Retroactivity and the General Anti-Avoidance Rule

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A. INTRODUCTION

The general anti-avoidance rule (GAAR) appears in section 245 of the Income Tax Act (ITA). The GAAR was introduced in 1988. Motivating its introduction was the concern expressed by the Department of Finance before its debut that “the existing provisions of the Income Tax Act are inadequate to deal with a number of blatant tax avoidance arrangements.” The GAAR remedies this inadequacy, at least theoretically, by providing a ready-made generic statutory basis for denying a “tax benefit” associated with an “avoidance transaction,” provided the avoidance transaction sat-
sifies the threshold limitation—the statutory text of which has been recently amended—of being a “misuse” or “abuse” of the ITA, the Income Tax Regulations, the Income Tax Application Rules, a tax treaty, or any other enactment relevant to determining tax liability. As the “misuse” or “abuse” limitation makes clear, the GAAR is intended to interfere only with abusive tax avoidance and not legitimate tax planning, which is consistent with the Department of Finance’s original concern with “blatant tax avoidance arrangements.”

The statutory text of subsection 245(4), the basis of the “misuse” or “abuse” limitation on the denial of a tax benefit associated with an avoidance transaction, remained unchanged from the time the GAAR first took effect—on 12 September 1988—until it was amended by the Budget Implementation Act, 2004, No. 2 (BIA).

The BIA received royal assent on 13 May 2005. Subsection 55(5) of the BIA provided that the amended language of subsection 245(4) applies “with respect to transactions entered into after September 12, 1988.” Because the amendment to 245(4) was made by Parliament to apply retroactively to all transactions since the GAAR was introduced, it is arguable that the old language of subsection 245(4) is now entirely without purchase. This paper addresses some of the legal and normative considerations relating to the sixteen-year retroactive effect of the amended version of subsection 245(4).

The manner in which the Supreme Court of Canada dealt with the retroactivity issue in Canada Trustco Mortgage Co. v. Canada is provocative. Despite the express provision for the retroactive effect of the new subsection 245(4) to transactions occurring after 12 September 1988, the Court

(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.

5 See Canada, Department of Finance, Tax Reform 1987, above note 2. See also, Peter Hogg, Joanne Magee & Jinyan Li, Principles of Canadian Income Tax, 5th ed. (Toronto: Thomson Carswell, 2005) at 599, who remark in a section entitled, “Identifying ‘Bad’ Avoidance” that “[t]he idea seems to be to exclude from GAAR those transactions that are in accordance with the object and spirit of the scheme of the Act.”

6 SC 2005, c. 19, s. 52.

7 Canada Trustco Mortgage Co. v. Canada, 2005 SCC 54.
in *Canada Trustco* rejected the idea that the amended language of 245(4) could apply to the transaction at issue in the appeal. At paragraph 7 of *Canada Trustco*, McLachlin C.J. and Major J. remarked:

A recent amendment to s. 245 ... has no application to the judgments under appeal. Although this amendment was enacted to apply retroactively, it cannot apply at this stage of appellate review, after the parties argued their cases and the Tax Court judge rendered his decision on the basis of the GAAR as it read prior to the amendment. Furthermore, even if this amendment were to apply, it would not warrant a different approach to the issues on appeal. In our view, this amendment to s. 245 serves *inter alia* to make it clear that the GAAR applies to tax benefits conferred by Regulations enacted under the *Income Tax Act*.

In disposing of the amendment issue, the Court made two central claims. The first was that the new language of subsection 245(4) “cannot apply” to the appeal on the basis that the trial judgment had been rendered and the appellate review process had reached too advanced a stage. This is contestable. The Court did not expressly rely on any legal authority or provide reasoning to support its conclusion, despite the conflicting views at various courts of appeal,9 and the strong arguments that could be marshalled for the position the Court adopted based on philosophical conceptions of the rule of law,9 and against the position the Court adopted based upon the Diceyan notion of Parliamentary supremacy.9 The second claim, that even if the amendment were to apply, it would not occasion a “different approach” to resolving the case, is also contestable. The assertion that there would not be a “different approach” under the revised “misuse” or “abuse” subsection can

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8 See the discussion in section B below.


10 Albert Venn Dicey wrote, “Parliament has, under the English constitution, the right to make any law whatever, and further, no person or body is recognised by the law of England as having a right to override or set aside the legislation of Parliament.” See Albert Venn Dicey, *Introduction to the Study of the Law of the Constitution*, 10th ed. (London: Macmillan, 1959) at 70.
be undermined on the basis that the new language substantially reduces
the burden on the minister to demonstrate a "misuse" or "abuse."\textsuperscript{11}

This paper seeks primarily to take up the first of these issues.\textsuperscript{12} To this
end, it proceeds in three stages. Section B sets out an account of the relevant
law surrounding the effectiveness and applicability of retroactive legislation
in Canada, outlining the general presumption against retroactive legislation
and addressing how express terms can override this presumption in many
(but not all) contexts. Particular attention is paid to how Canadian courts
have approached the application of retroactive enactments to pending pro-
ceedings. Section C uses this background to evaluate the Court's handling
of the amendment of subsection 245(4) in \textit{Canada Trustco}. Section D draws
on the tax policy literature in offering some thoughts on retroactivity and
the GAAR more generally. Section E concludes.

\section*{B. STATUTORY RETROACTIVITY IN CANADIAN LAW}

Generally speaking, legislation is effective immediately upon coming into
force and remains so until repealed. This idea is referred to by one leading
treatise on statutory interpretation as the principle of "simulactivity" or "si-
multaneous effect."\textsuperscript{13} Subsection 5(2) of the federal \textit{Interpretation Act}
provides that if legislation is silent as to when it comes into force, it is deemed
to come into force with prospective application on the date it receives royal
assent;\textsuperscript{14} provincial \textit{Interpretation Acts} contain similar provisions.\textsuperscript{15}

There is a long-standing presumption in Canadian law that legislation
does not have retroactive effect unless this is made explicit in the enactment
or is a necessary implication of the language used.\textsuperscript{16} Several of the decisions
affirming the presumption of non-retroactivity have been tax cases.\textsuperscript{17} A suc-

\begin{enumerate}
\item See Chapter 1 in this text by David Duff, "The Supreme Court and the General Anti-
Avoidance Rule: \textit{Canada Trustco} and Mathew."
\item The second issue has been discussed in depth elsewhere. See Duff, \textit{ibid.}
\item See Pierre-André Côté, \textit{The Interpretation of Legislation in Canada} (Toronto: Carswell,
2000) at 124. Ruth Sullivan does not use either of these terms, but the account of the
relevant principles is equivalent: see Ruth Sullivan, \textit{Sullivan and Driedger on the Con-
\item See Sullivan, \textit{ibid.}
\item \textit{Ibid.}
\item See \textit{Upper Canada College v. Smith} (1920), 61 SCR 413 at 419.
\item See, for example, \textit{Anderson Logging Co. v. The King}, [1925] SCR 45; \textit{M.N.R. v. Molson},
\end{enumerate}
cinct expression of the presumption against retroactive effect appeared in the Supreme Court of Canada's 1977 decision in *Gustavson Drilling (1964) Ltd. v. M.N.R.*. Dickson J. (as he then was) wrote for a 3–2 majority of the Supreme Court of Canada:

The general rule is that statutes are not to be construed as having retrospective operation unless such a construction is expressly or by necessary implication required by the language of the Act. An amending enactment may provide that it shall be deemed to have come into force on a date prior to its enactment or it may provide that it is to be operative with respect to transactions occurring prior to its enactment. In those instances the statute operates retrospectively.

The Supreme Court has subsequently quoted this passage with approval in a number of its more recent decisions.

The general presumption against retroactivity is not unique to Canadian law. Legal scholars have traced the presumption back through treaties of English law to Roman law, where it apparently appeared in several provisions of the *Corpus Juris Civilis*. Some scholars have claimed that from its original appearance in Roman law the presumption has made its way into all contemporary Western legal systems, though the strength of this claim is perhaps questionable given the intuitive attractiveness of the idea that the legal consequences associated with past conduct should not be alterable *ex post facto*.

Consistent with this intuitive attractiveness, there is indeed strong justification for a presumption of non-retroactivity. Legal theorists, Joseph Raz and Lon Fuller among them, have made qualities such as prospectivity, knowability, openness, and clarity the central hallmarks of theories of the rule of law. If the current law cannot be relied upon because future amendments can retroactively affect what the governing law is deemed to

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19 Ibid. at 279.
22 Ibid.
23 The suggestion is that a rule that makes intuitive sense is more likely to have arisen spontaneously in various legal systems without necessarily relying on earlier traditions.
24 See Raz and Fuller, above note 9.
have been at any given time in the past, then logically there cannot ever be conclusive compliance with the law. At any moment in the future the law deemed to have been governing now or in the past can be changed, and it is thus impossible to safeguard current or past action from retroactive declarations of illegality and, therefore, impositions of liability. In this regard, in a late nineteenth-century treatise on retroactive laws, William Pratt Wade remarked colourfully:

In all retroactive laws there must be an element of surprise, by which persons whose rights are affected are taken unawares. They are called upon to act in a manner different from what they had been led by the settled state of the law to anticipate. So repugnant is such a system of legislation to our natural sense of justice, that it has been stigmatized as more unreasonable than that adopted by Caligula, who was said to have written his laws in a very small character and hung them upon high pillars, the more effectually to ensnare the people.25

This intuition of the injustice of retroactive laws has been developed and discussed at considerable length in the legal literature, particularly in the United States,26 and to a lesser extent in Australia,27 the United Kingdom,28 and Canada29 as well.

The presumption that changes to the law will not apply retroactively is so important in some contexts — such as criminal law, where the liberty interests of individuals are at stake — that it has been specifically elevated to a constitutional principle. For example, paragraph 11(g) of the Charter

of Rights and Freedoms provides the right, "not to be found guilty on account of any act or omission unless, at the time of the act or omission, it constituted an offence under Canadian or international law or was criminal according to the general principles of law recognized by the community of nations." It is also arguable that any enactment which through retroactive application would threaten "life, liberty, or security of the person" would run afoul of section 7 of the Charter, an implicit assumption being that giving retroactive effect to such a law would not be in accordance with the principles of fundamental justice.

Nevertheless, where the stakes have been perceived to be lower (that is, where liberty interests are not in play) Canadian courts have on many occasions espoused the view that Parliamentary supremacy carries with it the power for Parliament (or a provincial legislature within its jurisdiction) to change the law with retroactive effect. For example, in Air Canada v. British Columbia, the Supreme Court of Canada considered the ability of a province to establish a retroactive excise tax on the sale of gasoline. La Forest J. held for a majority of the Court that:

None of the judges in the courts below casts any doubt on the legislative power of the province to impose a retroactive tax. ... In common with these judges, I am unable to see any constitutional impediment ... these provisions seem to be a proper exercise of its power to impose direct taxation in the province, the sole difference being that the 1981 provisions are given retroactive effect, a result that is not constitutionally barred.

And as recently as September 2005, in British Columbia v. Imperial Tobacco Canada Ltd., Major J. affirmed this approach in stating at paragraph 69 for a unanimous Supreme Court of Canada: "Except for criminal law, the retrospectivity and retroactivity of which is limited by s. 11(g) of the Char-

30 Schedule B to the Canada Act 1982 (U.K.) 1982, c. 11.
31 See Côté, Interpretation of Legislation, above note 13 at 140–42; and Sullivan, Sullivan and Driedger, above note 13 at 542–43.
32 See the discussion in Loomer, "Taxing Out of Time," above note 9.
33 The term "Parliament," when used below, should be understood as also encompassing provincial legislatures as appropriate.
35 ibid. at para. 51.
36 British Columbia v. Imperial Tobacco Canada Ltd, 2005 SCC 49.
ter, there is no requirement of legislative prospectivity embodied in the rule of law or in any provision of our Constitution.\textsuperscript{37}

Thus, from a legal perspective it is clear that absent specific constitutional objections relating primarily to the protection of liberty interests, so long as Parliament is direct and the enactment unambiguous, the doctrine of parliamentary supremacy supports the ability to give any particular enactment retroactive effect. This power is particularly clear in the context of taxation, since the imposition of tax liability will rarely engage constitutional protections under section 7 or paragraph 11(g) of the Charter.\textsuperscript{38}

A thornier issue surrounds precisely how the courts have approached amendments to legislation made applicable retroactively that do not involve questions of liberty and in which Parliament has expressed its intention clearly. In a passage that hints at the difficulty of the issues implicated, Ruth Sullivan writes:

The law governing the temporal application of legislation is notoriously difficult. There are several reasons for this. The problems addressed by transitional law are inherently complex and the general rules devised by the courts and legislatures to deal with these problems are often inadequate. There is a vast case law dealing with the temporal application of legislation and no shortage of academic commentary. Unfortunately, this body of material is confusing and often inconsistent. The fact is that transitional law lacks a coherent, well-established framework for analysis.\textsuperscript{39}

\textsuperscript{37} Ibid. See also Cusson v. Robidoux, [1977] 1 SCR 650 at 655.

\textsuperscript{38} In fact, property rights were deliberately not singled out for protection in the Charter, and subsequent attempts to establish constitutional protection of property rights have failed. See, for example, Patrick Monahan, Constitutional Law, 3d ed. (Toronto: Irwin Law, 2006). Monahan states in Chapter 13, note 33:

Both the U.S. Bill of Rights and the 1960 Canadian Bill of Rights ... had included protection for property rights, but a proposal to include a similar guarantee in s.7 was not proceeded with by the Trudeau government at the time of the Charter’s enactment. ... In the 1980s, the N.B. and Ont. legislative assemblies supported the addition of property rights to the Charter, as did the House of Commons in 1988. The federal government proposed to add protection for property rights to the Charter, as part of a package of comprehensive proposals to amend the Constitution. ... However, the Parliamentary Committee that held hearings and sponsored a series of conferences on the government proposal heard a great deal of opposition to the proposal. ... Ultimately, the proposal to include property rights in the Charter did not find its way into the Charlottetown Accord [references with the quoted text omitted].

\textsuperscript{39} Sullivan, Sullivan and Driedger, above note 15 at 543.
To see this difficulty in the context of legislation that has been amended with retroactive application, consider the two polar cases in which the legislation will apply. At one extreme is a fact situation that has not yet materialized. In a case in which an enactment that is incidentally retroactive is being applied prospectively, the fact that it may also have retroactive application with respect to some other cases of course poses no issue whatsoever—it applies just as would any prospective enactment. At the other extreme, however, are cases where a retroactive enactment purports to affect the law applying to facts that not only have already occurred, but have already been fully adjudicated. In these cases one might legitimately question whether the retroactive enactment could, should, or would somehow ‘undo’ what would be otherwise indisputable claims of res judicata.\footnote{A detailed treatment of res judicata is beyond the scope of this article. See generally Donald J. Lange, The Doctrine of Res Judicata in Canada, 2d ed. (Toronto: Butterworths, 2004).} 

At common law (and at civil law—Article 2848 of the Civil Code of Quebec establishes a similar principle),\footnote{See, for example, Boucher v. Stelco Inc., 2005 SCC 64 at para. 32.} the doctrine of res judicata (translated from Latin: “a thing adjudged”) precludes retrying of a claim or issue that has already been adjudicated by a competent court or tribunal.\footnote{See, for example, Zadvorny v. Saskatchewan Government Insurance (1985), 38 Sask. R. 59 (CA) at 62, Cameron J.: To change a law of general application, retroactively, is one thing; to legislate the extinguishment of a judgment is another. To satisfy us that the Legislature intended to deprive the respondent of his judgment—and Mrs. Payne of hers, since counsel for the appellant conceded that her position was no different than this man’s—would take the clearest of language. We are not saying the power to legislate a plaintiff out of the fruits of a successful suit does not exist (that was not argued before us) but we are saying, with the greatest of respect, that the Legislature cannot be taken to have done so in this case, involving this man, and his $37,000 recovery. If the Legislature had intended to do that, we are quite confident it would have used more express language than what appears in the general amending enactment in issue.} Ordinarily, the doctrine of res judicata has been found to protect judgments in cases that have already been fully adjudicated in the absence of perfectly clear parliamentary intention to the contrary.

This is consistent with the observation that Canadian courts have typically held that just as there is a presumption against retroactivity, there is also a presumption of minimal retroactivity. That is, even where an amendment is expressly stated to be applicable retroactively, the courts have on
many occasions resisted retroactive application through the use of strict construction. In *Kent v. The King*, Duff J. (as he then was) stated,

[W]here an enactment, admittedly retrospective, is expressed in language which leaves the scope of it open to doubt, and according to one construction it imposes retrospectively a new liability, while upon another at least equally admissible, it imposes no such burden, the latter construction is that which ought to be preferred.

In making this statement, Duff J. was relying on an earlier English case, *Reid v. Reid*, in which it was held, "That is a necessary and logical corollary of the general proposition, that you ought not to give a larger retrospective 'operation' to a section, even in an Act which is to some extent intended to be retrospective, than you can plainly see the legislature meant." In his treatise on statutory interpretation, Pierre-André Côté remarks, "The general principle calls for restrictive interpretation of retroactive legislation. When in doubt, the meaning which most limits a statute's retroactive effect should be preferred." A particularly difficult circumstance arises when a legislative enactment is amended with clearly expressed retroactive effect after the relevant events with which the law is concerned have occurred, but before proceedings to determine the legal consequences of the relevant events have been dispositively determined (that is, before res judicata would unambiguously apply to shield the litigants in the absence of clear statutory language). One of the leading judgments in this regard is the decision of the British Columbia Court of Appeal in *Hornby Island Trust Committee v. Stormwell*.

In *Hornby* the British Columbia Court of Appeal considered the validity of a municipal zoning by-law which at trial was held to be invalid because the municipality did not publish a synopsis of the by-law as required by section 769 of the *Municipal Act*. In the interim between the trial judgment and the appeal, the legislature attempted to reverse this result by amending section 769 of the *Municipal Act*, adding subsection 769(3). Subsection 769(3) provided: "A bylaw ... made before this section came into force that is

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43 See, for example, *Dwyer v. Town of Port Arthur* (1893), 22 SCR 241; *Schmidt and Froese v. Ritz and Widmeyer* (1901), 31 SCR 602.
45 Ibid. at 397.
46 *Reid v. Reid* (1886), 31 Ch.D. 402.
invalid by reason only that it did not comply with section 769 of this Act ... is conclusively deemed to have been validly made at the time it was made."

Lambert J.A. (Hutcheon J.A. concurring, MacDonald J.A. delivered separate reasons) refused to apply the new subsection 769(3), explaining that:

But even if a retroactive construction were to be given to the new s.s. 769(3), it is my opinion that such a construction should not be applied to change the outcome of a lawsuit that had reached the stage of an entered judgment before the legislation was enacted, unless the legislature has specifically required such an application.

In this case the pleadings were prepared, the evidence was led, the trial was conducted, and the judgment was rendered, before the enactment of the statute. Once the trial judgment was given, the issue between the parties could not be opened up in new litigation. It was res judicata. The matter had been contested on the basis of the law as it stood at all the relevant times. In that contest the defendants may have declined to advance defences that seemed to them to be unnecessary, on the basis of the law as it then stood. The defendants do not have a chance to resurrect those defences on the appeal if a change in the law has made it necessary for them to rely on the defences. They cannot do so because those defences were not pleaded at trial, and no evidence was led with respect to them.

Lambert J.A. went on to explain that although some cases will call for a new trial where the law has been amended retroactively in the interim period between a trial judgment being rendered and an appellate review process being concluded, Hornby was not one of them. This comment begs the question — when will it be appropriate for an appellate court to call for a new trial in the wake of newly introduced retroactive legislation?

Lambert J.A. does not offer a conclusive answer. On the facts of Hornby he determined that the case should not be remanded for a new trial on the basis that subsection 769(3) did not clearly wrest away the property rights that had vested as a result of the declaration of the trial judgment. In his opinion, retroactive legislation would have to make extremely clear its intention to disturb decided cases on account of the common law presumption against the retroactive interference with “vested rights.” In support of this conclusion, Lambert J.A. quoted from the judgment of Duff C.J. in Minchau v. Busse:49

The statute is expressly declared to apply to mortgages made before or after the passing of it, but it is not in express terms made applicable to pending proceedings and, in my opinion, that is not the effect of it; it does not in terms declare the law to be applied in proceedings commenced prior to the passing of it. In this view of the statute we are governed in pronouncing judgment by the law as it stood when the Court of Appeal gave their judgment, by which the Court of Appeal itself was governed.

Following this statement in Minchau v. Busse, conveniently not mentioned by Lambert J.A., Duff C.J. cited the decision of the Supreme Court of Canada in Boulevard Heights v. Veilleux.\(^{50}\) In this earlier case, Duff J. (as he then was) refused to consider amendments to the relevant legislation that had been enacted in the period after the Alberta Court of Appeal had rendered its judgment. He explained:

There can be no doubt, I think, that if these amendments had been enacted before the hearing of the appeal by the Appellate Division of Alberta, that Court would have been governed by them in the disposition of the appeal. ... The question we have to consider is another question. ... In my judgment, the appeal to this Court is an appeal strictly so called, not an appeal by way of re-hearing. The **Supreme Court Act** (sec. 51) expressly declares that this Court should give the judgment which ought to have been given by the Court below, and there are no words corresponding to those of ... the **Judicature Rules**, which enable the Court of Appeal to "make any further or other order as the case may require." Speaking generally ... it is the duty of this Court to give the judgment which the Court below ought to have given according to the state of the law on which it was the duty of that Court to base its judgment.

In light of the chain of reasoning, it is interesting to observe that the **Supreme Court Act**\(^ {51}\) no longer restricts the Supreme Court of Canada to give the judgment "which ought to have been given by the court below." Instead, the Court has broad discretion in exercising a variety of powers. For example, sections 46 and 46.1 provide:

46. On any appeal, the Court may, in its discretion, order a new trial if the ends of justice seem to require it, although a new trial is deemed necessary on the ground that the verdict is against the weight of evidence.

\(^{50}\) (1915), 26 DLR 333 (SCC).
The Court may, in its discretion, remand any appeal or any part of an appeal to the court appealed from or the court of original jurisdiction and order any further proceedings that would be just in the circumstances.

If the Court had these powers in 1915, based on his judgment, it seems likely that Duff J. in Boulevard Heights would have not have decided the case the same way. Instead, he probably would have (i) decided the appeal on the basis of the new amendments; (ii) remanded the case to the Alberta Court of Appeal; or (iii) ordered a new trial.

It might stand to reason that if Boulevard Heights had been decided differently, then so too would have Minchau v. Busse. And, so it would follow, Lambert J.A. would have had considerably less support for his conclusion that the legislature could not be taken to have interfered with vested rights in the absence of clear language to that effect. On the other hand, it is important to recognize that twenty-five years had passed between Duff J.'s judgment in Boulevard Heights and his judgment as Chief Justice in Minchau v. Busse. Duff C.J.'s reasoning also changed, even though he cited the Boulevard Heights decision in Minchau v. Busse. While the conclusion in Boulevard Heights turned on the idea that the Alberta Court of Appeal did not strictly speaking err (since the amendments to the legislation had not yet been made), the reasoning in Minchau v. Busse is based on the idea that in order to affect the outcome of pending proceedings, retroactive legislation must by its terms make clear that it intends to do so.

Following Hornby, a number of cases have addressed the issue of retroactivity and pending litigation. In C.I. Mutual Funds Inc. v. Canada, the retroactive application of an amendment to the Excise Tax Act was at issue. Linden J.A. of the Federal Court of Appeal approved the reasoning of Rip T.C.J., who at the Tax Court of Canada in the same case had held:

[There are ample authorities which stand for the proposition that the legislator need not refer specifically to pending actions in order for retroactive legislation to affect the rights of litigants. ... As such, there is no reason why the retroactive legislative amendments should not extinguish the appellants' purported vested right of having its refund claims adjudicated under the former legislation. I would add that I cannot see the logic of the

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52 The Right Honourable Sir Lyman Poore Duff served on the Supreme Court of Canada from 1906 to 1944, a period of thirty-seven years and three months. This is a remarkable feat given that retirement was (and remains) mandatory at age seventy-five.

53 C.I. Mutual Funds Inc. v. Canada, [1999] 2 FC 613 (CA).
proposition that a person who pursues an action in law is protected from retroactive legislation while a person in identical circumstances, who has not taken an action, is not protected from such legislation.\textsuperscript{54}

The 1988 Hornby decision is thus in direct conflict with the 1999 decision of the Federal Court of Appeal in C.I. Mutual Funds.

In 1991, the Supreme Court of Canada tangentially confronted issues similar to those raised in Hornby and C.I. Mutual Funds in Community Economic Development Fund v. Canadian Pickles Corp.\textsuperscript{55} In that case a number of amendments had been made to the relevant legislation after the Court of Appeal had ruled but before the parties appeared before the Supreme Court. Jacobucci J. explained the timing and circumstances of the amended legislation (and the reaction of the parties to the amendments) toward the end of his judgment:

After the hearing of this appeal, it came to the attention of the court that several amendments to the Act were recently passed which materially altered many of the provisions discussed above. ... On October 18, 1991, the court, through the registrar, formally asked for the views of the parties as to the effect of the legislative amendments on the issues in the appeal and why the amendments were not put before the court during argument. In their respective replies, counsel for the parties agreed, in essence, that the amendments do not affect the issues before the court because the amendments do not specifically address pending litigation. ... Counsel also candidly admitted they were unaware of the legislative changes when the appeal was argued. Accordingly, as the parties agree the recently made amendments do not affect the outcome of this appeal, they need not under the circumstances be considered further.\textsuperscript{56}

It is surprising given the concern expressed regarding the retroactive amendment issue by the Supreme Court of Canada in the Canadian Pickles appeal that the issues raised in Canada Trustco on precisely the same question received such short shrift. There is no indication that the parties


\textsuperscript{56} Ibid. at paras. 64–65.
in Canada Trustco agreed that the amendments should not affect the appeal. The failure to address the issue is particularly lamentable given the conflicting decisions in Hornby and C.I. Mutual Funds.

C. ASSESSING THE TREATMENT OF RETROACTIVITY IN CANADA TRUSTCO

In Canada Trustco, the Supreme Court of Canada rejected the idea that the amended language of 245(4) should apply to the transaction at issue in the appeal, even though the relevant events without question occurred during the period covered by the amendment. The Court made two claims in justification of its holding. The first was that the new language of subsection 245(4) could not apply to the appeal because the proceeding had reached too advanced a stage. The competing authorities of Hornby and C.I. Mutual Funds, and the discussion of the Supreme Court in Canadian Pickles, suggest that the issue is a serious one that probably should have been decided in a less cavalier fashion. Problematically, the Court did not expressly rely on or even refer to any authority, legal or otherwise in support of this first claim.

In addition, in a move that, ironically, seems to affirm the looseness of the reasoning underlying its first claim, the Court argued in the alternative that even if the amended language of subsection 245(4) did apply, it would not have resulted in a “different approach” to the appeal. This second claim is more dubious than the first. Whether the amendment effected a substantial change to the meaning of subsection 245(4) merited a closer analysis. It is true that explicitly extending the application of the GAAR beyond the Act itself to the Income Tax Regulations, the Income Tax Application Rules, and tax treaties, was an important change, as the Court recognized. But there is also a strong argument to be made that the amendment of subsection 245(4) did more than this. The underlying contention adopted in this paper, which echoes the more extensive analysis conducted and reported elsewhere by David Duff, is that the amended language of subsection 245(4) has considerably lessened the burden borne by the government in seeking to apply the GAAR to deny a tax benefit.

57 This alone is a significant change, since two earlier judgments had concluded that the GAAR did not apply to a misuse or abuse of the Income Tax Regulations. See Rousseau-Haule v. R., [2001] DTC 250 (TCC); and Fredette v. R., [2001] DTC 621 (TCC).

58 See, for example, Duff, “The Supreme Court and the General Anti-Avoidance Rule,” above note 11.
Prior to the amendment effected by the BIA on 13 May 2005 to subsection 245(4) of the ITA, the subsection read as follows:

For greater certainty, subsection 245(2) does not apply to a transaction where it may reasonably be considered that the transaction would not result directly or indirectly in a misuse of the provisions of this Act or an abuse having regard to the provisions of this Act, other than this section, read as a whole.

Subsection 245(4) was amended effective 13 May 2005, the date the BIA received royal assent. The provision now reads:

Subsection (a) 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.

Subsection 55(5) of the BIA provides that the amended language of subsection 245(4) applies "with respect to transactions entered into after September 12, 1988."

Given the express provision in the BIA providing for the retroactive application of the new language of subsection 245(4), the old language is now (at least as a legal matter) without effect with respect to transactions occurring after 12 September 1988. Moreover, given the foregoing analysis, the changes to the GAAR with retroactive effect are correctly understood to have been entirely within Parliament's purview as sovereign. Legally, it is uncontroversial that Parliament is entitled to make retroactive changes of this sort, since the only binding constraints (those that are constitutional in nature) are not impediments to the implementation of retroactive fiscal legislation (unlike the criminal law context, say, where individual liberty is at stake).
Given the dominance of parliamentary supremacy in discussions of retroactivity in Canadian law, and the lack of any doubt that Parliament can legally pass retroactive tax legislation, some might be tempted to argue a different approach. This alternative approach would be to argue that the previous wording of the GAAR provided a basis for a finding that there had been a legally binding contract between Parliament and taxpayers or, at least, resulted in a legally protected reliance interest on the part of taxpayers.\(^59\) This is legally a non-starter, however, at least with respect to the amendment of the GAAR. As an initial matter, it is unrealistic to think that most tax provisions involve an implicit promise that the tax law will not change or, if it does, that Parliament will provide compensation. There are probable exceptions to this general observation, however. Certain types of tax provisions by their nature put taxpayers in an expected and clearly anticipated position of reliance upon promises expressed by Parliament in the ITA; for example, the provisions establishing registered retirement savings plans (RRSPs). These provisions differ in kind from the GAAR. The GAAR is not a provision that invites taxpayers to rely on its wording in cobbled together ever more elaborate abusive tax avoidance transactions. The existence of the GAAR itself suggests that relying on the specific provisions of the ITA is unwise\(^60\) (or at least not protected) when one is contemplating an abusive tax avoidance scheme.

If the Court in Canada Trustco had engaged with the reasoning of the BC Court of Appeal in Hornby and that of the Federal Court of Appeal in C.I. Mutual Funds, and grappled with its own obiter comments in Canadian Pickles, it may well have reached the same conclusion as it ultimately did—that the amended language of 245(4) should not apply to the appeal before the Court. The basis of the decision could even have been as simple as an extension of the strict construction approach to statutory interpretation applied by courts to retroactive legislation. Even if the Court simply provided a statement to the effect that in order for amended legislation to

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\(^{60}\) It might not be unwise to run the risk of having the GAAR apply because there are no penalties associated with its application, and it will probably never be the case that all GAAR-able transactions will be detected and reversed, thereby rendering abusive tax avoidance an optimal strategy from a purely pecuniary perspective (that is, disregarding any possible moral objections). This is a long-standing observation. Plato is said to have remarked that, "When there is an income tax, the just man will pay more and the unjust less on the same amount of income."
apply to pending proceedings Parliament must expressly specify this result, the guidance would have been beneficial by providing certainty to lower courts, to provincial legislatures, and to Parliament.

It would also have been valuable for the Court to have addressed the reasoning of Rip T.C.J. at the Tax Court of Canada in *C.I. Mutual Funds* who concluded that “the legislator need not refer specifically to pending actions in order for retroactive legislation to affect the rights of litigants” on the basis that he could not “see the logic of the proposition that a person who pursues an action in law is protected from retroactive legislation while a person in identical circumstances, who has not taken an action, is not protected from such legislation.” It is regrettable that the Court did not supply this logic.

Subsequent to the decision of the Supreme Court in the GAAR cases, the retroactivity issue as it relates to the GAAR has been taken up by the lower courts. For example, in *MIL (Investments) S.A. v. Canada*, Bell T.C.J. mentioned the retroactivity issue in passing, stating with respect to the retroactive amendment of 245(4):

> These amendments, made in 2005, are retroactive to transactions completed some 17 years ago. Retroactive legislation, although within the power of Parliament is legal but undesirable. The inappropriateness of reassessing taxpayers who completed transactions in accordance with the law in force at the time of those transactions without any expectation of adverse retroactive effect is self-evident. [Footnotes omitted.]

For the proposition that retroactive legislation is “legal but undesirable,” Bell T.C.J. cited *Air Canada v. British Columbia*, and *British Columbia v. Imperial Tobacco Canada Ltd.* This is poor form. Neither decision actually states that retroactive legislation is “undesirable.” The addition of “but undesirable” is mere editorializing. Both decisions should only have been cited for the proposition that retroactive fiscal legislation is legal.

64 *British Columbia v. Imperial Tobacco Canada Ltd.*, 2005 SCC 49.
D. SOME RECOMMENDATIONS CONCERNING RETROACTIVITY AND THE GAAR

The tax policy literature addressing the retroactivity question is extensive, sophisticated, and well developed. A detailed treatment is beyond the scope of this paper. However, some of the insights of the literature will be used to help illuminate the question of whether amendments to the GAAR should be applied retroactively.

The literature on retroactivity in tax largely divides into two camps. The first camp maintains that it is generally undesirable to allow tax legislation to apply retroactively. The first camp can be further divided into two subcamps: (1) those relying on conceptions of fairness, the rule of law, and the protection of taxpayer reliance;⁶⁵ and (2) those relying on efficiency arguments.⁶⁶ A note in the Harvard Law Review in 1970, representative of the first subcamp, stated:

The primary factor militating against retroactive effect is taxpayer reliance on existing law. In the tax field precise knowledge of the law is commonly the basis for long-range planning. Indeed, such reliance is particularly strong here due to the taxpayer's paramount desire for certainty in tax planning combined with the unique degree of specificity found in the tax laws. Retroactivity often defeats reliance and penalizes a taxpayer for acting in a manner which was previously permitted. This is both harsh and frequently inequitable.⁶⁷

Martin Feldstein, whose writing is representative of the second subcamp, explained, "Tax changes make individuals uncertain about the future reliability of the tax laws. Their anticipation of future possible changes induces

⁶⁵ See, for example, Loomer, "Taxing Out of Time," above note 9; Note, "Setting Effective Dates for Tax Legislation: A Rule of Prospectivity" (1970) 84 Harv. L. Rev. 436; Comment, "Limits on Retroactive Decision Making by the Internal Revenue Service" (1976) 23 UCLA L. Rev. 529.


inefficient precautionary behavior." What distinguishes those in this first camp from those in the second camp is the claim that taxpayers who have acted in the shadow of a given tax law regime should be accommodated in some way, whether it is through some form of grandfathering or through explicit compensation when tax laws change.

Those in the second camp focus almost exclusively on efficiency arguments in arguing that grandfathering or compensation is usually unnecessary since taxpayers can be assumed to anticipate and therefore "price-in" the risk of changes to the law in various ways. This is equivalent to arguing that taxpayers cannot help but place bets on future tax policy whenever they engage in economic activities. The general insight as explained by Michael Graetz, one of the earliest proponents of this view, is that: "Because all changes in law, whether nominally retroactive or nominally prospective, will have an economic impact on the value of existing assets or on existing expectations, the distinctions commonly drawn between retroactive and prospective effective dates are illusory." On this basis, those in the second camp argue that accommodation is typically not desirable, since it can:

1) significantly delay or reduce the benefits associated with a change in the law;
2) increase complexity and thus compliance costs;
3) reward most those taxpayers who have taken the most aggressive tax avoidance positions; and
4) can be wasteful where delayed or phased-in effective dates are viable alternatives.

A recent book-length study of the consequences of changes to tax rules by Daniel Shaviro makes a significant contribution to the literature on retroactivity in tax law by clarifying the terminology and providing a clear framework for the analysis of issues relating to retroactivity. The most relevant

69 See, for example, Michael Graetz, "Legal Transitions: The Case of Retroactivity in Income Tax Revision" (1977) 126 U. Pa. L. Rev. 47; Michael Graetz, "Retroactivity Revisited" (1985) 98 Harv. L. Rev. 1830; Louis Kaplow, "An Economic Analysis of Legal Transitions" (1986) 99 Harv. L. Rev. 509; and Shaviro, When Rules Change, above note 59. Shaviro is not a perfect fit in this second camp; his analysis identifies changes for which it is appropriate to provide relief, though by and large his position does tend to favour the views of Graetz and Kaplow over the views of those in the first camp.
70 Graetz, "Retroactivity Revisited," ibid. at 1822.
71 Ibid. at 1825.
72 See Shaviro, When Rules Change, above note 69.
contribution Shaviro makes for the purposes of this paper is his analysis of the combined role of the desirability of the future anticipation of retroactivity and the steady-state desirability of the tax change. His conclusion in this regard is that, “Given multiple categories, one’s conclusions need to be context specific and to focus on exactly what the retroactive tax (as distinct from the steady-state new rule) actually does.”\textsuperscript{73} Shaviro demonstrates that it is naïve to think that either the first camp or the second camp is always correct. Rather, each given change must be analyzed independently.

Consider the retroactive amendment of subsection \textsuperscript{245(4)} of the GAAR. Any retroactive revision of the GAAR to make it more effective would likely come within the category “Retroactive Tax Good if and Only if the Rule Change is Good.”\textsuperscript{74} From the perspective of economic efficiency, amending the GAAR in order to make it more effective in combating abusive tax avoidance would be a good rule change. Such revisions constitute good rule changes because allowing abusive tax avoidance to occur unchecked invites additional abusive tax avoidance, which reduces tax revenues, increases rents paid to tax planners, and generates deadweight losses. Similarly, the retroactive amendment of the GAAR to increase its effectiveness should also likely be regarded as the type of change that Parliament would like taxpayers to anticipate, because such anticipation would tend to reduce the level of abusive tax avoidance engaged in by taxpayers. On this view, the retroactive application of changes to the GAAR would ideally be fully anticipated by taxpayers. Consider the consequences. If individuals expect the GAAR to become more and more effective — retroactively — through consistent parliamentary amendment, one might reasonably expect abusive tax avoidance to be dealt a serious blow, provided individuals form expectations about future retroactive changes to the GAAR rationally. In other words, if we assume that individuals are forward-looking, that they form expectations about future parliamentary action rationally, and that they believe Parliament has an interest to making the GAAR as effective as possible in combating abusive tax avoidance, it is likely that abusive tax avoidance in the present will on average take into account the future retroactivity of changes to the GAAR. And if Parliament is serious about improving the effectiveness of the GAAR over time in a retroactive manner, this belief will entail dramatic reductions in abusive tax avoidance conduct.

\textsuperscript{73} \textit{Ibid.} at 51.

\textsuperscript{74} \textit{Ibid.} at 48.
There are some caveats to add to this observation. First, not everyone will form the appropriate expectations about future government action in the future. It is enough if expectations do not systematically diverge from the most likely outcome. Those who do engage in abusive tax avoidance transactions are really placing bets that at some stage there will be a breakdown in government action that precludes retroactive enforcement of a more effective GAAR. This breakdown could be at one of a number of stages:

1) Parliament might not amend the GAAR to make it more effective;
2) if Parliament does amend the GAAR to make it more effective, it might not make the changes retroactive;
3) even if Parliament does amend the GAAR to make it more effective and makes the change retroactive, if trial proceedings have begun under the old wording of the GAAR, then the retroactive change will not apply in the absence of clear language;
4) the abusive tax avoidance might not be detected at the audit stage;
5) even if the abusive tax avoidance is detected at the audit stage, the GAAR committee might decide to not pursue the case;
6) even if the GAAR committee decides to pursue the case, and the CRA reassesses the taxpayer, and the case is slated to go to trial, the case might not be pursued;
7) even if the abusive tax avoidance scheme runs afoul of the GAAR, the trial court may erroneously conclude (assuming the error is not corrected on appeal) that the GAAR does not apply.

It is important to note that if the probability of breakdown at each of these seven stages is only 10 percent, the probability of engaging in abusive tax avoidance and having a retroactively more effective GAAR reverse the tax benefits will be 47.8 percent—less than 50/50. In addition, because the GAAR does not impose penalties when it does apply, one might expect taxpayers to be undeterred from continuing in abusive tax avoidance schemes.

An interesting question therefore surrounds the retroactive introduction of a GAAR penalty to combat the possibility of these breakdowns. Even if the remainder of the GAAR provision remains the same, it is possible that Parliament would see fit to introduce a penalty retroactively on transactions that run afoul of the GAAR. So long as the penalty is restricted to economic interests, and not liberty, it is strongly arguable that it is within Parliament's power to introduce such a penalty, even retroactively. Tax planners would be wise to consider advising clients of the potential risk of
Parliament introducing a GAAR penalty with retroactive effect in order to appropriately manage client expectations.

E. CONCLUSION

The statutory text of subsection 245(4)—the “misuse” or “abuse” limitation on the application of the GAAR—remained unchanged from the time the GAAR first took effect on 12 September 1988 until 13 May 2005. However, as of 13 May 2005, the amended language of subsection 245(4) applies retroactively to transactions entered into after 12 September 1988. The manner in which the Supreme Court of Canada dealt with the retroactivity issue in Canada Trustco is provocative. The Court claimed that despite the express retroactivity of the amendment, the new language of subsection 245(4) could not apply to the appeal on the basis that the trial judgment had been rendered and the appellate review process had reached too advanced a stage. The current indeterminacy in the law presented an opportunity for the Supreme Court of Canada in Canada Trustco to assess the conflicting authority, and to clarify the appropriate legal approach. Unfortunately, the Court did not do so.

By drawing on the tax policy literature on retroactivity in tax legislation, some thoughts surrounding the retroactive application of amendments to the GAAR are offered. The primary observation is that since the GAAR (by definition) deals with combatting abusive tax avoidance, it is desirable as a steady-state policy to improve the reach and effectiveness of the GAAR retroactively, and also for taxpayers to anticipate this. This suggests that in the future Parliament should be less timid about making amendments to the GAAR effective retroactively, and that the retroactivity should extend to litigants at any stage of pending proceedings. On this view, any reliance on the previous wording of the GAAR is like placing a bet on the future tools Parliament will use to combat abusive tax avoidance. To the extent that tax avoidance bets turn out badly, those who have bet and lost will no doubt complain noisily and at length. But the complaints are political objections, not legal arguments (or, to the extent they are legal arguments, they are not convincing). In addition, in order to properly condition expectations in their clients, tax planners would be wise to consider the potential introduction of a retroactive penalty on transgressions of the GAAR and advise their clients that such a retroactive penalty is both legally possible and, given its sensibility, perhaps likely at some point in the future.