SUPREME COURT OF CANADA

CITATION: Lipson *v.* Canada, 2009 SCC 1

DATE: 20090108
DOCKET: 32041

BETWEEN:

Earl Lipson
Appellant
and
Her Majesty The Queen
Respondent

AND BETWEEN:

Jordan B. Lipson
Appellant
and
Her Majesty The Queen
Respondent

CORAM: Binnie, LeBel, Deschamps, Fish, Abella, Charron and Rothstein JJ.

REASONS FOR JUDGMENT: (paras. 1 to 53)	LeBel J. (Fish, Abella and Charron JJ. concurring)
DISSENTING REASONS: (paras. 54 to 99)	Binnie J. (Deschamps J. concurring)
DISSENTING REASONS: (paras. 100 to 124)	Rothstein J.

---

lipson *v.* canada

Earl Lipson *Appellant*

v.

Her Majesty The Queen *Respondent*

- and -

Jordan B. Lipson *Appellant*

v.

Her Majesty The Queen *Respondent*

Indexed as: Lipson *v.* Canada

Neutral citation: 2009 SCC 1.

File No.: 32041.

2008: April 23; 2009: January 8.

Present: Binnie, LeBel, Deschamps, Fish, Abella, Charron and Rothstein JJ.

on appeal from the federal court of appeal

Taxation — Income tax — Tax avoidance — Series of transactions — Series of transactions beginning with wife borrowing money to purchase shares in family corporation and leading to husband deducting interest on the couple's home mortgage loan — Whether general anti-avoidance rule applicable to deny tax benefits — Whether series of transactions results in abuse and misuse of one or more provisions of Income Tax Act — Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.), s. 245(4).

The taxpayer E and his wife entered into an agreement of purchase and sale for a family residence. The wife borrowed $562,500 from a bank to finance the purchase of shares in a family corporation. She paid the borrowed money directly to the taxpayer who transferred the shares to her. The taxpayer and his wife obtained a mortgage from a bank for $562,500. That same day, they used the mortgage loan funds to repay the share loan in its entirety. On his 1994, 1995 and 1996 tax returns, the taxpayer deducted the interest on the mortgage loan and reported the taxable dividends on the shares as income when applicable. The brother of the taxpayer, J, conducted similar transactions. The Minister of National Revenue disallowed the deductions for those taxation years and reassessed the taxpayers accordingly. The Tax Court of Canada dismissed the taxpayers' appeals, holding that the series of transactions constituted a misuse of ss. 20(1)(*c*), 20(3), 73(1) and 74.1 of the *Income Tax Act* and the taxpayers' appeals were dismissed. The Federal Court of Appeal upheld that decision.

Held (Binnie, Deschamps and Rothstein JJ. dissenting): The appeals should be dismissed.

Per **LeBel**, Fish, Abella and Charron JJ.: It has long been a principle of tax law that taxpayers may order their affairs so as to minimize the amount of tax payable. However, this principle has never been absolute, and Parliament has enacted the general anti-avoidance rule ("GAAR") to limit the scope of allowable avoidance transactions while maintaining certainty for taxpayers. The GAAR denies a tax benefit where three criteria are met: the benefit arises from a transaction (ss. 245(1) and 245(2)); the transaction is an avoidance transaction as defined in s. 245(3); and the transaction results in an abuse and misuse within the meaning of s. 245(4). The taxpayer bears the burden of proving that the first two of these criteria are not met, while the burden is on the Minister to prove, on the balance of probabilities, that the avoidance transaction results in abuse and misuse within the meaning of s. 245(4). Here, all the transactions were conceded to result in two tax benefits and to be avoidance transactions. [21-23]

A two-part inquiry must be followed to determine whether a transaction results in a misuse and an abuse for the purposes of s. 245(4) of the Act. First, a court must conduct a unified textual, contextual and purposive analysis of the provisions giving rise to the tax benefit in order to determine their essential object, spirit and purpose. It is important to identify which provision is associated with each tax benefit. Here, the tax benefit of interest deductibility is associated with ss. 20(1)(*c*) and 20(3) and the tax benefit arising out of the use of the attribution rules by the taxpayer to reduce his income is linked with ss. 73(1) and 74.1(1). Second, a court must determine whether the avoidance transaction frustrates the object, spirit or purpose of the relevant provisions.

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 of the provisions of the Act. Individual transactions must be viewed in the context of the series. This approach is consistent with the wording of the GAAR provisions, in particular with ss. 245(2) and 245(3)(*b*), which contemplate the denial of a tax benefit resulting from a series of transactions. Further, the use of the words "directly or indirectly" in s. 245(4), indicates that Parliament intended the GAAR to apply even where abuse is an indirect result of a transaction and consequently, that regard may be had to the series of transactions when determining whether a transaction within the series is abusive. It is preferable to refer to the "overall result" of the transactions which more accurately reflects the wording of s. 245(4), and the jurisprudence of this Court rather than "overall purpose" which may incorrectly imply that the taxpayer's motivation or the purpose of the transaction is determinative. An avoidance purpose is needed to establish a violation of the GAAR when s. 245(3) is in issue, but is not determinative in the s. 245(4) analysis. [25-28] [33-34] [36-38]

The Minister has failed to establish that the purpose of ss. 20(1)(*c*) and 20(3) have been misused and abused. The series of transactions did not become problematic until the taxpayer and his wife turned to ss. 73(1) and 74.1(1), in order to obtain the result contemplated in the design of the series of transactions which resulted in the taxpayer applying his wife's interest deduction to his own income. The attribution by operation of s. 74.1(1) that allowed the taxpayer to deduct the interest in order to reduce the tax payable on the dividend income from the shares and other income, which he would not have been able to do were the wife dealing with him at arm's length, qualifies as abusive tax avoidance. It does not matter that s. 74.1(1) was triggered automatically when the

taxpayer did not elect to opt out of s. 73(1). To allow s. 74.1(1) to be used to reduce the taxpayer's income tax from what it would have been without the transfer to his wife frustrates the purpose of the attribution rules. The GAAR was not at issue in *Singleton*, nor was s. 74.1 of the Act, and consequently *Singleton* is distinguishable. [20] [41-42]

Here, it is not open to the Court to consider the interpretation and application of the specific anti-avoidance rule in s. 74.5(11) as it was expressly disavowed by all parties throughout the proceedings. The GAAR's application was the focus of the appeals and was the proper basis for the reassessments of the transactions. These transactions are caught by the GAAR. Courts should avoid extending the GAAR beyond its statutory purpose. But, bearing this purpose in mind, where the language of and principles flowing from the GAAR apply to a transaction, the court should not refuse to apply it on the ground that a more specific provision — one that both the Minister and the taxpayers considered to be inapplicable throughout the proceedings — might also apply to the transaction. [43-47]

Finally, in determining the tax consequences of the GAAR's application under s. 245(5), courts must be satisfied that an avoidance transaction has been found under s. 245(4), that s. 245(5) provides for the tax consequences and that they deny the tax benefits that would flow from the abusive transactions. Courts must then determine whether these tax consequences are reasonable in the circumstances. In the present case, the disallowance of the interest expense in computing the income or loss attributed to the taxpayer and allocation of that interest deduction back to his wife is a reasonable outcome. [51]

Per **Binnie** and Deschamps JJ. (dissenting): The GAAR is a weapon that, unless contained by the jurisprudence, could have a widespread, serious and unpredictable effect on legitimate tax planning. At the same time, the GAAR must be given a meaningful role. That role is circumscribed by the requirement in s. 245(4) that the transactions not only be shown to be "avoidance transactions", but in addition that the Minister demonstrate that the tax benefit results from a misuse/abuse of the provisions of the *Income Tax Act* relied upon to produce it. In the present case, the Minister has failed to make such a demonstration. When the series of transactions at issue is properly characterized, it is a tax avoidance scheme that should not have been found to be abusive under the GAAR. [55] [59] [64]

Singleton illustrates the proposition that there is nothing abusive in principle for a taxpayer to rearrange his or her capital (borrowed or non-borrowed) in a tax efficient manner. The Minister is not asking the Court to revisit *Singleton*. He does not claim that GAAR would have applied in that case. The Minister acknowledges here that "it is common ground that the interest was deductible". Thus, applying *Singleton*, the only question is whether the deduction becomes "abusive" when income or losses are attributed back to the transferor (appellant) by the spousal attribution rules in ss. 73(1) and 74.1(1). [57-58] [60]

If the tax plan in *Singleton* is not abusive, the Minister has failed to establish that *Singleton* with a spousal twist is abusive tax avoidance either. There is nothing in the Act to discourage the transfer of property at fair market value between spouses. Indeed, by allowing a spouse to transfer property to the other spouse at the transferor's adjusted cost base, Parliament intended to make such inter-spousal transfers attractive. The Minister has failed to identify a

specific policy shown to be frustrated by the taxpayer's plan as required by *Canada Trustco* and *Kaulius*. The approbation by the Court of the Minister's resort to vague generalities or "overriding policy" will only increase the element of uncertainty in tax planning that *Canada Trustco* and *Kaulius* sought to avoid. [59] [67]

Canada Trustco requires the Minister to identify the misuse and abuse of an "object, spirit or purpose" that is "anchored in a textual, contextual and purposive interpretation of the *specific* provisions that are relied upon for the tax benefit". By ignoring the initial sale of shares to the spouse and re-characterizing the interest payment in relation thereto as nothing more than interest on a house mortgage, and effectively arguing for a stand-alone prohibition on the deductibility of a house mortgage interest (despite *Singleton*), the Minister engages in the sort of vague appeal to "overriding policy" that *Canada Trustco* sought to eliminate from the GAAR analysis. [65]

In this case, as in *Singleton*, there was a change in the taxpayer's position with real economic substance. The share sale must be accepted as an essential part of the "series of transactions." Parliament must have contemplated that by giving taxpayers a choice under s. 73(1) in the context of an inter-spousal transfer of property, they would exercise it in a tax-minimizing manner. Far from offending the "object, spirit or purpose" of the spousal attribution rules, the taxpayer's tax plan fulfilled them, or at a minimum did not abuse them. It cannot be right that whenever a lower income spouse borrows money to purchase shares from a higher income spouse there is an abuse of the spousal attribution rules unless the transferring spouse opts out of ss. 73(1) and 74.1(1), and thereby forfeits a tax benefit clearly available under the Act. While many spouses

regard themselves as forming an economic unit, the rate at which spousal units implode serves as a reminder that the economic union of marriage is neither indissoluble nor free of risk. [87] [91-93] [96]

The "overall purpose" approach which the Tax Court judge adopted, and the Federal Court of Appeal accepted, was an error of law. The principal focus in s. 245(4) is on results not purpose. While the legal relationships actually created by the taxpayer do not control the application of the GAAR, they cannot be ignored. Here, the application of the GAAR would mean paying lip service to the principle that taxpayers are entitled to arrange their affairs to minimize the amount of tax payable, without taking seriously its role in promoting consistency, predictability and fairness in the tax system. [86] [90] [98]

Per **Rothstein** J. (dissenting): There was no abuse of ss. 20(1)(*c*) and 20(3) of the Act. There is no reason why a taxpayer may not arrange his or her affairs so as to finance personal assets out of equity and income earning assets out of debt. With respect to the taxpayer's use of s. 74.1(1), ss. 245(2) and 245(4) require that all other relevant provisions of the Act be read before the Minister may have recourse to the GAAR. This Court held in *Canada Trustco* that the GAAR is a provision of last resort. If there is a specific anti-avoidance rule that precludes the use of an enabling rule to avoid or reduce tax, then the GAAR will not apply. The Minister did have other recourse in this case. Section 74.5(11) is a specific anti-avoidance rule that precludes the use of the attribution rules where one of the main reasons for the transfer of property was to reduce the amount of tax that would be payable on the income derived from the property. Here, one of the main reasons for the transfer of shares to the wife was to reduce or eliminate the dividend income on the shares.

Therefore because s. 74.5(11) applied, s. 245 did not apply, and could not be relied upon by the Minister. The Minister should have resorted to s. 74.5(11) in order to reassess the taxpayer in respect of his use of s. 74.1(1). The Minister's failure to invoke s. 74.5(11) is fatal to his reassessment in respect of s. 74.1(1). The Minister cannot preemptively rely on the GAAR to address the alleged abusive use of s. 74.1(1) as if s. 74.5(11) did not exist. The fact that the parties did not rely on s. 74.5(11) — either as the basis for reassessment or as the reason why the Minister's claim should fail — does not change the fact that the section applies in law. If the Minister had reassessed the taxpayer by use of the relevant specific anti-avoidance provision, s. 74.5(11), then the tax benefit that resulted from the taxpayer's use of the attribution rules would have been precluded. The Minister could not invoke the GAAR to reassess in respect of the taxpayer's use of s. 74.1. [100] [102] [104-105] [108] [110] [114-115] [118] [124]

Cases Cited

Cited by LeBel J.

Distinguished: *Singleton v. Canada*, 2001 SCC 61, [2001] 2 S.C.R. 1046, aff'g [1999] 4 F.C. 484; **referred to:** *Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54, [2005] 2 S.C.R. 601; *Mathew v. Canada*, 2005 SCC 55, [2005] 2 S.C.R. 643; *Commissioners of Inland Revenue v. Duke of Westminster*, [1936] A.C. 1; *Placer Dome Canada Ltd. v. Ontario (Minister of Finance)*, 2006 SCC 20, [2006] 1 S.C.R. 715; *Ludco Enterprises Ltd. v. Canada*, 2001 SCC 62, [2001] 2 S.C.R. 1082; *Shell Canada Ltd. v. Canada*, [1999] 3 S.C.R. 622; *Thibaudeau v. Canada*, [1995] 2 S.C.R. 627.

Cited by Binnie J. (dissenting)

Canada Trustco Mortgage Co. v. Canada, 2005 SCC 54, [2005] 2 S.C.R. 601; *Commissioners of Inland Revenue v. Duke of Westminster*, [1936] A.C. 1; *Singleton v. Canada*, 2001 SCC 61, [2001] 2 S.C.R. 1046; *Jabs Construction Ltd. v. The Queen*, 99 D.T.C. 729; *Mathew v. Canada*, 2005 SCC 55, [2005] 2 S.C.R. 643.

Cited by Rothstein J. (dissenting)

Canada Trustco Mortgage Co. v. Canada, 2005 SCC 54, [2005] 2 S.C.R. 601.

Statutes and Regulations Cited

Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.), ss. 18(1)(*a*), (*h*), 20, 73(1), 74, 74.1 to 75.4, 245.

Authors Cited

Ahmed, Firoz, and Cassandra Priede. "Case Comment — *Lipson v. Canada*" (2007), 17 *Can. Curr. Tax* 77.

Krishna, Vern. *The Fundamentals of Canadian Income Tax*, 9th ed. Toronto: Thomson/Carswell, 2006.

McDonnell, Thomas E. "The Relevance of 'Overall Purpose' in a GAAR Analysis" (2007), 55 *Can. Tax J.* 720.

Thivierge, Manon. "GAAR Redux: After Canada Trustco", 2006 Conference Report, *Report of Proceedings of the Fifty-Eighth Tax Conference*. Toronto: Canadian Tax Foundation, 2007, 4:1.

APPEALS from a judgment of the Federal Court of Appeal, 2007 FCA 113, [2007] 4 F.C.R. 641, 280 D.L.R. (4th) 714, 361 N.R. 191, [2007] 3 C.T.C. 110, 2007 D.T.C. 5172, [2007] F.C.J. No. 402 (QL), 2007 CarswellNat 640, affirming a decision of Bowman C.J.T.C., 2006 TCC 148, [2006] 3 C.T.C. 2494, 2006 D.T.C. 2687, [2006] T.C.J. No. 174 (QL), 2006 CarswellNat 982. Appeals dismissed, Binnie, Deschamps and Rothstein JJ. dissenting.

Edwin G. Kroft and *Rosemarie Wertschek, Q.C.*, for the appellants.

Wendy Burnham and *Daniel Bourgeois*, for the respondent.

The judgment of LeBel, Fish, Abella and Charron JJ. was delivered by

LEBEL J. —

I. Introduction

[1] These consolidated appeals raise the issue of what constitutes abusive tax avoidance for the purposes of the general anti-avoidance rule ("GAAR") provided for in the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) ("*ITA*" or "*Act*"). More specifically at issue is whether a series of transactions beginning with a wife borrowing money to purchase shares in a family corporation and leading to the husband deducting the interest on the couple's home mortgage loan results in an abuse and misuse of one or more provisions of the Act, as contemplated in s. 245(4) of the *ITA*.

[2] The framework for identifying abusive tax avoidance was set out in the cases of *Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54, [2005] 2 S.C.R. 601, and *Mathew v. Canada*, 2005 SCC 55, [2005] 2 S.C.R. 643, ("*Kaulius*"). In those companion cases, the Court held that, for the purposes of s. 245(4), abusive tax avoidance occurs where the impugned transaction frustrates the object, spirit or purpose of one or more of the provisions relied on by the taxpayer.

[3] For the reasons that follow, I agree with the courts below that the respondent has established abusive tax avoidance. The GAAR applies to one of the transactions within the series and can accordingly be used to deny one of the tax benefits sought by the appellants. As a result, the appeals should be dismissed.

II. Facts

[4] These appeals were heard on the basis of a statement of agreed facts and conclusion, on which I will rely in reviewing the relevant facts. The appellant Earl Lipson ("Mr. Lipson") conducted a series of transactions whose purpose, he concedes, was to minimize his income tax. He also concedes that his transactions were avoidance transactions within the meaning of s. 245(3) of the *ITA*. First, in April 1994, Mr. Lipson and his wife, Jordanna Lipson ("Mrs. Lipson"), entered into an agreement of purchase and sale for a family residence in Toronto. The purchase price was $750,000. On August 31, 1994, Mrs. Lipson borrowed $562,500 from the Bank of Montreal to finance the purchase at fair market value of 20 and 5/6 shares in Lipson Family Investments Limited, a family corporation. Mrs. Lipson did not earn enough income to pay the interest on this loan (the "share loan") and the bank would not have lent it to her on an unsecured basis but for the fact that

Mr. Lipson had agreed to repay the loan in its entirety the following day. Mrs. Lipson paid the borrowed money directly to her husband, who transferred the shares to her. It should be noted that the brother of Earl Lipson, the appellant Jordan B. Lipson, conducted similar transactions. It was agreed in the courts below that the outcome in Earl Lipson's appeal would be dispositive of his brother's appeal. In this Court, the two appeals were consolidated and continued as one appeal in file No. 32041.

[5] Mr. and Mrs. Lipson obtained a mortgage from the Bank of Montreal for $562,500 (the "mortgage loan"), which was advanced on the closing date of September 1, 1994. They were joint chargers under the mortgage. That same day, they used the mortgage loan funds to repay the share loan in its entirety.

[6] Mr. Lipson relied on four provisions of the *ITA* to claim a deduction of the mortgage loan interest on his 1994, 1995 and 1996 tax returns. The first was s. 73(1), pursuant to which a taxpayer may defer tax on interspousal transfers of property. Mr. Lipson did not elect out of this provision, as he was entitled to do. As a result, the transfer of shares from him to his wife was deemed to have occurred at his adjusted cost base rather than at fair market value, such that he neither sustained a loss nor realized a gain on the sale.

[7] Second, s. 74.1 attributes any income or loss from property transferred from one spouse to another back to the transferring spouse for tax purposes. Thus, although Mrs. Lipson owned the shares acquired from her husband, the dividend income and losses were attributed to Mr. Lipson.

[8] The third provision, although the shares were paid for with the proceeds of the share loan rather than the mortgage loan, was s. 20(3), which allows a deduction for interest on money borrowed to repay previously borrowed money if the interest on the original loan is deductible. As the Tax Court judge noted, the purpose of this provision is to facilitate refinancing (2006 TCC 148, [2006] 3 C.T.C. 2494, para. 20). The mortgage loan was therefore treated as having funded the share purchase.

[9] Finally, Mr. Lipson deducted the interest on the mortgage loan pursuant to s. 20(1)(*c*), which permits the deduction of interest on money borrowed "for the purpose of earning income from a business or property". It is not in dispute that the shares in Lipson Family Investments Limited were income-producing assets for Mrs. Lipson and that, were it not for the attribution rule of s. 74.1, she would be entitled, under s. 20(1)(*c*), to deduct the interest on the money borrowed to purchase the shares. As a result of that attribution rule, however, the dividend income and the interest expense were attributed to Mr. Lipson.

[10] On his 1994, 1995 and 1996 tax returns, Mr. Lipson deducted the interest on the mortgage loan and reported the taxable dividends on the shares as income where applicable. The Minister of National Revenue ("Minister") disallowed the interest expenses of $12,948.19, $47,370.55 and $44,572.95, respectively, for those years and reassessed Mr. Lipson accordingly. The Minister originally disallowed the deductions on the basis that the true economic purpose for which the borrowed money was used was not to earn income and that the interest was therefore not deductible under s. 20(1)(*c*) of the *ITA*. However, by the time the case reached the Tax Court of Canada, this Court had rejected the "true economic purpose" approach in *Singleton v. Canada*, 2001

SCC 61, [2001] 2 S.C.R. 1046, aff'g [1999] 4 F.C. 484. The Minister therefore argued the case on the basis of the GAAR set out in s. 245 of the *ITA* and submitted that the series of transactions amounted to abusive tax avoidance.

III. Judicial History

[11] The appellants appealed the Minister's reassessments to the Tax Court of Canada. The only issue at trial was whether the transactions, which the parties agreed were avoidance transactions resulting in a tax benefit, constituted abusive tax avoidance and were prohibited by the GAAR. Bowman C.J.T.C. relied on the approach to the GAAR set out by this Court in *Canada Trustco* and *Kaulius*. He held that "[t]he overall purpose as well as the use to which each individual provision was put was to make interest on money used to buy a personal residence deductible" (para. 23). He emphasized this overall purpose in relation to the purposes of each of the provisions in question and found that the series of transactions resulted in a misuse of ss. 20(1)(*c*), 20(3), 73(1) and 74.1 of the *ITA* (para. 23). He therefore dismissed the appeals.

[12] On appeal to the Federal Court of Appeal, the appellants claimed that Bowman C.J.T.C. had erred by relying on the overall purpose of the series of transactions in concluding that the transactions resulted in a misuse of specific *ITA* provisions. They added that Bowman C.J.T.C. had relied on the economic purpose and substance of the transactions, which is not the test for interest deductibility under s. 20(1)(*c*). The proper approach, according to the appellants, would have been to assess each transaction, and the resulting legal relationships, separately, in which case the court could find no abuse and misuse of the provisions. They argued that this approach was consistent

with the Supreme Court's rulings in *Canada Trustco* and *Kaulius*.

[13] Noël J.A. agreed that, viewed separately and without regard to the overall purpose of the scheme, no single one of the transactions appeared abusive (2007 FCA 113, [2007] 4 F.C.R. 641, para. 33). However, he concluded that Bowman C.J.T.C. was entitled to consider the transactions as a series. Indeed, both s. 245(2) and s. 245(3)(*b*) contemplate the denial of a tax benefit resulting from a "series of transactions". Further, Noël J.A. quoted para. 46 of *Kaulius*, in which this Court spoke of assessing the "object, spirit or purpose" of the provision "in light of the series of transactions". He concluded that "the series cannot be ignored in conducting the abuse analysis" for the purposes of the GAAR (para. 45). He held that it had been open to Bowman C.J.T.C. to find, as he did, that the transactions resulted in a misuse of several provisions of the *ITA*. He dismissed the appeals.

IV. Analysis

A. *Issues and Positions of the Parties*

[14] The appellants submit that the Minister has not established that abusive tax avoidance had occurred. They point out that it is not disputed that the share purchase transaction was a *bona fide*, legal transaction in which Mrs. Lipson acquired shares in Lipson Family Investments Limited. She earned income on those shares and, were it not for s. 74.1 of the *ITA*, would have been required to report that income for tax purposes but would, pursuant to s. 20(1)(*c*), have been entitled to deduct the interest paid on the money borrowed to purchase those shares. The purpose of s. 20(1)(*c*) is to

encourage the accumulation of income-producing assets. The fact that the applicability of this provision depends on tracing (i.e., of the actual use of the borrowed funds) rather than on apportionment or ordering (based on assumptions about use) means that the provision is concerned with legal relationships rather than with the true economic purpose of the transaction or series of transactions (Appellants' Factum, at paras. 72-76). This principle was confirmed in *Singleton*, where a taxpayer was effectively permitted to deduct his home mortgage interest under s. 20(1)(*c*) because the direct use of the funds in issue was to acquire an income-producing asset, not to purchase a house. Therefore, the transactions in that case did not frustrate the purpose of s. 20(1)(*c*).

[15] Similarly, according to the appellants, the purposes of the other three provisions on which they rely are not frustrated. Section 20(3) contemplates the refinancing of a loan, and that was what the Lipsons did in using the mortgage loan to pay off the share loan. Section 73(1) applies automatically unless the taxpayer opts out, and s. 74.1 also applies automatically if the taxpayer does not elect out of s. 73(1). The provisions operated as intended. It would have been a misuse had they *not* applied.

[16] The appellants argue that the courts below erred in their analysis of the GAAR by relying on the "overall purpose" of the transactions, since an "overall purpose" test is not part of the inquiry under s. 245(4). Further, to the extent that "overall purpose" is synonymous with "true economic purpose", this Court rejected the application of such a test under s. 20(1)(*c*) in *Singleton* and stated in *Canada Trustco* that "economic substance" is not determinative in the inquiry under s. 245(4) (*Canada Trustco*, at paras. 57 and 59). The effect of adopting an "overall purpose" test

under s. 245(4) would be to cause uncertainty and inconsistency for taxpayers.

[17] The respondent, on the other hand, submits that the appellants' approach effectively reads the GAAR out of the *ITA*. The very purpose of the GAAR is to negate arrangements that would result in a tax benefit "but for this section" (s. 245(2)). In other words, even if the provision being relied on allows a tax benefit, this does not preclude the transaction from being abusive under s. 245(4) of the Act.

[18] A contextual and purposive approach to the GAAR, as is mandated by *Canada Trustco* and *Kaulius*, requires a court to consider the purpose of each provision relied on and whether that purpose was defeated by the transaction or series of transactions. According to the respondent, such an analysis leads inevitably to the conclusion that to allow the interest to be deducted in the case at bar would frustrate the purpose of the provisions being relied on. Specifically, the deduction of mortgage interest frustrates the purpose of s. 20(1)(*c*) because personal expenses such as home mortgage interest are not deductible under s. 20(1)(*c*), as is clear from ss. 18(1)(*a*) and 18(1)(*h*) of the *ITA*. Such a deduction also frustrates s. 74.1, because that provision is aimed at preventing income splitting. Section 74.1 is an anti-avoidance provision, but it was used here precisely to avoid tax. It cannot be consistent with the object, spirit or purpose of s. 20(1)(*c*), s. 73(1) or s. 74.1 to permit one spouse to deduct interest on money borrowed to fund a personal expense for the benefit of both spouses. The respondent therefore submits that the courts below were correct in finding that the transactions were prohibited by the GAAR.

B. *Applicability of the Singleton Case to the Present Situation*

[19] As I mentioned above, the appellants consider this Court's decision in *Singleton* to weigh in their favour because of its focus on legal relationships. The Minister concedes that, were it not for the GAAR, Mr. Lipson could properly deduct the interest expense under s. 20(1)(*c*) (Statement of Agreed Facts and Conclusion, at para. 15). If, as in *Singleton*, the issue in the instant case were whether the deduction was properly available under s. 20(1)(*c*), the Minister's concession would be fatal.

[20] However, neither the GAAR nor s. 74.1 of the *ITA* was at issue in *Singleton*, so the present case is distinguishable. By treating *Singleton* as dispositive of the present appeals, the appellants in effect read the GAAR out of the *ITA*.

C. *Interpretation of Tax Statutes and the Principle of Minimizing Tax Liability*

[21] It has long been a principle of tax law that taxpayers may order their affairs so as to minimize the amount of tax payable (*Commissioners of Inland Revenue v. Duke of Westminster*, [1936] A.C. 1 (H.L.)). This remains the case. However, the *Duke of Westminster* principle has never been absolute, and Parliament enacted s. 245 of the *ITA*, known as the GAAR, to limit the scope of allowable avoidance transactions while maintaining certainty for taxpayers (*Canada Trustco*, at para. 15). In brief, the GAAR denies a tax benefit where three criteria are met: the benefit arises from a transaction (ss. 245(1) and 245(2)); the transaction is an avoidance transaction as defined in s. 245(3); and the transaction results in an abuse and misuse within the meaning of s. 245(4). The taxpayer bears the burden of proving that the first two of these criteria are not met, while the burden is on the Minister to prove, on the balance of probabilities, that the avoidance

transaction results in abuse and misuse within the meaning of s. 245(4).

[22] The appellants argue that the courts below erred by disregarding the existence of two tax benefits stemming from the series of transactions. They contend and concede that the series of transactions involves two tax benefits: Mrs. Lipson's entitlement to the interest deduction and the actual deduction of that interest from Mr. Lipson's income by application of the attribution rules (see Transcript, at pp. 9, 10 and 17). I would add that, as specified in *Canada Trustco*, at para. 19, the existence of a tax benefit is a factual determination best left to the Tax Court judge. However, in the case at bar, the Tax Court judge did not clearly decide whether the series of transactions created more than one tax benefit. This Court must therefore make that determination. I agree that the GAAR analysis should be conducted in respect of each of those tax benefits. The appellants sought an overall result, that is, the deduction of the interest payments on the mortgage from their income. Nevertheless, the legal analysis required by the GAAR cannot stop at this level. Its focus must be on the individual benefits — which may in combination have led to the overall result — in the context of the series of transactions.

[23] Mr. Lipson concedes that all the transactions were avoidance transactions (see Statement of Agreed Facts and Conclusion, at para. 16). Therefore, the issue before us is whether any of the transactions result in a misuse and an abuse having regard to the provisions the taxpayers have relied on.

[24] The GAAR is set out in s. 245 of the *ITA*. The provision at issue in the present case, s. 245(4), reads as follows:

> Subsection (2) [i.e. the denial of a tax benefit] 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.

[25] In other words, a taxpayer will not be denied a tax benefit resulting from an avoidance transaction unless that transaction directly or indirectly results in the abuse and misuse of provisions of the Act (or regulations, etc.). The approach to determining whether a transaction results in a misuse and an abuse for the purposes of s. 245(4) was set out in *Canada Trustco*, at paras. 44-62, the key portion of which reads as follows:

> 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.

> This analysis will lead to a finding of abusive tax avoidance when a taxpayer relies on specific provisions of the *Income Tax Act* in order to achieve an outcome that those provisions seek to prevent. As well, abusive tax avoidance will occur when a transaction defeats the underlying rationale of the provisions that are relied upon. An abuse may also result from an arrangement that 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. By contrast, abuse is not established where it is reasonable to conclude that an avoidance transaction under s. 245(3) was within the object, spirit or purpose of the provisions that confer the tax benefit. [paras. 44-45]

[26] In determining the purpose of the relevant provision(s) of the Act, a court must take a unified textual, contextual and purposive approach to statutory interpretation (*Canada Trustco*, at para. 47). This approach is, of course, not unique to the GAAR. As this Court confirmed in *Kaulius*, the approach to statutory interpretation is the same for provisions of the *ITA* as for those of any other statute: it is necessary "to determine the intention of the legislator by considering the text, context and purpose of the provisions at issue" (*Kaulius*, at para. 42; see also *Placer Dome Canada Ltd. v. Ontario (Minister of Finance)*, 2006 SCC 20, [2006] 1 S.C.R. 715, at paras. 21-23).

[27] Thus, the first analytical step is to interpret the four provisions at issue in the present case to determine their essential object, spirit and purpose. The parties do not generally dispute Bowman C.J.T.C.'s analysis in this regard, although they emphasize different aspects of the provisions' object, spirit and purpose. For example, the Minister highlights the link between certain provisions and Parliament's goal of regulating taxation within the spousal unit (Respondent's Factum, at para. 47). The appellants, on the other hand, submit that the Tax Court judge erred in his analysis of the purpose of s. 20(1)(*c*) by failing to appreciate the importance of "tracing" (Appellants' Factum, at para. 33(*c*)).

[28] At this step, it is important to identify which provisions are associated with each tax benefit. Here, it is clear that the tax benefit of deductibility of interest relates to ss. 20(1)(*c*) and 20(3). On the other hand, the tax benefit arising out of Mr. Lipson's use of the attribution rules, namely the possibility of deducting the interest to reduce his income, is linked with ss. 73(1) and 74.1(1). By virtue of these provisions, Mr. Lipson retains, for tax purposes, the stream of income from the shares sold to his wife but is able to deduct the interest payments on the mortgage from his income.

[29] Section 20(1)(*c*) allows taxpayers to deduct interest on borrowed money used for a commercial purpose. The purpose of this provision is to "create an incentive to accumulate capital with the potential to produce income" (*Ludco Enterprises Ltd. v. Canada*, 2001 SCC 62, [2001] 2 S.C.R. 1082, at para. 63), or to "encourage the accumulation of capital which would produce taxable income" (*Shell Canada Ltd. v. Canada*, [1999] 3 S.C.R. 622, at para. 57).

[30] Section 20(3) was enacted "[f]or greater certainty" in order to make it clear that interest that is deductible under s. 20(1)(*c*) does not cease to be deductible because the original loan was refinanced. It serves "a practical function in the commercial world of facilitating refinancing" (Tax Court judgment, at para. 20).

[31] The effect of s. 73(1) is to facilitate interspousal transfers of property without triggering immediate tax consequences (Tax Court judgment, at para. 21). This is an exception to the general rule that capital gains and losses are recognized when property is disposed of. According to Professor Vern Krishna:

> The rationale for permitting a taxpayer to rollover assets is that it is undesirable, and perhaps unfair, to impose a tax on transactions that do not involve a fundamental economic change in ownership, even though there may be a change in form or legal structure.
>
> (*The Fundamentals of Canadian Income Tax* (9th ed. 2006), at p. 1112)

[32] Finally, the attribution rules in ss. 74.1 to 74.5 are anti-avoidance provisions whose purpose is to prevent spouses (and other related persons) from reducing tax by taking advantage of their non-arm's length status when transferring property between themselves. The most common example of such a benefit is one derived from income splitting, but it is not the only example. In Canada, the unit of taxation is the individual: "Each individual is a taxpayer in his or her own right" (Krishna, at p. 16; see also *Thibaudeau v. Canada*, [1995] 2 S.C.R. 627, at para. 93). Thus, s. 74.1(1) is designed to prevent spouses from benefiting from their non-arm's length relationship by attributing, for tax purposes, any income or loss from property transferred to a spouse back to the transferring spouse.

[33] The second step in the s. 245(4) analysis is to determine whether the avoidance transaction frustrates the object, spirit or purpose of the relevant provisions. The appellants submit that the courts below erred at this step of the analysis by relying on the "overall purpose" of the transactions in question, that is, by collapsing the series of legally effective transactions into a single transaction and recharacterizing them by attributing an overall purpose to them (Appellants' Factum, at paras. 134-43). As I interpret the appellants' submissions, the objection to an "overall purpose" approach is twofold: First, transactions under s. 20(1)(*c*) should be assessed individually rather than as a series (Appellants' Factum, at paras. 90-91). This is an objection to the "overall" aspect of the

"overall purpose" test. Second, this approach is legally incorrect because the purpose of the transactions — whether in the sense of the taxpayer's motivation, of the primary purpose or perhaps even of economic substance — is not determinative in the s. 245(4) inquiry. This is an objection to the "purpose" aspect of the "overall purpose" test.

[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*. I will now review the arguments of the parties from this perspective.

[35] First, with regard to viewing transactions individually versus as a series (i.e., the "overall" aspect of the "overall purpose" test), the appellants argue that the results of a series of transactions are not relevant in an analysis under s. 20(1)(*c*). This submission is based both on the wording of s. 20(1)(*c*) itself, which does not refer to a series of transactions, and on the decisions of this Court and of the Federal Court of Appeal in *Singleton*.

[36] It is true that this Court has held that no recourse may be had to a series of transactions in determining whether s. 20(1)(*c*) applies (*Singleton*, at para. 34). However, at issue is not whether the series is relevant in a s. 20(1)(*c*) analysis, but rather whether it is relevant to an analysis under s. 245(4) of the GAAR. There is no question that a court may consider a series of transactions of which the transaction is a part in order to determine whether the transaction results in abuse and misuse of one or more provisions of the Act. As Noël J.A. noted, this is clear from the wording of the GAAR provisions, and in particular from ss. 245(2) and 245(3)(*b*), which contemplate the denial of a tax benefit resulting from a series of transactions.

[37] Section 245(3)(*b*) indicates that an avoidance transaction is not necessarily a transaction that results in a tax benefit on its own, but may instead be one that is part of a series of transactions that result in a tax benefit. It would be odd if a court could not then consider the rest of that series in determining whether an avoidance transaction resulted in abuse and misuse of provisions of the Act. Further, s. 245(4) states that a tax benefit may be denied if a transaction would result "directly or indirectly" in a misuse of the provisions of the Act or in an abuse having regard to those provisions read as a whole. The use of the words "directly or indirectly" indicates that Parliament intended the GAAR to apply even where abuse is an indirect result of a transaction. It follows logically that regard may be had to the series of transactions when determining whether a transaction within the series is abusive; — otherwise, the GAAR would apply only to transactions that directly result in abuse and misuse. Finally, this Court agreed in *Kaulius* that the s. 245(4) analysis may be conducted "in light of the series of transactions" (para. 46; see also para. 56).

[38] The appellants raise another objection to an "overall purpose" approach. In their view, the Tax Court judge may have been relying on the taxpayers' motivation, the true economic purpose of the transactions, or their economic substance when he adopted this approach. They submit that none of these is determinative at this stage of the analysis (Appellants' Factum, at para. 140). The appellants are correct on this point: it is clear from *Canada Trustco* that the proper approach under s. 245(4) is to determine whether the transaction frustrates the object, spirit or purpose of the provisions giving rise to the tax benefit. An avoidance purpose is needed to establish a violation of the GAAR when s. 245(3) is in issue, but is not determinative in the s. 245(4) analysis. Motivation, purpose and economic substance are relevant under s. 245(4) only to the extent that they establish whether the transaction frustrates the purpose of the relevant provisions (*Canada Trustco*, at paras. 57-60).

[39] Turning to the Tax Court judge's reasons, it is not entirely clear what Bowman C.J.T.C. meant by "overall purpose". He cited and applied the *Canada Trustco* analysis (paras. 17-30), but also appeared, at times, to rely on the taxpayers' motivation and on the economic substance of the transactions. For example, in para. 31, he mentioned that the primary objective of the transactions was to make the interest on the purchase of the house tax deductible. However, as I mentioned above, Bowman C.J.T.C. seems to have focussed on the result of the series of transactions. I will now turn to a review of the specific transactions within the series at issue.

D. *Abuse and Misuse*

[40] According to the framework set out in *Canada Trustco*, a transaction can result in an

abuse and misuse of the Act in one of three ways: where the result of the avoidance transaction (a) is an outcome that the provisions relied on seek to prevent; (b) defeats the underlying rationale of the provisions relied on; or (c) circumvents certain provisions in a manner that frustrates the object, spirit or purpose of those provisions (*Canada Trustco*, at para. 45). One or more of these possibilities may apply in a given case. I should reiterate that in a case like the one at bar, the individual tax benefits must be analysed separately, but always in the context of the entire series of transactions and bearing in mind that each step may have an impact on the others, in order to determine whether any of the provisions relied upon for each tax benefit was misused and abused.

[41] First of all, in accordance with the analytical approach described above, we must consider the tax benefit conferred on Mrs. Lipson by ss. 20(1)(*c*) and 20(3), namely the entitlement to deduct the interest. In my opinion, the respondent has not established that in view of their purpose, these provisions have been misused and abused. Mr. Lipson sold his shares to his wife and bought the residence with the proceeds of that sale (see Statement of Agreed Facts and Conclusion, at para. 12). In the result, Mrs. Lipson financed the purchase of income-producing property with debt, whereas Mr. Lipson financed the purchase of the residence with equity. To this point, the transactions were unimpeachable. They became problematic when the parties took further steps in their series of transactions. The problem arose when Mr. Lipson and his wife turned to ss. 73(1) and 74.1(1) in order to obtain the result contemplated in the design of the series of transactions, namely to have Mr. Lipson apply his wife's interest deduction to his own income. This was contrary to the purpose of s. 74.1(1).

[42] As I mentioned above in para. 32, the purpose of s. 74.1(1) is to prevent spouses from

reducing tax by taking advantage of their non-arm's length relationship when transferring property between themselves. In this case, the attribution to Mr. Lipson of the net income or loss derived from the shares would enable him to reduce the dividend income attributed to him by the amount of the interest on the loan that financed his wife's purchase of those shares. However, before the transfer, when the dividend income was in Mr. Lipson's hands, no interest expense could have been deducted from it. It seems strange that the operation of s. 74.1(1) can result in the reduction of the total amount of tax payable by Mr. Lipson on the income from the transferred property. The only way the Lipsons could have produced the result in this case was by taking advantage of their non-arm's length relationship. Therefore, the attribution by operation of s. 74.1(1) that allowed Mr. Lipson to deduct the interest in order to reduce the tax payable on the dividend income from the shares and other income, which he would not have been able to do were Mrs. Lipson dealing with him at arm's length, qualifies as abusive tax avoidance. It does not matter that s. 74.1(1) was triggered automatically when Mr. Lipson did not elect to opt out of s. 73(1). His motivation or purpose is irrelevant. But to allow s. 74.1(1) to be used to reduce Mr. Lipson's income tax from what it would have been without the transfer to his spouse would frustrate the purpose of the attribution rules. Indeed, a specific anti-avoidance rule is being used to facilitate abusive tax avoidance.

[43] My colleague Rothstein J. agrees that the impugned transactions fall afoul of the *Income Tax Act* but would nevertheless refer the reassessment back to the Minister on the ground that the Minister ought to have relied on the specific anti-avoidance rule in s. 74.5(11) *ITA* instead of the GAAR. In my respectful view, this approach is not open to the Court in this case. Both parties have contended from the outset and reasserted in this Court that s. 74.5(11) *ITA*, on which Rothstein J. rests his conclusion, does not apply on the facts of this case.

[44] Although I agree with Rothstein J. that this Court is not bound to adopt, on a question of law, an interpretation on which the parties agree, it is quite another matter to settle their dispute on a basis of a construction and an application of the statute expressly disavowed by all parties throughout the proceedings. Our decision must turn on the issues as framed in the proceedings and litigated in the courts below and on appeal to this Court. The issue in these appeals was whether the GAAR applies to the impugned transactions.

[45] In my view, for the reasons set out above, the GAAR applies to these transactions. It is true that courts should avoid extending the GAAR beyond its statutory purpose. But, bearing this purpose in mind, where the language of and principles flowing from the GAAR apply to a transaction, the court should not refuse to apply it on the ground that a more specific provision — one that both the Minister and the taxpayers considered to be inapplicable throughout the proceedings — might also apply to the transaction.

[46] In this context, I need not decide whether the taxpayers could have succeeded under s. 74.5(11) *ITA*. I seriously doubt that that provision would have properly addressed the complex series of transactions before this Court in the present appeals. It may have been mentioned in factums and in questions at the hearing, but its interpretation and application were not the issues litigated by the parties in this case. The GAAR was and remains the focus of the present appeals. I would leave the issue of the interpretation of s. 74.5(11) *ITA* for another day.

[47] In the end, the parties focussed on the application of the GAAR, which was the proper

basis for the reassessment. The GAAR is a residual provision, but it is designed to address the complexity of transactions which fall outside the scope of specific anti-avoidance provisions. As I mentioned above, it relates specifically to the impact of complex series of transactions which often depend on the interplay of discrete provisions of the *ITA*. The Minister could properly use the GAAR in respect of a series of transactions that had an impact on more than just one stream of income.

[48] In summary, the tax benefit of the interest deduction resulting from the refinancing of the shares of the family corporation by Mrs. Lipson is not abusive viewed in isolation, but the ensuing tax benefit of the attribution of Mrs. Lipson's interest deduction to Mr. Lipson is. It follows that this latter tax benefit can be denied under s. 245(2), which is triggered because the transactions in the series include the attribution of the interest deduction under s. 74.1(1) and this attribution frustrates the object, spirit and purpose of that provision. I must now briefly consider the tax consequences of the denial of the tax benefit and the application of the GAAR.

E. *Determination of the Tax Consequences of the Application of Section 245(2)*

[49] The Minister seeks to deny the deductibility of the interest expense in the hands of Mr. Lipson, while still attributing the dividend income back to him (see Transcript, at p. 40). The appellants respond that such an outcome is impossible, since s. 74.1(1) only attributes the income or loss back to the transferor (see Transcript, at p. 22). Thus, the tax consequences of the application of s. 245(2) are in issue here.

[50] Section 245(5), without restricting the generality of s. 245(2), sets forth a scheme for determining the tax consequences of the application of that provision. Section 245(5) reads as follows:

> **245.** ...
>
> (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.

[51] When considering the application of s. 245(5), a court must be satisfied that there is an avoidance transaction that satisfies the requirements of s. 245(4), that s. 245(5) provides for the tax consequences and that the tax benefits that would flow from the abusive transactions should accordingly be denied. The court must then determine whether these tax consequences are reasonable in the circumstances. In the present case, disallowing the interest deduction in computing the income or loss attributed to Mr. Lipson and attributing that deduction back to Mrs. Lipson is a reasonable outcome.

F. *Uncertainty and the GAAR*

[52] The appellants and several commentators have warned of the potential for uncertainty should this Court find that the GAAR applies in the instant case. The appellants argue that to maintain certainty for taxpayers, the direct use of the borrowed funds — as determined by tracing — should be determinative of whether the GAAR applies to deductions claimed under s. 20(1)(*c*) (Appellants' Factum, at para. 82). As I mentioned above, such an approach would effectively read the GAAR out of the *ITA*, since the "direct use" test applies only to determine whether interest is deductible under s. 20(1)(*c*) and involves an inquiry that is distinct from the one under s. 245, in which it must be asked whether otherwise valid transactions, such as those in *Singleton* and in the present case, frustrate the object, spirit and purpose of the provisions relied on. Indeed, contrary to the judgments in *Canada Trustco* and *Kaulius*, my colleague Binnie J. essentially guts the GAAR and reads it out of the *ITA* under the guise of an exercise in legal interpretation. To the extent that it may not always be obvious whether the purpose of a provision is frustrated by an avoidance transaction, the GAAR may introduce a degree of uncertainty into tax planning, but such uncertainty is inherent in all situations in which the law must be applied to unique facts. The GAAR is neither a penal provision nor a hammer to pound taxpayers into submission. It is designed, in the complex context of the *ITA*, to restrain abusive tax avoidance and to make sure that the fairness of the tax system is preserved. A desire to avoid uncertainty cannot justify ignoring a provision of the *ITA* that is clearly intended to apply to transactions that would otherwise be valid on their face.

[53] I would therefore dismiss the appeal of Earl Lipson with costs in this Court. Given the agreement between the parties, I would also dismiss the appeal of Jordan B. Lipson with costs in this

Court.

The reasons of Binnie and Deschamps JJ. were delivered by

BINNIE J. —

[54] How healthy is the *Duke of Westminster*? There is cause for concern. Although this Court in *Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54, [2005] 2 S.C.R. 601, affirmed, at para. 11, the continuing viability of the principle that taxpayers are entitled to arrange their affairs to minimize the amount of tax payable (a principle enshrined in *Commissioners of Inland Revenue v. Duke of Westminster*, [1936] A.C. 1 (H.L.)), the traditional approach is now tempered by the application of the general anti-avoidance rule ("GAAR"). The question in these appeals, as it was in *Canada Trustco*, is where the appropriate balance is to be struck.

[55] The GAAR is a weapon that, unless contained by the jurisprudence, could have a widespread, serious and unpredictable effect on legitimate tax planning. At the same time, of course, the GAAR must be given a meaningful role. That role is circumscribed by the requirement in s. 245(4) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.), that the transaction[s] not only be shown to be "avoidance transaction[s]", i.e. transactions structured primarily to obtain a tax benefit, but *in addition* that the Minister demonstrate that the tax benefit results from a misuse/abuse of the provisions of the Act relied upon to produce it.

[56] The tax plan at issue in this case is "*Singleton* with a spousal dimension" — or *Singleton*

with a twist — see *Singleton v. Canada*, 2001 SCC 61, [2001] 2 S.C.R. 1046. In that case, the taxpayer used $300,000 of existing equity in his law firm to purchase a house. He refinanced his law firm equity with borrowed money. He deducted the interest on the loan claiming that the borrowed money now represented his investment in the law firm. Despite the Minister's objection, our Court held that he was entitled to do so.

[57] *Singleton* was not a GAAR case, and it did not involve the spousal attribution rules. Its outcome turned on the Court's view of s. 20(1)(*c*) interest deductibility. Nevertheless, it is important to emphasize at the outset that the Minister is not asking the Court to revisit *Singleton*. He does not claim that the GAAR would have applied on the facts of that case.

[58] In the Statement of Agreed Facts and Conclusion, the Minister acknowledged that it is common ground that the interest was deductible (para. 15). Applying *Singleton*, the only question is whether the deduction becomes "abusive" when income or losses are attributed back to the transferor (appellant) by the spousal attribution rules in ss. 73(1) and 74.1(1).

[59] In my opinion, the spousal "twist" added to *Singleton* should not cause the entire series of transactions to be characterized as abusive. After all, there is nothing in the Act to discourage the transfer of property at fair market value between spouses. Indeed, by allowing a spouse to transfer property to the other spouse at the transferor's adjusted cost base, Parliament intended to make such transfers attractive. If the tax plan in *Singleton* is not abusive, I do not believe the Minister has established that *Singleton* with a spousal twist is abusive tax avoidance either. I would therefore allow the appeals.

Overview

[60] My colleague LeBel J. concludes that the series of transactions in the two appeals at issue here not only amounted to tax avoidance (which it was conceded to be) but *abusive* tax avoidance in the GAAR sense that the series of transactions initiated by the husband's sale of dividend-producing shares to his wife, and ending with his deduction of the interest on the loan used to fund the share acquisition, frustrated "the object, spirit or purpose of one or more of the provisions relied on by the taxpayer" (para. 2). It is true that by means of a series of transactions, the appellant turned the equity in his shares into the part purchase (with his wife) of a house, but as stated, *Singleton* illustrates the proposition that there is nothing abusive in principle for a taxpayer to rearrange his or her capital (borrowed or non-borrowed) in a tax efficient manner.

[61] My colleague Rothstein J. finds in s. 74.5(11) a sort of *deus ex machina* to dispose of the appeals on a basis not advanced by any of the parties. When asked at the hearing of the appeal by Rothstein J. about the possible application of s. 74.5(11), counsel for the Minister stated that in the Minister's view s. 74.5(11) "did not address the particular problem[s] of this case" because "the transfer of the shares by the appellant to the wife was not merely to reduce the tax payable on any future dividends. It was really to get the interest expense up to the appellant" (tr. p. 41). The Minister was not prepared even to argue as a matter of fact "that one of the main reasons in the transfer or loan was to reduce the amount of tax that would, but for this subsection, be payable" within the meaning of s. 74.5(11). The appellant taxpayer was not called on to meet a case under s. 74.5(11) and I do not believe we should assume a factual basis for the application of s. 74.5(11)

("one of the main reasons") which none of the parties was prepared to support. The Minister defends the disputed reassessment squarely on the basis of the GAAR. The appellant responds that the GAAR, in its own terms, has no application. The proper limits of the GAAR raise questions of considerable interest to both taxpayers and tax collectors. I believe we should respond to these questions and leave the more narrowly circumscribed role of s. 74.5(11) to another day when one or other of the parties sees fit to allege a factual basis for its application.

[62] The Minister takes the selective view that while it was perfectly appropriate for s. 74.1(1) to attribute the net dividend income to increase the tax payable by the appellant, it was abusive for s. 74.1(1) to attribute the losses to him, even though, as I see it, (i) the losses and income were both associated with the same transferred shares, (ii) whether the transfer resulted in net income or loss depended on the fluctuating dividends generated by the shares from year to year and (iii) s. 74.1(1) itself draws no distinction between the attribution of "income or loss[es]". Counsel for the Minister maintains that "[i]t is perfectly logical that the attribution rule works to attribute back the net income and that application of the GAAR then denies the interest deduction, under 245(2)" (Transcript, at p. 40). With respect, once it is accepted (as it was here by the Federal Court of Appeal) that the wife borrowed money from the bank to purchase the shares, which qualified the interest as deductible under s. 20(1)(*c*), and that the subsequent bank borrowing secured by a mortgage on the house constituted a refinancing of the original share purchase loan under s. 20(3), which is the result anticipated by *Singleton*, I do not believe that the Minister has shown that the application of the spousal attribution rules to the appellant by operation of law was abusive even though, in the end result, it produced the intended tax benefit. To hold otherwise is to say that whereas it is legitimate for a taxpayer to rearrange his or her capital (borrowed or non-borrowed)

in a tax efficient manner, it becomes abusive when the rearrangement involves a sale of property at fair market value between spouses. Introduction of the spousal element, according to the Minister, forfeits the s. 20(1)(*c*) interest deduction otherwise available under *Singleton*. Neither spouse in this case is to be allowed the benefit even though, under our system of tax assessment, each spouse is taxed individually. As observed in *Jabs Construction Ltd. v. The Queen*, 99 D.T.C. 729: "Section 245 is an extreme sanction. It should not be used routinely every time the Minister gets upset just because a taxpayer structures a transaction in a tax effective way, or does not structure it in a manner that maximizes the tax" (para. 48).

Identification of the Alleged Abuse

[63] The GAAR declares that a transaction or series of transactions which comply with the letter of the *Income Tax Act* may nevertheless be disallowed if the result is directly or indirectly "a misuse of the provisions [of the Act] or an abuse having regard to [the] provisions [of this Act], other than this section, read as a whole" (s. 245(4)). The principles governing the application of the GAAR were considered by the Court in the companion cases of *Canada Trustco*, where the GAAR was held not to be applicable, and *Mathew v. Canada*, 2005 SCC 55, [2005] 2 S.C.R. 643, ("*Kaulius*"), where the GAAR was applied to disallow deductions claimed by the taxpayers. *Canada Trustco* recognized that the line between legitimate tax minimization and abusive tax avoidance is "far from bright" (para. 16). This has proven to be an understatement, and must be read together with the rule in *Canada Trustco* that

> [i]f the existence of abusive tax avoidance is unclear, the benefit of the doubt goes to the taxpayer. [para. 66, point 3]

[64] In my view, when the series of transactions at issue in this case is properly characterized, it is a tax avoidance scheme that falls on the *Canada Trustco* side of the line, and should not have been found to be abusive under the GAAR.

[65] Here, as in *Canada Trustco* and *Kaulius*, it is clear that the series of transactions in question produced a tax benefit in some years for the appellant, and that the "shuffle of cheques" (as these schemes are sometimes characterized) was designed to obtain a tax benefit. Nevertheless the following cautionary observations in *Canada Trustco* are pertinent:

> The courts cannot search for an overriding policy of the Act that is not based on a unified, textual, contextual and purposive interpretation of the specific provisions in issue. . . . To send the courts on the search for some overarching policy and then to use such a policy to override the wording of the provisions of the *Income Tax Act* would inappropriately place the formulation of taxation policy in the hands of the judiciary . . . .
>
> Second, to search for an overriding policy of the *Income Tax Act* that is not anchored in a textual, contextual and purposive interpretation of the specific provisions that are relied upon for the tax benefit would run counter to the overall policy of Parliament that tax law be certain, predictable and fair, so that taxpayers can intelligently order their affairs. [Emphasis added; paras. 41-42.]

Counsel for the Minister argues that the appellant "wanted to take advantage of the tax-free rollover. He wanted to sell the shares to his wife in order to trigger the income-earning use, but he didn't want the consequences that a sale of shares would normally carry with it" (Transcript, at p. 46). But this is precisely the outcome contemplated by Parliament when it enacted the spousal attribution rules. The outcome was not so much an abuse "of the specific provisions" as it was a fulfilment of them. The Minister's argument paints with too broad a brush. *Canada Trustco* requires him to identify

the misuse and abuse of an "object, spirit or purpose" that is "anchored in a textual, contextual and purposive interpretation of the specific provisions that are relied upon for the tax benefit" (para. 42 (emphasis added)). By ignoring the initial sale of shares and recharacterizing the interest payment in relation thereto as nothing more than interest on a house mortgage, and effectively arguing for a stand-alone prohibition on the deductibility of a house mortgage interest (despite *Singleton*), the Minister, with respect, engages in the sort of vague appeal to "overriding policy" or "overarching policy" that *Canada Trustco* sought to eliminate from the GAAR analysis (para. 41).

[66] The Minister argues that Mr. Lipson's use of the attribution rules was abusive because he used them to reduce his tax. At the same time, his counsel readily acknowledged at the hearing that s. 74.1(1) *can* operate to transfer a loss from the lower income spouse up to the higher income spouse (Transcript, at p. 46), thereby opening the door to the higher income spouse (in this case Mr. Lipson) to reduce his tax (see further para. 75 below). Of course Mr. Lipson obtained a tax benefit in some years but the Minister's proposition would, in this respect, further blur the distinction under the GAAR between tax avoidance and *abusive* tax avoidance. As *Canada Trustco* states:

> Even if an avoidance transaction is established under the s. 245(3) inquiry, the GAAR will not apply to deny the tax benefit if it may be reasonable to consider that it did not result from abusive tax avoidance under s. 245(4), as discussed more fully below. [para. 35]

[67] In my opinion the Minister has failed to identify a specific policy shown to be frustrated by the appellant's plan. The approbation by the Court of the Minister's resort to vague generalities or "overriding policy" would only increase the element of uncertainty in tax planning that *Canada Trustco* sought to avoid.

The Series of Transactions

[68] In order to gain a proper appreciation of the context in which abuse is alleged to have resulted, it is useful to identify each distinct legal step in the series of transactions, and relate that step to the relevant provision of the *Income Tax Act.* Of course, in the GAAR analysis, the entire series of transactions must ultimately be taken into consideration to determine whether the tax benefit results from an abuse of the provisions relied upon.

[69] Counsel for the Minister concedes that the GAAR does not permit the re-characterization of these individual transactions. "[E]ach transaction has to be respected for what it is" (Transcript, at p. 35).

[70] At the outset, the appellant owned a substantial block of stock in Lipson Family Investments Ltd. (which I will refer to as "Holdco"). At the conclusion of the series of transactions, he was no longer the owner of $562,500 of the stock. It had been sold to his wife, Jordanna, at what the Minister does not dispute was fair market value.

[71] The wife did not have the cash on hand to buy the shares, so she took out a $562,500 bank loan. I agree with the Federal Court of Appeal that, viewed in isolation, the interest on this loan was clearly deductible under s. 20(1)(*c*) of the Act as money borrowed to acquire an income-producing asset, i.e. the shares in Holdco. Noël J.A. wrote:

> Jordanna having acquired an income producing asset and having financed the cost of acquisition, there is an obvious link between the borrowed money and a current eligible use. As such, paragraph 20(1)(*c*) cannot be said to have been misused.
>
> (2007 FCA 113, [2007] 4 F.C.R. 641, at para. 40)

In other words, deductibility of the interest on the share purchase loan satisfied both the letter *and* the spirit of s. 20(1)(*c*).

[72] Prior to the share purchase, but plainly as part of the same series of transactions, the appellant and his wife agreed to purchase a house for $750,000. On closing, the Lipsons took out a $562,500 mortgage whose proceeds were used to pay off the wife's bank loan. The advantage to the bank of this refinancing was that the $562,500 loan was now secured by a $750,000 house. The Minister concedes that the $562,500 mortgage loan is properly considered to be a refinancing of the $562,500 stock purchase loan. (It is true that the husband was co-charger on the mortgage, but this was necessarily so, given his joint ownership interest in the $750,000 house.) Interest payments were made from a joint account. There is no evidence about the source of funds going into that account. The Minister concedes that viewed in isolation s. 20(3) properly applied to preserve the deductibility of the interest payments. If the Minister's position were otherwise, the parties would be arguing about deductibility under s. 20(3), not the GAAR.

[73] Deductibility is based on the use of the borrowed funds prior to the refinancing (in this case the purchase of income-producing shares), not on the nature of the security eventually provided to secure the refinanced borrowings. Again, I agree with the Federal Court of Appeal that, viewed in isolation, the refinancing of the share purchase loan preserved the deductibility of the interest

payments. Noël J.A. wrote:

> In this case, the mortgage loan was used to repay the money which had been previously borrowed to purchase the shares. As such, the text, context and purpose of subsection 20(3), is to attribute to the mortgage loan the same purpose as the demand loan. Again, ignoring the overall purpose identified by Bowman C.J., I see no basis for holding that there has been an abuse or a misuse of that provision. [para. 42]

[74] At this point, in the sequence of events, the choice offered by Parliament in s. 73(1) presents itself, as explained by Bowman C.J.T.C.:

> Subsection 73(1) has as its purpose the facilitation of inter-spousal transfers of property without immediate tax consequences. Such transfers, in the case of non-depreciable property, are deemed to take place at the transferor's [adjusted cost base] unless the transferor elects to have subsection 73(1) not apply. [2006 TCC 148, [2006] 3 C.T.C. 2494, at para. 21]

The appellant *could* have elected not to enjoy the s. 73(1) rollover. In that event, the disposition of the shares would have been subject to the capital gains tax provisions. However, he did not make that election, and as the Federal Court of Appeal held, *per* Noël J.A.:

> Subsection 73(1) also operated as intended. The shares were transferred from the appellant to Jordanna on a rollover basis (i.e., at the appellant's [adjusted cost base]) and any future gain or loss resulting from the disposition of the shares by Jordanna will be attributed back to the appellant. [para. 37]

[75] Since the appellant did not opt out of s. 73(1), any income or loss from the shares in the hands of Jordanna are deemed to be that of the appellant pursuant to s. 74.1(1) of the *Income Tax Act*. This is understandable. If for tax purposes there is no realization of the property, then for tax

purposes Parliament has decided that the income or losses should stay with the transferor.

[76] My colleague LeBel J. states that "[t]he purpose of s. 74.1(1) is to prevent spouses from reducing tax by taking advantage of their non-arm's length relationship when transferring property between themselves" (para. 42). This concept of an abuse of s. 74.1(1) is so broad that it would include interspousal transfers of assets at fair market value for *bona fide* economic reasons. It offers, I think, too large a field of operation for the GAAR. The reality is that such a reduction in the total amount of tax is the likely result of any interspousal rollover from a higher income spouse to a lower income spouse, a result that s. 74.1 plainly contemplates. Nowhere in the provisions at issue does Parliament indicate that attribution of a loss could only be made from lower income spouses to higher income spouses. On the contrary, even counsel for the Minister acknowledged at the hearing that

> . . . there could be a situation where it is the lower-income spouse transferring a loss up to the higher-income spouse. It can work both ways and that is why you have "income or loss". [Transcript, at p. 46]

Further, it seems that my colleague's definition of s. 74.1(1) abuse is framed broadly enough to include *any* debt-financed transfer of assets between spouses where the tax consequences are attributed back to the transferor spouse, whether such attribution happens because the transferor fails to make the election out of s. 73(1) or because the election is not available in the circumstances. This too gives the GAAR too wide a field of potential operation, in my view.

[77] The focus of my colleague's analysis is the appellant's ability to deduct the interest expense against dividend income, and thus to reduce his taxable income from what it would have

been if the series of transactions had never taken place. Yet the Minister seems to concede that the *Singleton* deduction *per se* is not abusive. And as well, the Minister seems to accept that the deduction would not be abusive if the "income or loss" had been left in the wife's hands. Before the transactions in *Singleton* occurred, it will be recalled, Singleton was responsible for the tax consequences of his partnership stake and there was no interest deduction. Then he withdrew his stake, spent the proceeds on a house, and borrowed money to deposit back into the partnership. The end result was that the partnership stake remained with Singleton — along with a new interest deduction. If the interest deduction is not *per se* abusive, I do not believe the Minister has shown why it becomes abusive with the addition of a spousal rollover that operates precisely as it was intended by Parliament to operate.

[78] When Parliament used the words "income or loss" in s. 74.1(1), it expressly contemplated that regardless of the relative income of the spouses, interest expenses incurred by the transferee (here the wife) will in the circumstances dictated by Parliament be attributed to the transferor (here the appellant). Section 74.1(1) does not change the ownership of the property. It simply attributes the net income or loss arising from the transferred property to the transferor in circumstances where the transferor has decided not to opt for a deemed disposition and thereby risk capital gains tax.

[79] Parliament recognized that an attribution back to the transferor spouse might be inappropriate in some circumstances. The attribution rules include an anti-avoidance provision. Section 74.5(11) provides that the spousal attribution rules

> do not apply to a transfer or loan of property where it may reasonably be concluded that one of the main reasons for the transfer or loan was to reduce the amount of tax that would, but for this subsection, be payable under this Part on the income and gains derived from the property or from property substituted therefor.

The Minister made no attempt to bring this case within s. 74.5(11) (R.F., at para. 45).

[80] In an effort to identify the "object, spirit or purpose" of s. 74.1(1) abused by the appellant's plan, my colleague LeBel J. states, as mentioned, that "the attribution rules in ss. 74.1 to 74.5 are anti-avoidance provisions whose purpose is to prevent spouses (and other related persons) from reducing tax by taking advantage of their non-arm's length status when transferring property between themselves" (para. 32). In my respectful view, what LeBel J. believes s. 74.1(1) is designed to *prevent* is actually a reasonable statement of what s. 74.1(1) seeks to *permit*. This case, as my colleague appears to acknowledge at para. 32, is not about income splitting. The taxpayer's evident purpose was to postpone capital gains tax on the transfer of property to the wife while in the meantime allowing any "income or loss[es]" to be attributed to himself.

[81] My colleague further says at para. 42 that "[t]he only way the Lipsons could have produced the result in this case was by taking advantage of their non-arm's length relationship." I agree, but, far from constituting an *indicia* of abuse, the spousal relationship is precisely the reason Parliament permits the attribution of income or loss back to the transferor. In other words, in my respectful view, the tax consequence my colleague condemns is precisely the consequence called for by s. 74.1(1) unless the taxpayer opts out. Thus, in the view of Noël J.A. writing for the Federal Court of Appeal:

> Considering the transactions as they unfolded, the purposes of subsections 74.1(1) and 73(1) were fulfilled. The appellant (presumably in a higher tax bracket his Counsel suggests) transferred the shares to his spouse with the result that (pursuant to ss. 74.1(1)) any income or loss incurred by Jordanna with respect to the shares was attributed back to the appellant. [Emphasis added; para. 36.]

I agree with the Federal Court of Appeal to the extent that it recognized that the specific purposes of s. 74.1(1) and s. 73(1) were fulfilled, not abused. In my view, moreover, the additional fact that the attribution occurred as part of a *Singleton* "shuffle" does not render the "series of transactions" abusive unless the *Singleton* shuffle itself is abusive, which is a position the Minister declined to advance.

[82] In one of the three years at issue, the appellant's failure to opt out resulted in an *increase* in the appellant's income. In 1995, the taxable dividend paid on the transferred shares and attributed to him under s. 74.1(1) exceeded the interest expense paid on the loan. In the other two years (1994 and 1996), the interest expense exceeded the Holdco dividends. Whether or not the appellant suffers a loss or gains additional income in any particular taxation year depends on the fluctuating amount of the dividends. There was no evidence about the dividend practice or policy of Holdco.

[83] In the Minister's view, apparently, the spousal attribution rules provided in this case a narrow bridge over which income may pass, but not losses.

Identification of the "Overall Purpose"

[84] Having accepted that none of the transactions in the series, taken in isolation, offended

the letter or intent of the tax provisions relied upon by the appellant, the Federal Court of Appeal nevertheless upheld the Tax Court on the basis of the view of the trial judge that "[t]he overall purpose of the scheme obviously was to make the interest on the mortgage on the home deductible by Earl" (Bowman C.J.T.C., at para. 8). Again, at para. 23, the Tax Court judge stated:

> The overall purpose as well as the use to which each individual provision was put was to make interest on money used to buy a personal residence deductible.

This, of course, is the issue subsequently decided in the taxpayer's favour by *Singleton*.

[85] The Federal Court of Appeal saw nothing wrong with the "overall purpose" approach taken by the Tax Court judge:

> Bowman C.J. was entitled to consider the transactions as a whole and their overall purpose in the conduct of his misuse and abuse analysis and to give this factor the weight that he did. [para. 43]

[86] While *Canada Trustco* requires deference to Tax Court judges who have "proceeded on a proper construction of the provisions of the *Income Tax Act*" (para. 66), in my view the "overall purpose" approach that he adopted, and the Federal Court of Appeal accepted, was an error of law that invites our intervention. Identification of "purpose" is relevant to a determination under s. 245(3) about whether the impugned transaction is or is not an "avoidance transaction". The appellant conceded before the Federal Court that it *was* a tax-avoidance scheme. The focus therefore shifts to s. 245(4) which disallows a tax benefit that would, but for the GAAR, "<u>result</u> directly or indirectly in a misuse [or] abuse". At that stage, the principal focus is on results, not

purpose.

[87] Moreover, it is not sufficient, in my view, for the Minister to offer a general "overall" conclusory snapshot of the series of transactions without regard to the legal relationships thereby created. Here, as in *Singleton*, there was a change in the taxpayer's position with real economic substance. The wife became owner of the shares. Apart from the spousal attribution rules, which applied automatically as a result of the appellant's failure to opt out of s. 73(1), she would have been taxed on the dividends, and she would have been taxed on the capital gain or loss on the shares when she sold them. While many spouses regard themselves as forming an economic unit, the rate at which spousal units implode serves as a reminder that the economic union of marriage is neither indissoluble nor free of risk. As the Federal Court of Appeal wrote:

> In this case, Jordanna borrowed money to acquire shares which had the potential to produce and did produce non-exempt income. The change in the respective ownership positions of the appellant and his spouse is real from both a legal and an economic perspective, and this is unaltered by the distinct treatment which the attribution rules provide for the purposes of the Act. The shares no longer belong to the appellant; they belong to Jordanna. [para. 39]

See also M. Thivierge, "GAAR Redux: After Canada Trustco", *Report of Proceedings of the Fifty-Eighth Tax Conference, (2006)*, 4:1; F. Ahmed and C. Priede, "Case Comment — *Lipson v. Canada*" (2007), 17 *Can. Curr. Tax* 77; and T. E. McDonnell, "The Relevance of 'Overall Purpose' in a GAAR Analysis" (2007), 55 *Can. Tax J.* 720.

The Spousal Attribution Rules

[88] Section 74.5(1) provides that the spousal attribution rules do not apply where an individual transfers property to his or her spouse at fair market value *and* elects out of the s. 73(1) spousal rollover. The spousal attribution rules *do* apply if the transferor does *not* elect out of the spousal rollover (as was the case here). Thus, by operation of the spousal attribution rules in ss. 73(1) and 74.1(1), the losses associated with the shares in Holdco were attributed to the appellant.

[89] My colleague LeBel J. concludes that the only provision of the *Income Tax Act* for which the Minister had established abuse contrary to the GAAR is s. 74.1(1) because "the attribution by operation of s. 74.1(1) that allowed Mr. Lipson to deduct the interest in order to reduce the tax payable on the dividend income from the shares and other income, which he would not have been able to do were Mrs. Lipson dealing with him at arm's length, qualifies as abusive tax avoidance" (para. 42). This conclusion it seems to me, with respect, gives the GAAR a sweeping effect not contemplated in *Canada Trustco* or *Kaulius*.

[90] Counsel for the Minister says that in this case, unlike *Singleton*, there was no rearrangement of capital:

> Unlike Mr. Singleton, who had cash sitting in his partnership and was then able to take a mortgage out on his house, Mr. Lipson doesn't have those options because he has only one pot of money, and that is borrowed money. At the end of the day he uses that borrowed money to buy the house. [Transcript, at p. 53]

The Minister's argument simply ignores the initial step in the "series of transactions" , whereby the appellant did in fact and in law sell his dividend-generating shares to his wife at fair market value. I do not believe that *Singleton* can be distinguished on the basis suggested by the Minister. While

the legal relationships actually created by the taxpayer do not control the application of the GAAR, they cannot be ignored.

[91] *Kaulius* states that "the entire factual context of the series of transactions" must be considered and applied to the provisions, properly interpreted (para. 59). If the Minister wished to contend that the share sale was a sham, it was open to him to make the argument, but he didn't, and it must therefore be accepted as an essential part of the "series of transactions".

Was There an Abuse of Section 74.1(1)?

[92] In my view, Parliament must have contemplated that by giving taxpayers a choice under s. 73(1), they would exercise it in a tax-minimizing manner. Once it is accepted that interest is deductible under *Singleton*, the Minister's argument is simply that the appellant's tax plan offended the "object, spirit or purpose" of the spousal attribution rules when the interest deduction was attributed to him by the operation of s. 73(1) and the application of s. 74.1(1). The appellant's counsel suggests that "[t]he attribution rules will always offend the Crown when there is a reduction of tax by virtue of their application" (Transcript, at p. 23). This seems a plausible summary of the Minister's position in this case.

[93] I have already stated the reasons for my conclusion that far from offending the "object, spirit or purpose" of the spousal attribution rules, the appellant's tax plan fulfilled them, or at a minimum did not abuse them.

The Onus is on the Minister to Establish Abuse

[94] *Canada Trustco* is emphatic that the GAAR "was enacted as a provision of last resort" (para. 21), and Parliament "intends taxpayers to take full advantage of the provisions of the *Income Tax Act* that confer tax benefits" (para. 31). The onus of establishing abuse is on the Minister to identify with some precision the "object, spirit or purpose" frustrated by the impugned series of transactions.

[95] As mentioned earlier, the Minister in the Statement of Agreed Facts and Conclusion acknowledged that the interest was deductible. It is also clear that by virtue of s. 20(3), what is being deducted (despite the refinancing) is correctly characterized for tax purposes as the interest on the original share purchase loan. The only question was whether the deductions available to the wife became abusive when attributed by s. 74.1(1) to the appellant.

[96] My colleague LeBel J. says that the foregoing analysis would essentially "gu[t]" the GAAR provision and "reads it out of the *ITA*" (para. 52), but, with respect, this seems a somewhat apocalyptic verdict on a disagreement about whether or not the Minister has met his onus of demonstrating abuse of a specific "object, spirit or purpose" arising out of the "specific provisions" relied upon by the taxpayers to claim the tax benefit. It cannot be right that whenever a lower income spouse borrows money to purchase shares from a higher income spouse there is an abuse of the spousal attribution rules unless the transferring spouse opts out of ss. 73(1) and 74.1(1), and thereby forfeits a tax benefit clearly available under the Act. As stated in *Canada Trustco*:

> 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. [para. 11]

[97] In *Kaulius*, at para. 58, the Court was satisfied that "[i]nterpreted textually, contextually and purposefully", the partnership provisions of the *Income Tax Act* were abused by a series of transactions under which a trust company purported to "sell" unrealized losses to unrelated parties who were entirely at arm's length. The Court stated that the "abusive nature of the transactions [in issue was] confirmed by the vacuity and artificiality" of the transactions which, in the result, "frustrated Parliament's purpose of confining the transfer of losses such as these to a non-arm's length partnership" (para. 62). In this case, the sale of the shares in Holdco was neither vacuous nor artificial. No specific policy was frustrated or defeated by the series of transactions, for the reasons already discussed, in my opinion.

[98] The question here is not whether the series of transactions constituted a tax avoidance scheme. Clearly it did. The appellant readily admits it. However, *Canada Trustco* says that

> a finding of abuse is only warranted where the opposite conclusion — that the avoidance transaction was consistent with the object, spirit or purpose of the provisions of the Act that are relied on by the taxpayer — cannot be reasonably entertained. In other words, the abusive nature of the transaction must be clear. [para. 62]

I do not believe the Minister has shown that the abusive nature of this transaction is "clear". The application of the GAAR in these circumstances, in my respectful view, means paying lip service to the *Duke of Westminster* principle without taking seriously its role in promoting consistency, predictability and fairness in the tax system.

Disposition

[99] I would therefore allow the appeals, with one set of costs throughout.

The following are the reasons delivered by

ROTHSTEIN J. —

Introduction

[100] I have had the benefit of reading the reasons of my colleagues Binnie J. and LeBel J. I am in agreement with their analyses insofar as ss. 20(1)(*c*) and 20(3) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (the "Act"), are concerned. There is no reason why taxpayers may not arrange their affairs so as to finance personal assets out of equity and income earning assets out of debt.

[101] However, I am unable to agree with either of my colleagues' approaches to the attribution rules.

[102] With respect to the views of my colleague, LeBel J., I do not believe it was appropriate for the Minister to rely on the general anti-avoidance rule ("GAAR") in this case. In my opinion, the GAAR does not apply here because there is a specific anti-avoidance rule that pre-empted its application. Had the Minister reassessed Mr. Earl Lipson using the relevant specific anti-avoidance

provision, s. 74.5(11), the tax benefit that resulted from Mr. Lipson's use of the attribution rules would have been precluded.

[103] I agree with Binnie J. that the GAAR does not apply in this case. However, I am unable to agree with his reasons because in my view they do not take account of s. 74.5(11) of the Act. He says, at para. 66:

> ... s. 74.1(1) can operate to transfer a loss from the lower income spouse up to the higher income spouse (Transcript, at p. 46), thereby opening the door to the higher income spouse (in this case Mr. Lipson) to reduce his tax. ... [Emphasis deleted.]

While s. 74.1(1) permits a net loss to be transferred between spouses, this section must be read harmoniously with s. 74.5(11). I agree with Binnie J. that the attribution of a net loss from a lower income spouse to a higher income spouse can occur, in some cases. However, this is not the case where, as here, s. 74.5(11) precludes the attribution of the net loss because one of the main reasons for the transfer of the shares was to reduce the amount of tax that would be payable on the dividend income derived from the shares. By not addressing s. 74.5(11), Binnie J.'s reasons leave the inaccurate impression that because the GAAR did not apply in this case, nothing in the Act prevented the attribution of the net loss to Mr. Lipson.

Analysis

The Relationship Between the GAAR and Section 74.5(11)

[104] In my opinion, the Minister could not reassess Mr. Lipson's use of the attribution rules

on the basis of the GAAR. The Minister can only resort to the GAAR when he has no other recourse. In *Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54, [2005] 2 S.C.R. 601, McLachlin C.J. and Major J. stated at para. 21:

> The GAAR was enacted as a provision of last resort in order to address abusive tax avoidance, it was not intended to introduce uncertainty in tax planning.

In my respectful view, the Minister did have other recourse in this case.

[105] Section 74.5(11) provides:

> Notwithstanding any other provision of this Act, sections 74.1 to 74.4 do not apply to a transfer or loan of property where it may reasonably be concluded that one of the main reasons for the transfer or loan was to reduce the amount of tax that would, but for this subsection, be payable under this Part on the income and gains derived from the property or from property substituted therefor.

Section 74.5(11) is a specific anti-avoidance rule that precludes the use of the attribution rules where one of the main reasons for the transfer of property was to reduce the amount of tax that would be payable on the income derived from the property. As I will explain, that is what occurred here.

[106] The fact that the GAAR is a provision of last resort is indicated by the words of s. 245 itself. Section 245(2) provides:

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

For the Minister to invoke the GAAR, a tax benefit must result unless the GAAR were applied to prevent it.

[107] The wording of s. 245(4) is to the same effect:

> 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
>
> ...
>
> (*b*) would result directly or indirectly in an abuse having regard to those provisions, other than this section, read as a whole.

[108] Again, it is apparent that in order for there to be a finding of misuse and abuse in respect of a transaction, the Act must be read without reference to the GAAR. In other words, s. 245(4) requires that all other relevant provisions of the Act be read before the Minister may have recourse to the GAAR. This would include not only the enabling provision that is alleged to be misused and abused, but also provisions that themselves would prevent the use of the enabling provision for the purpose objected to by the Minister. If there is a specific anti-avoidance rule that precludes the use of an enabling rule to avoid or reduce tax, then the GAAR will not apply.

The Application of Section 74.5(11)

[109] The issue here is whether s. 74.5(11) applies to preclude the attribution back to Mr. Lipson of the net income or loss with respect to the shares transferred to Mrs. Lipson. As I read s. 74.5(11), it provides that there can be no attribution under s. 74.1(1) when one of the main reasons for the transfer of property (the transfer of the shares from Mr. Lipson to Mrs. Lipson) was to reduce the amount of tax that would, but for s. 74.5(11), be payable on the income (dividends less interest) derived from the property (the shares).

[110] It is uncontroversial that one of the main reasons for the transfer of shares to Mrs. Lipson was to use mortgage interest on a loan to reduce or eliminate the income from the dividends on the shares. There were other reasons, but certainly it is reasonable to conclude that this was one of the main reasons.

[111] In 1995, the dividend income exceeded the interest expense and so there was net income. But that net income was less than what it would have been had the transfer not taken place. Without the transfer, the dividends in Mr. Lipson's hands would not have been reduced by any interest expense. In 1994 and 1996, the interest expense exceeded the gross dividend income and no tax was payable on the dividends. There was a net loss. Again, there would have been tax payable by Mr. Lipson on the dividends had the transfer not taken place, whereas with the transfer, no tax was payable on the dividend income.

[112] By using s. 74.1(1), Mr. Lipson was presumably able to apply the net loss on the dividends in 1994 and 1996 to offset his other income in those years. While reducing tax on income earned from sources other than the transferred property would not be caught directly by s. 74.5(11),

offsetting other income cannot take place without the income on the dividends first having been reduced to zero. That is because under s. 74.1(1) the amount attributed back to the transferor, Mr. Lipson, would be the net income or loss from the property transferred. Therefore, the transfer had to have as one of its main purposes the reduction of tax on the income from the transferred property, namely the dividends on the shares transferred to Mrs. Lipson.

[113] In the circumstances, s. 74.5(11) precluded the application of s. 74.1(1). As a result, if it had been invoked by the Minister as the basis for reassessing in respect of the use of s. 74.1(1) by Mr. Lipson, the tax benefit in his hands would have been precluded. By the same reasoning, there could be no misuse and abuse of s. 74.1(1) for purposes of the GAAR because its use would have been pre-empted by s. 74.5(11).

[114] The Minister was obliged to resort to s. 74.5(11) in order to reassess Mr. Lipson in respect of his use of s. 74.1(1). Section 245 did not apply and could not be relied upon by the Minister. The Minister's failure to invoke s. 74.5(11) is fatal to his reassessment in respect of s. 74.1(1).

Responses to LeBel J. and Binnie J.

[115] LeBel J. (at para. 47 of his reasons) says that the GAAR was the appropriate remedy in this case because, in his view, the GAAR "relates specifically to the impact of complex series of transactions". I cannot agree. In my respectful view, my colleague can only reach this conclusion by ignoring the relevant specific anti-avoidance rule contained in the Act, s. 74.5(11), which

precluded Mr. Lipson's use of s. 74.1(1). The fact that a transfer of property between spouses, to which s. 74.1(1) applied, was part of a "complex series of transactions" does not preclude a determination that one of the main reasons for the transfer of property between the spouses was to reduce or eliminate tax on the income derived from the property. The fact that the transfer occurred as part of a series does not permit the Minister to ignore the specific anti-avoidance rule that would preclude the attribution of net income or loss under s. 74.1(1) to the transferor. Nothing in s. 74.5(11) says that it does not apply where the transfer of property between spouses is part of a series of transactions. On the contrary, by its express terms, it does apply. The Minister cannot preemptively rely on the GAAR to address the alleged abusive use of s. 74.1(1) as if s. 74.5(11) did not exist.

[116] LeBel J. writes (at para. 45) that "the court should not refuse to apply it [the GAAR] on the ground that a more specific provision ... might also apply to the transaction." This passage indicates that both the GAAR and s. 74.5(11) may be concurrently applicable. That cannot be correct. This Court was clear in *Canada Trustco* that the GAAR is a provision of last resort. It can only be relied upon by the Minister to address abusive tax avoidance when a relevant specific anti-avoidance rule in the Act does not apply (see also V. Krishna, *The Fundamentals of Canadian Income Tax* (9th ed. 2006), at p. 1018). The GAAR is a supplementary rule. It is not a catch-all provision that the Minister can choose to deploy any or every time that he suspects a taxpayer of abusive tax avoidance.

[117] At para. 47 of his reasons, LeBel J. says that "[t]he Minister could properly use the GAAR in respect of a series of transactions that had an impact on more than just one stream of

income". This passage implies that the tax benefit from the series of transactions included the possibility that Mr. Lipson might set the net losses attributed to him against his other sources of income (other than the dividend income from the shares) to reduce tax and that, because s. 74.5(11) does not preclude this tax benefit, it is not the appropriate provision for the Minister to have relied on. However, in the context of this case, the tax benefit of setting the attributed net losses against Mr. Lipson's other sources of income was precluded by s. 74.5(11). Section 74.5(11) precludes the operation of s. 74.1(1) where, as here, one of the main reasons that Mr. Lipson transferred the shares to Mrs. Lipson was to reduce the amount of tax payable on the dividends from those same shares. No attributed loss could be set off against Mr. Lipson's other sources of income unless the dividend income from the shares was first reduced to zero. On the facts of this case, the Minister did not have to resort to the GAAR to preclude Mr. Lipson from setting off the attributed net losses against his other sources of income because s. 74.5(11) precluded this tax benefit.

[118] Finally, LeBel J. asserts at paras. 43-46 of his reasons that s. 74.5(11) was not the focus of this litigation. Rather, this case was litigated on the basis of the GAAR. Binnie J. makes the same argument at para. 61 of his reasons. While this is true, s. 74.5(11) was referred to in both parties' factums and counsel for both parties were questioned about s. 74.5(11) in oral argument. The fact that the parties did not rely on s. 74.5(11) – either as the basis for reassessment or as the reason why the Minister's claim should fail – does not change the fact that the section applies in law. In my view, the parties cannot avoid the proper application of the Act by conceding or asserting that the relevant provision does not apply. It is not open to this Court to assist the Minister by allowing him to ignore the applicable specific anti-avoidance rule and instead rely on the GAAR.

[119] Binnie J. says that the Court should deal with "[t]he proper limits of the GAAR" and leave s. 74.5(11) to another day. At para. 46 of his reasons, LeBel J. also says that the "interpretation and application" of s. 74.5(11) should be considered in another case. The problem with this argument is that, as noted above, the GAAR is only intended to operate as a provision of last resort. Debating the proper application of the GAAR without taking into account the specific anti-avoidance rule that displaces it ignores the words of the GAAR itself. In my respectful view, it is impossible to define "[t]he proper limits of the GAAR" while failing to recognize the limits imposed by the express terms of the provision itself. Binnie J.'s reliance on an overly broad foundation to base his opinion distorts the actual site of legal conflict. This leads to an unhelpful legal analysis because it ignores the applicable limits that the legislature has chosen to impose on the operation of the GAAR in favour of an analysis that is based on the assumption that the GAAR would be the appropriate anti-avoidance rule where the Minister is able to establish Mr. Lipson's abuse and misuse of s. 74.1(1).

[120] Binnie J. also says that I am "assum[ing] a factual basis for the application of s. 74.5(11)". He asserts that s. 74.5(11) was inapplicable in this case because counsel for the Minister was of the view that the purpose of the transfer of shares from Mr. Lipson to Mrs. Lipson "was not merely to reduce the tax payable on any future dividends. It was really to get the interest expense up [from Mrs. Lipson] to the appellant [Mr. Lipson]" (tr. p. 41). With respect, s. 74.5(11) applies so long as "<u>one of the main reasons</u> for the transfer" was to reduce tax payable on the dividend income from the transferred shares. I do not disagree that one of the main reasons for the transfer of shares from Mr. Lipson to Mrs. Lipson was "to get the interest expense up to the appellant" . However to accomplish that objective, the interest expense deduction first had to be applied to

reduce the dividend income. This is because the operation of s. 74.1(1) only attributes the net income or losses from Mrs. Lipson (the transferee) to Mr. Lipson (the transferor). Section 74.1(1) mandates that the only way to "get the interest expense up to the appellant" was by first reducing or eliminating the dividend income from the transferred shares contrary to s. 74.5(11). Thus, s. 74.5(11) was engaged by operation of law, not by reason of an assumed factual basis.

Conclusion

[121] I accept that the tax benefit that the Minister sought to prevent was obtained by the series of transactions involving ss. 20(1)(*c*) and 20(3) as well as s. 74.1(1). If the Minister wished to reassess in respect of the transactions, relying on the use of all three sections, then his recourse was to reassess in respect of the alleged misuse and abuse of ss. 20(1)(*c*) and 20(3) by invoking the GAAR and s. 74.1(1) by invoking s. 74.5(11).

[122] Had the Minister reassessed on the basis of s. 74.5(11), his remedy would simply have been to disallow Mr. Lipson's use of the attribution rules and leave the dividend income and interest deduction in the hands of Mrs. Lipson. The rollover of the shares from Mr. to Mrs. Lipson at their adjusted cost base would not have been affected.

[123] It may seem anomalous that the rollover would be allowed to stand while the attribution rules would not apply. However, that is the way in which s. 74.5(11) must be interpreted. It does not prevent the operation of s. 73(1) which enables a taxpayer to elect either to rollover the shares to his or her spouse or sell them to him or her at fair market value and pay whatever tax may be

applicable on any capital gains on the shares. Section 74.5(11) is the Minister's remedy when the attribution rules are being used to reduce tax on income from transferred property and it applies "[n]otwithstanding any other provision of this Act", including the GAAR. It is the remedy that Parliament provided in the circumstances. If it does not go far enough in some cases, it is up to the Minister to ask Parliament to change it.

[124] Because there was no abuse of ss. 20(1)(*c*) and 20(3) of the Act and because the Minister could not invoke the GAAR to reassess in respect of Mr. Lipson's use of s. 74.1, I am of the opinion that the appeals should be allowed with one set of costs in this Court and the courts below.

APPENDIX

Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.)

> **18.** (1) In computing the income of a taxpayer from a business or property no deduction shall be made in respect of
>
> (*a*) an outlay or expense except to the extent that it was made or incurred by the taxpayer for the purpose of gaining or producing income from the business or property;
>
> ...
>
> (*h*) personal or living expenses of the taxpayer, other than travel expenses incurred by the taxpayer while away from home in the course of carrying on the taxpayer's business;
>
> **20.** (1) Notwithstanding paragraphs 18(1)(*a*), (*b*) and (*h*), in computing a taxpayer's income for a taxation year from a business or property, there may be deducted such of the following amounts as are wholly applicable to that source or such part of the following amounts as may reasonably be regarded as applicable thereto:
>
> ...
>
> (*c*) an amount paid in the year or payable in respect of the year (depending on the method regularly followed by the taxpayer in computing the taxpayer's income),

pursuant to a legal obligation to pay interest on

(i) borrowed money used for the purpose of earning income from a business or property (other than borrowed money used to acquire property the income from which would be exempt or to acquire a life insurance policy),

(ii) an amount payable for property acquired for the purpose of gaining or producing income from the property or for the purpose of gaining or producing income from a business (other than property the income from which would be exempt or property that is an interest in a life insurance policy),

(iii) an amount paid to the taxpayer under

(A) an appropriation Act and on terms and conditions approved by the Treasury Board for the purpose of advancing or sustaining the technological capability of Canadian manufacturing or other industry, or

(B) the *Northern Mineral Exploration Assistance Regulations* made under an appropriation Act that provides for payments in respect of the Northern Mineral Grants Program, or

(iv) borrowed money used to acquire an interest in an annuity contract in respect of which section 12.2 applies (or would apply if the contract had an anniversary day in the year at a time when the taxpayer held the interest) except that, where annuity payments have begun under the contract in a preceding taxation year, the amount of interest paid or payable in the year shall not be deducted to the extent that it exceeds the amount included under section 12.2 in computing the taxpayer's income for the year in respect of the taxpayer's interest in the contract,

or a reasonable amount in respect thereof, whichever is the lesser;

...

20. (3) For greater certainty, it is hereby declared that where a taxpayer has used borrowed money

(*a*) to repay money previously borrowed, or

(*b*) to pay an amount payable for property described in subparagraph 20(1)(*c*)(ii) previously acquired,

subject to subsection 20.1(6), the borrowed money shall, for the purposes of paragraphs (1)(*c*), (1)(*e*) and (1)(*e*.1), subsections 20.1(1) and (2), section 21 and subparagraph 95(2)(*a*)(ii) and for the purpose of paragraph 20(1)(*k*) of the *Income Tax Act*, Chapter 148 of the Revised Statutes of Canada, 1952, be deemed to have been used for the purpose for which the money

previously borrowed was used or was deemed by this subsection to have been used, or to acquire the property in respect of which the amount was payable, as the case may be.

73. (1) For the purposes of this Part, where at any time any particular capital property of an individual (other than a trust) has been transferred in circumstances to which subsection (1.01) applies and both the individual and the transferee are resident in Canada at that time, unless the individual elects in the individual's return of income under this Part for the taxation year in which the property was transferred that the provisions of this subsection not apply, the particular property is deemed

(*a*) to have been disposed of at that time by the individual for proceeds equal to,

(i) where the particular property is depreciable property of a prescribed class, that proportion of the undepreciated capital cost to the individual immediately before that time of all property of that class that the fair market value immediately before that time of the particular property is of the fair market value immediately before that time of all of that property of that class, and

(ii) in any other case, the adjusted cost base to the individual of the particular property immediately before that time; and

(*b*) to have been acquired at that time by the transferee for an amount equal to those proceeds.

74.1 (1) Where an individual has transferred or lent property (otherwise than by an assignment of any portion of a retirement pension pursuant to section 65.1 of the *Canada Pension Plan* or a comparable provision of a provincial pension plan as defined in section 3 of that Act or of a prescribed provincial pension plan), either directly or indirectly, by means of a trust or by any other means whatever, to or for the benefit of a person who is the individual's spouse or common-law partner or who has since become the individual's spouse or common-law partner, any income or loss, as the case may be, of that person for a taxation year from the property or from property substituted therefor, that relates to the period in the year throughout which the individual is resident in Canada and that person is the individual's spouse or common-law partner, shall be deemed to be income or a loss, as the case may be, of the individual for the year and not of that person.

...

(3) For the purposes of subsections (1) and (2), where, at any time, an individual has lent or transferred property (in this subsection referred to as the "lent or transferred property") either directly or indirectly, by means of a trust or by any other means whatever, to or for the benefit of a person, and the lent or transferred property or property substituted therefor is used

(*a*) to repay, in whole or in part, borrowed money with which other property was acquired, or

(*b*) to reduce an amount payable for other property,

there shall be included in computing the income from the lent or transferred property, or from property substituted therefor, that is so used, that proportion of the income or loss, as the case may be, derived after that time from the other property or from property substituted therefor that the fair market value at that time of the lent or transferred property, or property substituted therefor, that is so used is of the cost to that person of the other property at the time of its acquisition, but for greater certainty nothing in this subsection shall affect the application of subsections (1) and (2) to any income or loss derived from the other property or from property substituted therefor.

74.5 ...

(11) Notwithstanding any other provision of this Act, sections 74.1 to 74.4 do not apply to a transfer or loan of property where it may reasonably be concluded that one of the main reasons for the transfer or loan was to reduce the amount of tax that would, but for this subsection, be payable under this Part on the income and gains derived from the property or from property substituted therefor.

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;

"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;

"transaction" includes an arrangement or event.

(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.

(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.

(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.

(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.

(6) Where with respect to a transaction

(*a*) a notice of assessment, reassessment or additional assessment involving the application of subsection (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 (*a*) or (*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 (2) or make a determination applying subsection 152(1.11) with respect to that transaction.

(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.

(8) On receipt of a request by a person under subsection (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 (6).

Appeals dismissed with costs, BINNIE, DESCHAMPS *and* ROTHSTEIN JJ. *dissenting.*

Solicitors for the appellants: McCarthy Tétrault, Vancouver.

Solicitor for the respondent: Attorney General of Canada, Ottawa.