR without a broader review of the Canadian tax system has the potential to lead to greater inequity rather than less and, as a natural outcome, greater cost of administration.

Observations on the GAAR through the lens of a practitioner

Some of our key observations are:

a) many proposed transactions do not occur because of GAAR concerns;

b) it has taken a number of years for the current framework of the GAAR to evolve to a point where its applicability can be reasonably assessed;

c) findings of clear abuse can be difficult to come by.

As tax practitioners, we regularly engage in discussions with taxpayers on compliance and planning activities – which in many circumstances will entail discussion and analysis in respect of the GAAR. This analysis typically involves input from multiple tax advisors, resulting in a broad lens of perspectives. Rarely have we seen transactions implemented where the GAAR is expected to successfully apply and almost never do we see public corporations engage in transactions where the GAAR is expected to successfully apply. In other words, we see on a first-hand basis, the very real deterrent effect of the GAAR as it currently stands from a perspective that the CRA and the Government would not have, nor could they have, as it is in respect of transactions that never occur. When we couple this perspective with the data reflected in the GAAR Consultation Paper, we suggest that the GAAR, is in fact, a successful tool in deterring abusive tax planning.

While we do acknowledge that the GAAR may not be seen as perfect by both the CRA and the Government, we also submit that it is the fundamental nature of this type of measure; the often-opposing interpretive views of taxpayers and the CRA, and the desire for fairness for all stakeholders, and tax certainty will always be an imperfect balance from the perspective of any particular stakeholder. Changes to the structure of the provision will, in our view, generally result in a tilt of the fairness balance between taxpayers or in favour of

[1] Canada, Department of Finances, *The White Paper: Tax Reform 1987* (Ottawa: Department of Finance, June 18, 1987) at 129 (the "1987 Tax Reform White Paper").

the Government. Given that this balance was carefully considered and debated with the introduction of the GAAR, we suggest that significant caution should be exercised in making changes given the potential for perceived erosion of fairness and competitiveness, economic disruption, and increased disputes. It does not appear to us that the original considerations that gave rise to the introduction of the GAAR have materially changed.

In the first few years after the introduction of the GAAR, there was considerable uncertainty in terms of its application. It was not until the Supreme Court's decision in *Canada Trustco*[2] that the tax community had reasonable guidance in terms of the interpretation and application of the GAAR. The jurisprudence has since provided necessary refinements and we are now at a point where the application of the GAAR can be reasonably assessed by all stakeholders. In our view, any changes to the GAAR at this stage should be minimal and iterative, in order to build upon the current body of case law, rather than render it relatively meaningless. Introducing significant change to the structure of the GAAR at this juncture could very well have the effect of putting all stakeholders back in a position where it becomes more difficult to reasonably predict the tax outcomes of transactions and will likely increase the number of disputes and related cost for all stakeholders.

Much of the focus in an analysis as to the applicability of the GAAR is with respect to potential misuse or abuse and trying to determine the object, spirit and purpose of the relevant provisions relied upon. Here, we acknowledge that it can be challenging to make a clear case for abuse (the standard that has arisen in relevant jurisprudence) when assessing the application of subsection 245(4) of the Act. Equally, it can be challenging to proactively prove the opposite. Putting this in context, shifting the burden of persuasion to the taxpayer as to whether there is any misuse or abuse is not reasonable in the current paradigm as taxpayers would be faced with having to prove a negative (i.e., that there is no misuse or abuse) all within a context in which there is typically little guidance as to the types of outcomes that provisions of the Act are intended not to permit.

In our experience, notwithstanding the fact that explanatory notes are not enacted or specifically approved by Parliament, written comments from the Department of Finance are helpful at informing the interpretation of a provision, particularly when combined with broader policy statements in documents tabled in Parliament, such as the Federal Budget, from which links can naturally be drawn.

We would welcome preambles and purpose statements embedded in legislation at the time of its enactment by Parliament. We would also welcome more guidance from Parliament or the Department of Finance, or both, as to what is the purpose of particular provisions as well as general guidance as to what those provisions are intended not to provide for. In addition, adding purpose statements in the context of a SAAR would help enhance its effectiveness, make this effectively a one-step "purpose" test, and perhaps reduce the need for reliance on the GAAR. In the less likely event of the application of the GAAR, such statements would greatly contribute to the fairness of imposing a burden on the taxpayer (should this be pursued, as also discussed in the GAAR Consultation Paper) to persuade the court that there is no misuse or abuse. For greater certainty, we would caution against the adoption of retrospective preambles and purpose statements in existing legislation in the absence of a more comprehensive review of the Canadian tax system.

Economic substance

Our comments are predicated on the stated intention in the GAAR Consultation Paper to "add an explicit economic substance rule to the GAAR, so that it applies more appropriately."

[2] *Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54.

Difficulty in defining economic substance

As the GAAR Consultation Paper notes, economic substance is difficult to define and any one definition may not adequately account for particular commercial reasons that may drive a particular transaction (or series of transactions as the case may be) nor may a static definition be appropriate in what is a dynamic local and global environment. The concern here being that any notion of economic substance should be broad enough such that transactions executed primarily for non-tax reasons are not automatically deemed avoidance transactions because of a definitional gap. At a minimum, caution must be applied here.

Our observations are that predictable tax results contribute to Canada's attractiveness to investors – domestic and foreign. In our view, the Canadian tax system's reliance on the clear and predictable concept of legal substance rather than a potentially unpredictable notion of economic substance has contributed favourably to a reputation as a reliable and predictable jurisdiction.

Given the complexity of the tax system noted previously, it is common for taxpayers to undertake very specific form-driven legal steps to ensure that they do not inadvertently undertake a transaction which would give rise to an inappropriate application of a SAAR while genuinely seeking to respect the underlying object, spirit, and purpose of relevant provisions. One such example is the common practice of transferring cash between entities to ensure that commercially required debt instruments are characterized as loans, advances, and/or borrowed money, such that conditions precedent for the deductibility of interest, or exemptions from imputed interest income under subsection 17(8) of the Act are met. In such situations, it would often be easier and/or simpler for taxpayers to issue new promissory notes, without transferring cash between entities. An inappropriate application of an economic substance rule in such circumstances could cause taxpayers, investors, and/or tax authorities to question whether the transferring of cash actually achieves the desired outcome of ensuring compliance with the relevant provisions of the Act, notwithstanding that such provisions deliberately make a distinction between borrowed money and amounts payable. In summary, this is just one example of a situation in which the certainty and fairness historically achieved through longstanding reliance on legal form within the Canadian tax system could be eliminated through the introduction of an overly broad or vague concept of economic substance.

The introduction of an economic substance rule could limit even the most sophisticated taxpayers' ability to appropriately navigate the provisions of the Act, and in particular, the various SAARs, let alone that of taxpayers with fewer resources. It is well known that there is no principle of equity in the application of the Act. Thus, an economic substance component could place a greater burden on legislators and members of Parliament to correct inequities by enacting more specific and detailed remedial provisions to mitigate the undue application of specific anti-avoidance rules beyond their intended scope. This, in turn, would only further increase the complexity and cost of the tax system.

Integration of an explicit economic substance component into the GAAR

To the extent that the Government intends on introducing an explicit economic substance component, our suggestion is that it would be less disruptive to build on the existing GAAR framework at the initial gateway (i.e., avoidance transaction). If economic substance were to be moved to the misuse or abuse portion of the provision, it would have the potential to significantly increase uncertainty given the broader impacts through the statute, as well as negate an important body of jurisprudence. Moreover, it could, as indicated in the

GAAR Consultation Paper, negatively impact transactions that are generally acceptable from a tax policy perspective but that nevertheless do not have economic substance.

Our submission should not be taken as saying that economic substance is an irrelevant consideration. Rather, our suggestion is that incorporating it into what is essentially the final interpretative assessment point in the statute (being the GAAR) has the potential to substantively transform one of the most important precepts of the interpretation of the Act and negate the benefit of an established body of jurisprudence.

Introducing this type of change could be so fundamental that it would, in our view, only be appropriate in the context of comprehensive tax reform – something that we have long advocated. Clear guidance, regularly updated, would be required for such a regime to maintain predictability. As we discuss below, further highlighting potentially abusive transactions through other mechanisms, is likely more practical.

Accordingly, we do not believe it would be appropriate to incorporate economic substance as part of the misuse or abuse analysis given the potential for far-reaching substantive impacts, as well as the potential to capture transactions that are not offensive from a tax policy point of view. It should only be emphasized in a very measured way. If introduced as part of the misuse or abuse test, this may contribute to a lack of fairness for less sophisticated taxpayers. More specifically, evaluating the potential ways in which a series of transactions might be recharacterized on the basis of economic substance would be a highly costly exercise. Planning and dispute resolution in this regard would require reliance on experts, including economists, much like in the transfer pricing realm. Less sophisticated taxpayers would be ill-equipped to undertake such analyses, notwithstanding that such analyses would continue to be required in order to rely on the tax effect of transactions that are not inherently abusive.

Arguably, economic substance (which can be viewed as a subset of commercial purpose), is already built into the avoidance transaction definition. To place more emphasis on it would allow for flexibility for assessing a transaction's tax elements relative to broader commercial purposes, which can evolve during different economic and business cycles. Such emphasis may, in our view, refine the avoidance transaction definition, while retaining its primary role of an economic gateway, as articulated in the main text of the 1987 Tax Reform White Paper.

> For the purposes of the new rule, an avoidance transaction will be defined in a way that introduces a statutory business purpose test and a statutory concept of step transaction into Canadian tax law.[3]

The concept was further elaborated in the draft explanatory notes in the same paper:

> Proposed subsection 245(2) defines an avoidance transaction on an inclusive basis. It is expected that whether or not a particular transaction is an avoidance transaction will be determined on the basis of many factors, including the particular transaction, its form and substance and the expressed intent of the relevant provisions of the Act, but the definition is intended to differentiate between artificial tax avoidance transactions and legitimate commercial and family transactions.[4]

Commercial purposes evolve over time and are fundamentally derived from a dynamic economic environment. As such, we are of the view that economic substance should be a subjective and objective test

[3] Supra, note 1, at 130.
[4] Supra, note 1, Annex I, at 138.

based on the relevant facts and circumstances. As we have said previously, we do not believe that a static prescriptive definition would keep pace with such an environment.

Here, we pause to note that foreign tax purposes are often a dominant purpose of taxpayers with obligations in multiple jurisdictions for entering into transactions. If foreign tax consequences are eliminated from the determination of an avoidance transaction, the concept of the economic gateway is significantly weakened, as transactions that do not have tax benefits as their primary motive would effectively be deemed avoidance transactions. Where Canadian tax benefits are a significant or primary consideration, notwithstanding the existence of a foreign tax consideration, in our experience the existing definition of "avoidance transaction" should suffice. As such, the appropriate area of focus should be in assessing primacy of purpose as opposed to an automatic exclusion of foreign tax purposes as relevant considerations when assessing an avoidance transaction.

Burden of persuasion: misuse or abuse

One of the more complex procedural aspects of the resolution of GAAR disputes in the Tax Court is the scope of discovery by taxpayers of the inner machinations within branches of the Government that could be relevant to the GAAR dispute. This extends to disputes over obtaining CRA GAAR Committee documents and any other relevant internal communications or materials that were considered in issuing the disputed reassessment.[5]

In our view, the reversal of the burden with respect to the misuse or abuse test is likely to lead to a higher volume of procedural disputes in the context of discovery in GAAR appeals. If the taxpayer has a case to meet that is largely based on information that is peculiarly within the knowledge or control of the Government, including the Department of Finance, the taxpayer will have to assert the right to obtain such information and, perhaps, argue the need for an expansion of what can currently be sought in the context of discovery in order to be able to establish the object, spirit and purpose of the operative (or avoided) provisions of the Act. As a matter of procedural fairness and based on current case law, it is possible that the Tax Court would be receptive to these arguments.

We would also submit that while, in theory, the reversal of the burden with respect to misuse or abuse would appear neutral as to the nature of what must be shown to a court, it could, in practical effect, lessen that burden. One way this could happen is that taxpayers will likely argue in favour of (and courts may feel compelled to afford) more significant meaning to the Supreme Court's statement in *Canada Trustco* to the effect that "the abusive nature of the transaction must be clear,"[6] by requiring that taxpayers merely persuade the court of a threshold lack of clarity in order to prevail in GAAR appeals.

Accordingly, it appears to us that the reversal of the burden with respect to misuse or abuse may give rise to material unforeseen consequences that have the real potential of increasing the time and financial investments required by all parties to resolve tax disputes.

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[5] See, for example, the Tax Court's recent decision in *Coopers Park Real Estate Development Corporation v. The Queen*, 2022 TCC 82.
[6] Supra, note 2, at para. 62.

Penalties and other deterrents

We acknowledge the CRA's concern with situations where taxpayers undertake transactions similar to those to which the courts have applied the GAAR. We submit that the appropriate framework in which to address these situations is not the GAAR itself, but rather, the proposed notifiable transactions framework. Under the latter framework, one could easily envisage how the failure to notify the CRA of the implementation of transactions that are substantively similar to those to which the courts have applied the GAAR could be penalized and not subject to the normal reassessment period. We would also expect that, coupled with the sustained investments in the CRA's audit capabilities, the notifiable transactions framework, more generally, will provide earlier insight into potentially abusive structures. This, in turn, could inform additions to the list of notifiable transactions.

In our experience, the majority of taxpayers value tax certainty, and many are regularly under audit as part of ongoing CRA programs such as *Large Case Files* or through the *Related Party Initiative*. The existing audit functions, combined with the proposed notifiable transactions framework, has the potential to implement rules that would provide additional deterrents for abusive tax planning without the need for an express financial penalty – which could inappropriately apply to transactions that lack economic substance but that are acceptable (or even encouraged) from a tax policy point of view.

Where taxpayers deliberately undertake transactions to which the courts have previously confirmed the GAAR applies, we would not be opposed to the imposition of financial penalties. However, in addition to suggesting that this would be most usefully achieved under a construct similar to the notifiable transactions framework, we would also caution that this should be limited to situations in which a court has made a final determination as to the applicability of the GAAR. Financial penalties should not be imposed simply because the CRA has an untested view that a transaction is egregious or subject to the GAAR, as such an approach would essentially vest this determination in the executive, rather than Parliament or the judiciary. While the question of whether or not a transaction is substantively similar to one that was subject to the GAAR could remain a question in respect of which tax authorities and taxpayers may have differing views, a construct similar to the proposed notifiable transactions framework would appear ideally suited to precisely defining the scope of transactions to which financial penalties ought to apply.

Conclusion

The GAAR has been an effective deterrent in our experience. The effectiveness of this tool has been enhanced through the willingness of the Government to make ongoing changes to tax legislation, while providing increased resources to the CRA to enable them to fulfil their administrative responsibilities. Some of these developments, such as the enactment of the rules concerning notifiable transactions, have not yet been enacted, and thus, it would be premature in our view to dismiss their effectiveness at deterring the behaviour which has been highlighted in the GAAR Consultation Paper as a concern for the Government. We do not think that the factors taken into account with the implementation of the GAAR in 1988 have changed today – rules of this type will always be a balance of action and reaction by taxpayers and the Government.

To modernize the GAAR, outside of a comprehensive review of the tax system, we suggest minimal, iterative changes, so as not to significantly disrupt the current system. That said, we would welcome a comprehensive review of Canada's tax system given that the last time this took place was in 1966 with the Carter Commission and given that the economic paradigm in Canada and globally has materially changed since then.

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We hope that our specific comments are helpful in your consideration of the evolution of the GAAR and its role within the Act. We would be pleased to meet with you or other officials to discuss our submission. Deloitte is committed to making a significant contribution to help shape Canada's tax policy and its application to the future of our country.

Yours very truly,

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