Copthorne Holdings and the Future of the GAAR

Benjamin Alarie

University of Toronto, Faculty of Law

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The Court's Renewed GAAR Guidance

- ▶ (1) tax benefit
- ▶ (2) avoidance transaction
- ▶ (3) misuse or abuse

(1) tax benefit

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- ▶ Assessing whether there is a tax benefit can be done by comparing what happened "with an alternative arrangement that could reasonably have been carried out"
- ▶ The finding of the trial judge will be overturned only when an appellate court has found that there was a palpable and overriding error made by the trial judge

(2) avoidance transaction

- ▶ An avoidance transaction is a transaction that leads to a tax benefit if the transaction is not undertaken primarily for a bona fide non-tax purpose

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- ▶ An avoidance transaction is a transaction that leads to a tax benefit if the transaction is not undertaken primarily for a bona fide non-tax purpose
- ▶ Also includes each transaction in a series of transactions if the series leads to a tax benefit and at least one of the transactions in the series was not undertaken primarily for a bona fide non-tax purpose

"series of transactions"

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- ▶ There is a series of transactions at common law when the investigated sequence of events "is pre-ordained to produce a final result" (OSFC Holdings)
- ▶ Subsection 248(10) extends this common law meaning to include "any related transactions or events completed in contemplation of the series"

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- ▶ The determination of whether a given transaction is sufficiently related to a series to be part of the series will be decided on its own facts
- ▶ Requires more than a "mere possibility or a connection with an extreme degree of remoteness" but not a "strong nexus"

(3) misuse or abuse

- ▶ Court must first determine the "object, spirit or purpose" of the provisions relied upon by the taxpayer that generate the "tax benefit"

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- ▶ Reference should be made to the legislative scheme, the provisions themselves, and "permissible extrinsic aids"
- ▶ Where the "avoidance transaction" is part of a series, the inquiry should include the entire context of the series of transactions
- ▶ There will be abuse where the transaction (1) achieves a result the provision intended to prevent; (2) defeats the underlying rationale of the provision; or (3) circumvents the provision and "frustrates or defeats its object, spirit or purpose"

In Brief: The Key Copthorne Transactions

- ▶ Events Leading to 1993 Share Sale
- ▶ Amalgamating Copthorne I and VHHHC Holdings
- ▶ Amalgamating Copthorne II and VHHHC Investments
- ▶ The Redemption

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Realized Gain on Toronto Harbour Castle Hotel, Creation of COIL

Creation of the VHHHC Companies

VHHC Holdings Sold to Copthorne

The 1993 Share Sale

Amalgamating Copthorne I and VHHC Holdings

Amalgamating Copthorne II and VHH Holdings

Amalgamating Copthorne II and VHH Holdings

The Redemption

The Copthorne GAAR Analysis

- ▶ (1) tax benefit
- ▶ (2) avoidance transaction
- ▶ (3) misuse or abuse

(1) tax benefit

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- ▶ The Court held that, "but for" the difference in how PUC was treated, a vertical amalgamation would have been reasonable
- ▶ The taxpayer did not meet the test of showing that there was no "tax benefit"
- ▶ Moreover, the Court found that the comparison of a vertical amalgamation with a horizontal amalgamation "was entirely appropriate"

(2) avoidance transaction

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(2) avoidance transaction

- ▶ The Court held that there was a series of transactions that resulted in a "tax benefit"
- ▶ Moreover, it was appropriate to conclude that the 1995 share redemption had the requisite degree of connection with the 1993 share sale
- ▶ The "because of" or "in relation to" test from 248(10) does not require a "strong nexus"
- ▶ The Tax Court judge took notice of the FAPI rule changes and the time elapsed (from 1993 to 1994) and did not make a "palpable and overriding error of fact"

"series of transactions"

- ▶ The Court held that because the word "contemplation" in 248(10) should be regarded as including both prospective and retrospective elements, "the redemption transaction was part of the same series as the prior sale and amalgamation, and that the series, including the redemption transaction, resulted in the tax benefit"

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- ▶ The 1993 share sale was an avoidance transaction that was part of the series of transactions that resulted in the tax benefit

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- ▶ The 1993 share sale was an avoidance transaction that was part of the series of transactions that resulted in the tax benefit
- ▶ The taxpayer did not demonstrate that there was a bona fide non-tax purpose to the 1993 share sale

(3) misuse or abuse

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- ▶ It explained that in light of the reliance taxpayers place on the text of the Act, "The court's role must be to conduct an objective, thorough and step-by-step analysis and explain the reasons for its conclusion"

(3) misuse or abuse

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- ▶ The Court analyzed three provisions—the definition of PUC in 89(1); 87(3); and 84(3)—in a “unified textual, contextual and purposive” way
- ▶ “Having regard to the text, context and purpose of s. 87(3), I would conclude that the object, spirit and purpose of the parenthetical portion of the section is to preclude preservation of PUC of the shares of a subsidiary corporation upon amalgamation of the parent and subsidiary where such preservation would permit shareholders, on a redemption of shares by the amalgamated corporation, to be paid amounts as a return of capital without liability for tax, in excess of the amounts invested in the amalgamating corporations with tax-paid funds.”

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- ▶ The Court stated that the question is whether the transactions at issue "frustrate" or "defeat" the purpose of 87(3)
- ▶ More specifically, "The GAAR analysis looks to determine whether the avoidance of a vertical amalgamation and preservation of the VHHC Holdings' PUC of 67,401,279 circumvented s. 87(3), achieves an outcome s. 87(3) was intended to prevent or defeats the underlying rationale of s. 87(3). If such a finding is made, the taxpayer is not 'throwing away' a valuable asset. It is the application of the GAAR that applies to deny the benefit of that 'asset' to the taxpayer."

(3) misuse or abuse

- ▶ The Court concludes that, "The sale of VHHC Holdings shares to Big City circumvented the parenthetical words of s. 87(3) and in the context of the series of which it was a part, achieved a result the section was intended to prevent and thus defeated its underlying rationale. The transaction was therefore abusive and the assessment based on application of the GAAR was appropriate."

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- ▶ How important is the Court's emphasis on the parenthetical language of 87(3)?
- ▶ What is the status of the Duke of Westminster (HL, 1936) in Canadian tax law?
- ▶ Are we in a different place than we were after Canada Trustco (2005) and Lipson (2009)?