WORKING PAPER

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AGGRESSIVE TAX PLANNING

Québec

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Finances Québec

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A WORD FROM THE MINISTER

In the 2008-2009 Budget Speech, I pointed out that the aggressive tax planning (ATP) phenomenon was a matter of serious concern for Québec's tax authorities. I also explained that ATP schemes undermine the integrity and the fairness of the tax system and threaten the tax base. Because the tax revenue lost through ATP will have to be collected, sooner or later, from other taxpayers, this conflicts with the well-established principle that everyone should pay its fair share of taxes.

As Minister of Finance, I have a duty to take the necessary actions to protect the tax base. These considerations prompted me to announce, in the 2008-2009 Budget Speech, that a specialized unit would be funded and set up at Revenu Québec to fight against ATP.

I also explained that a review of the legislative framework applicable to ATP was needed and that this review would be preceded by a public consultation.

Accordingly, this document examines the problem of ATP and the legislative tools available to the tax authorities to fight against it. It also describes the actions under consideration for enhancing these tools.

The actions under consideration are measured and reasonable. They are substantially inspired by what is done in some OECD countries. They demonstrate a responsible approach that takes into account the competitive environment we live in, the canadian fiscal context and the characteristics of Québec's tax system.

I invite members of the tax community, associations and professional groups concerned as well as all people with an interest in the subject to read this paper and send us their comments, opinions or suggestions by filing a brief with the ministère des Finances, as prescribed in the appendix.

At the conclusion of the consultation period, the briefs received will be studied and, if applicable, adjustments may be made to the actions under consideration. I thank you in advance for taking the time to participate in this consultation.

Minister of Finance
and Minister responsible for Infrastructure

Monique Jérôme-Forget

TABLE OF CONTENTS

INTRODUCTION

In May 2006, together with federal tax authorities and those of the other provinces, Revenu Québec uncovered an aggressive tax planning (ATP) scheme that, had it not been discovered, would have enabled a group of fewer than 200 taxpayers to avoid payment of more than half a billion dollars of provincial income tax.

In 2004, following an assessment of its activities concerning tax compliance, the Canada Revenue Agency (CRA) concluded that ATP was one of the top four risks of tax non-compliance in Canada.

Meeting in Korea in September 2006, the members of the Forum on Tax Administration of the Organization for Economic Co-operation and Development (OECD) identified compliance with tax legislation as one of the two main challenges facing tax administrations in the coming years. In what is known as the "Seoul Declaration", they emphasized:

> Enforcement of our respective tax laws has become more difficult as trade and capital liberalisation and advances in communications technologies have opened the global marketplace to a wider spectrum of taxpayers. While this more open economic environment is good for business and global growth, it can lead to structures which challenge tax rules, and schemes and arrangements by both domestic and foreign taxpayers to facilitate non-compliance with our national tax laws.[1]

The point to be taken from the above quote is that the phenomenon of ATP is not exclusive to Québec but a global phenomenon that constitutes a risk to the integrity of tax systems.

On the basis of that conclusion, in particular, the Minister of Finance announced, in the 2008-2009 Budget Speech, a two-pronged initiative to fight against ATP schemes: the first in terms of the tax administration and the second in terms of fiscal policy.

In terms of tax administration, $5.3 million in funding has been allocated to Revenu Québec to implement a specialized unit to fight against ATP schemes.

With regard to fiscal policy, this discussion paper is the first step. It depicts the problem of ATP, the legislative tools available in Québec and those used by certain foreign jurisdictions to fight against ATP and, lastly, describes the actions being considered.

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1 OECD, *Seoul Declaration*, third meeting of the OECD Forum on Tax Administration, Seoul, Korea, September 14-15, 2006, online: <http://www.oecd.org/dataoecd/38/29/37415572.pdf> (viewed January 19, 2009).

More specifically, the first section, “Background”, describes the concept of ATP and provides examples of ATP schemes used in Québec. It also explains how the phenomenon is currently growing and identifies what is at stake.

Section 2, “Efforts to fight against ATP in Québec”, provides a status report on Québec’s tax administration and the legislative tools available to it to fight against ATP. It also describes the needs of Québec’s tax authorities and the contextual components that influence fiscal policy in curbing ATP.

Section 3, “Examination of Legislative Tools Used in Other Countries to fight against ATP”, describes some of the legislative tools used by certain foreign jurisdictions to detect ATP at an early stage and the means used by others to curb them.

Lastly, before the conclusion, section 4, “Actions Under Consideration”, describes the changes that are being considered to alter the current risk/reward ratio for a taxpayer who makes use of ATP schemes and discourage the development of a new business model based on designing and distributing off-the-shelf tax products.

1. BACKGROUND

Essentially, tax practice has three components: tax compliance, tax litigation and tax planning. While the purpose of tax compliance is to ensure that taxpayers meet their tax obligations and tax litigation seeks to settle differences between taxpayers and the tax authorities, tax planning is designed to enable taxpayers, within the applicable rules, to organize their affairs so as to minimize their tax burden.

Although the vast majority of tax planning in Québec occurs in the course of genuine business transactions and consists of legitimate tax burden minimization transactions that comply with both the letter and the spirit of the law, tax practice in this field has changed over a number of years, not only in Québec but in all western economies. More specifically, the development of "aggressive tax planning"[2] is now growing vigorously.[3]

Besides, the proliferation of ATP schemes reduces government revenues and impairs the integrity of the tax regime.

1.1 The concept of ATP

In the field of Canadian taxation as in Québec taxation, a distinction is made between tax avoidance and tax evasion in that, usually, the former does not directly contravene any specific rule of the law while the latter violates at least one statutory provision and, consequently, is illegal. That is why ATP is sometimes described as a tax avoidance transaction that complies with the letter but abuses the spirit of the law.

While, at a technical level, aggressive tax planning covers both tax avoidance and tax evasion, the focus of this paper is limited to situations of tax avoidance. Consequently, the expression "aggressive tax planning" or "ATP" is to be understood as a generic reference to tax avoidance excluding tax evasion. The expression "ATP scheme" refers to a specific tax avoidance plan.

The expression "aggressive tax planning" does not refer to a particular type of operations or transactions, but rather to a result obtained in circumstances other than those provided by fiscal policy and not sought by the latter.

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2 Other expressions, such as "abusive tax planning", are also used to designate this type of tax planning. In this paper, the expression "aggressive tax planning" has been used for consistency with the expression used by OECD whose work in this field is authoritative.

3 *Supra*, note 1.

That is why the expression ATP is usually defined by the attributes that characterize this type of tax planning rather than by the operations on which the planning is based.

Accordingly, in general, in terms of income tax, an ATP is said to be a tax avoidance transaction that consists in reducing the effective tax rate of a particular income to a level below the one sought by fiscal policy for such income.

In addition, an ATP scheme is usually a sophisticated transaction including a number of steps and making use of complex mechanisms. Except for the resulting tax benefits, the economic justification of an ATP scheme is generally limited and may even be totally non-existent.

Often, an ATP scheme exploits shortcomings or weaknesses in one, if not more, tax laws at a time. It frequently involves circular movements of funds, shell companies or the use of financial instruments or entities that are treated differently depending on the tax jurisdictions.

Lastly, an ATP scheme usually involves a substantial discrepancy between the financial risk assumed by the taxpayer and the tax benefit expected from the scheme.

1.1.1 ATP, inter-provincial ATP and international ATP

In the context of Québec's income tax system, depending on the tax a particular ATP is seeking to avoid, it is useful to distinguish between ATP, inter-provincial ATP and international ATP.

Accordingly, ATP is at issue where the purpose of a planning is to avoid both provincial and federal income tax, while inter-provincial ATP is at issue where an ATP scheme seeks to avoid provincial income tax exclusively.

In addition, in general, the objective of inter-provincial ATP schemes is either to eliminate all or practically all provincial income tax on income or on certain types of income (for example taxable capital gains), or a double deduction of certain expenses. Consequently, rules dealing precisely with inter-provincial ATP may at times be necessary to combat these practices effectively.

Like ATP, international ATP seeks to avoid income tax at both the provincial and federal levels. However, to achieve its objective, international ATP also relies in part on the tax system of one or more foreign jurisdictions.

Efforts to fight against international ATP are chiefly the responsibility of the federal tax authorities, that have, at their disposal, the international tax treaties and agreements necessary for this activity. Consequently, the role of Québec's tax administration in this regard is especially to share its expertise with the federal tax administration and work with it, in particular by providing data that lie within its jurisdiction.

While ATP, inter-provincial ATP and international ATP all share similar design method and ultimate goal, the distinction between these categories of ATP can be important in examining the legislative tools to fight against each of these tax planning categories.

1.1.2 ATP in Québec

ATP is not a recent phenomenon in Québec. Over the last twelve years, Québec's tax authorities have intervened with legislation a number of times to close ATP schemes. The purpose of these schemes was either to avoid Québec income tax or another provincial income tax, or to avoid both Québec income tax and federal income tax.

The tax authorities also intervened to put an end to interpretation disputes, designed to unduly obtain, regarding sales tax, tax rebates. In this case, while ATP schemes in the strict sense were not at issue, the approach taken by the tax intermediaries with their clients deserves mention.[4]

Here are some examples of ATP schemes and interpretation objections.

4 In most situations, procedures were initiated following actions taken by consultants remunerated on a percentage basis (up to 50% in some cases) who urged their clients to call into question well-established tax rules consistently applied since their introduction.

❑ Québec Shuffle (1996)

The inter-provincial ATP scheme commonly known as the "Québec Shuffle" sought to avoid tax resulting from the alienation of property by taking advantage of the autonomous character of certain provincial legislations. Here is an example of how this ATP scheme would be used by a corporation residing in Québec (the seller) that held shares in the capital stock of another corporation (the shares of the target corporation) for which a takeover bid was made by a third party at a price substantially above their tax cost for the seller:

> The seller would transfer the shares of the target corporation to a newly constituted corporation established, for example, in Ontario (the Ontario corporation) in consideration for shares of the latter. This transfer was made with no immediate tax impact (tax rollover) in Québec by making the election allowed by Québec law, while not making such an election under federal law. Accordingly, no capital gain was realized under Québec law upon the transfer of the shares, but there was a capital gain under the federal law. For the Ontario corporation, the tax cost of the shares of the target corporation was equal to the cost of the shares for federal purposes, i.e. a cost equal to their fair market value. Subsequently, the Ontario corporation alienated the shares of the target corporation to the third party without realizing a capital gain. Accordingly, the seller only paid federal tax on the capital gain realized on the transfer of the shares from the target corporation to the Ontario corporation. No provincial tax was paid either on the transfer or the alienation to the third party. A subsequent merger of the seller with the Ontario Corporation enabled the shares of the Ontario corporation issued as consideration for the shares of the target corporation to be cancelled.

The rollover rules in Québec's tax law that allow a tax deferral were thus used to completely avoid provincial tax, thus thwarting the purpose of these rules. Québec has amended its law to counter this ATP scheme.

❑ Truffles (1998 and 2006)

By placing the residence of a trust in a different province from the one where the beneficiaries reside, the ATP scheme commonly known as the Truffle allowed provincial tax to be avoided by taking advantage of the flexibility of the system applicable to trusts, which, briefly, allows for an election as to which of the trust or the beneficiary assumes the tax relating to the income of the trust. Like the preceding scheme, by making different elections in the jurisdictions involved, this inter-provincial ATP scheme took advantage of the autonomous nature of Québec's legislation to avoid provincial income tax.

Despite a clear and unequivocal fiscal policy regarding the abusive character of Truffles, taxpayers continued to make use of them. A retroactive amendment covering non-prescribed years was added to the legislation to put an end to this ATP scheme.

❑ The amendment to the Québec sales tax (QST) system – School transportation services (2001)

Despite a clear, well-known fiscal policy consistently applied by the taxation community since the QST system had come into force, school boards objected, on the basis of technical arguments, to the exempt character of the school transportation services they supplied. The objective was to raise the rate of the tax rebate school boards could claim from 47% to 100%. A declaratory amendment was necessary to protect tax revenues and ensure that the fiscal policy was maintained.

❑ Amendments to the QST system - Services of sub-contractors and input tax refund (ITR) on energy (2002)

Declaratory amendments were also required to protect tax revenues and ensure compliance with fiscal policy, in the case of undue claims submitted by public service bodies and large businesses that contested well-established tax rules consistently applied by all stakeholders since the QST system had come into effect.

Public service bodies (municipalities, school boards and transit authorities) sought to obtain a full rather than a partial rebate of the QST paid on the taxable services of sub-contractors they acquired to carry out their exempt supplies of services, by contesting the restrictive scope given to the concept of "non-taxable supply of a service".

Moreover, some municipalities sought the same thing by contesting the exempt character of the supply of standard municipal services they provided when they entrusted the execution of these services to sub-contractors.

Lastly, large businesses tried to extend the scope of the exception to the restriction on obtaining an ITR regarding energy acquired in the course of their commercial activities, in order to obtain an ITR regarding such acquisitions.

❑ Charitable donations (2003)

ATP schemes were developed so that registered charities would issue, following acceptance of a donation of physical property, a tax receipt indicating a fair market value of the property well above the price paid by the donors in a transaction involving the immediate transfer of the property to the charities. A retroactive amendment was announced, covering non-statute-barred years, to put an end to these ATP schemes.

❑ Elimination of separate elections (2006)

Some provisions of the tax legislation stipulate that a taxpayer may choose a given tax treatment in certain circumstances. However, most of these circumstances involve separate elections that must be made, if necessary, with each of the two levels of government.

After discovering ATP schemes designed to avoid Québec income tax by comparing various Québec elections separate from the corresponding elections at the federal level, and the various characteristics of the Québec system relating to the federal system, the possibility of making a Québec election different from the corresponding federal election was withdrawn regarding some 80 separate Québec elections.

In addition, it was specified, on the one hand, that the fact that an election was not indicated in the list of withdrawn elections did not mean that such election could be used to avoid payment of provincial taxes and, on the other hand, that, if need be, other separate elections could be withdrawn.

❑ Desynchronization of fiscal periods (2008)

Briefly, despite a similar definition of the expression “taxation year” for all tax jurisdictions in Canada, an inter-provincial ATP scheme took advantage of the autonomous nature of Québec's tax legislation to designate an end of fiscal period date different, in Québec, from the one used for federal income tax purposes and from that of the other provinces.

After desynchronizing end of fiscal period dates, an appropriate combination of the nature, source and amount of income earned by the taxpayer as well as salaries it paid would make it possible to manipulate the provincial income allocation formula – by which the tax base of the taxpayer is divided among the various Canadian tax jurisdictions – so as to avoid all or nearly all provincial income tax and tax on taxable capital gains.

A retroactive amendment was made to the legislation to shut down this ATP scheme.

1.2 Proliferation of ATP schemes

As these examples indicate, ATP phenomenon is not new in Québec’s taxation universe. However, it is only recently that ATP schemes have proliferated to a growing pool of taxpayers, in particular corporations.

The proliferation of ATP schemes can be explained by economic and commercial factors, such as the increase in the supply of and demand for ATP, an attractive risk/reward ratio for taxpayers that make use of them and the emergence of a new business model for tax intermediaries. In addition, some features of Québec's tax system have an impact on the development of ATP schemes and on how the tax administration can go about fighting against them.

1.2.1 Economic and commercial factors

Economic and commercial factors include factors outside the ATP universe, therefore factors foreign to this universe, and endogenous factors, i.e. factors specific to it.

❑ Increase in the supply of and demand for ATP

The development of communication technologies and electronic finance, the introduction of innovative financial products and the global integration of national economies, are exogenous factors that have led to greater competition among businesses as well as a greater need for them to control their costs, including their tax costs, which usually represent a significant expense item.

This need among businesses in turn fostered the expansion of firms of tax intermediaries – lawyers, accountants, investment banks, in particular – and the development among the latter of an advanced knowledge of various tax regimes as well as sophisticated expertise for integrated management of their clients' tax situation on a global basis. The highly competitive market for tax consulting services fuelled the appetite of taxpayers to further reduce their tax costs and encouraged advisors to design ATP schemes.

❑ An attractive risk/reward ratio for the taxpayer

The virtual absence of negative financial consequences regarding ATP is one of the most important endogenous factors in the proliferation of these schemes because it ensures a very attractive risk/reward ratio for the taxpayer.

Accordingly, when assessing the advisability of participating in an ATP scheme or not, a taxpayer must first estimate the risk that the scheme will be detected by the tax authorities. The simple ratio between the number of taxpayers and the number of audits that the tax administration can carry out each year shows that, without indicators to attract the attention of the tax administration to a specific ATP scheme, the risk that the taxpayer will be subject to a tax audit is rather low. In the taxation field, this favourable ratio in favour of the taxpayer is known as audit lottery.[5]

Second, in assessing his risk, the taxpayer must also take into account the existence of a limitation period in tax matters. Accordingly, the taxpayer can note that the tax administration has a time period, generally three or four years following the date the first notice of assessment is sent, to contest the ATP scheme. In a field known for its complexity, a limitation period of three or four years is relatively short. Consequently, in the ATP universe, the passage of time works in favour of the taxpayer and can influence his decision to participate in an ATP scheme.

Third, after assessing the risk of timely detection of his ATP scheme by the tax administration, the taxpayer must estimate the risk that the tax administration successfully applies the general anti-avoidance rule. As discussed in subsection 2.2.2, the courts apply the general anti-avoidance rule only where a scheme is clearly abusive, with the burden of proof concerning abuse resting on the tax administration. Consequently, at this stage in the assessment of his risk, the taxpayer may consider that, despite the possibility that the tax administration may contest the ATP scheme, the likelihood of keeping the tax benefit he is seeking is relatively good.

Lastly, after assessing the likelihood of the tax administration detecting the ATP scheme in good time and successfully contesting it before the courts, the taxpayer must then assess the potential cost should the tax administration prove successful. As the law currently stands, since the application of the general anti-avoidance rule does not involve penalty on the taxpayer, the negative consequences of participating in an ATP scheme are limited to the withdrawal of the tax benefit sought by the taxpayer.

Of course, and it is normal, the usual interest costs, calculated on the difference between the amount of tax payable by the taxpayer, without the ATP scheme, and the amount of tax he initially paid, taking the ATP scheme into consideration, are added to the loss of the tax benefit to the taxpayer. These interest costs are often offset by the yield the taxpayer obtains on the difference in unpaid tax during the period concerned.

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5 Daniel N. SHAVIRO, "Disclosure and Civil Penalty Rules in the U.S. Legal Response to Corporate Tax Shelters", (January 9, 2007), New York University School of Law, *New York University Law and Economics Working Papers*, Paper 83; Kyle D. LOGUE, "Optimal Tax Compliance and Penalties When the Law is Uncertain", 27 *Va. Tax Rev.*, 241 (2007).

Obviously, the taxpayer bears the cost of setting up the ATP scheme. However, should the scheme prove unsuccessful, these costs can be reduced considerably to the extent that the remuneration of his advisors depends on obtaining the tax benefit sought by the taxpayer.

In short, the current risk/reward ratio clearly favours the taxpayer seeking to participate in an ATP.

❑ A new business model for tax intermediaries

The need among companies for tax efficiency, coupled with relative impunity regarding ATP, has fostered the development of ATP as a new specialty in the field of taxation. That is the second endogenous factor encouraging the growth of ATP.

This specialized practice has itself given rise to a new business model for tax advisors.[6] According to this new business model, the tax intermediary first designs an ATP scheme, i.e. an appropriate combination of factors and transactions that can generate appreciable tax benefits for certain taxpayers. Subsequently, a target client group is identified and the "tax idea" is further refined so it can be proposed to the largest number of clients possible as an "off-the-shelf tax product".

The marketing features of off-the-shelf tax products often include requirements regarding the confidentiality of the scheme, for example, by prohibiting the taxpayer from revealing the ATP scheme used to anyone during a certain period. In addition, the remuneration of the tax intermediary is usually conditional, in whole or in part, on the taxpayer obtaining the tax benefits he is seeking and is proportional to them. Lastly, the tax intermediary can also try to limit his professional liability by having the taxpayers concerned sign a release of liability clause.[7]

Accordingly, based on this new business model of tax intermediaries, a trade relation based on the sale of an off-the-shelf tax product, in return for remuneration that is conditional and proportional to the tax avoided, replaces the traditional relation of consulting service remunerated on the basis of an hourly rate.

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6 Here is how Thomas E. McDonnell described the new business model:

> In Des Chênes, the school board evidently used the services of a commodity tax bounty hunter. This is an example of the modern style of tax planning. In an era marked by increasingly complicated tax provisions and intense competition for clients, an industry has sprung up that is devoted to mining the anomalies of the tax rules as an end in itself. (Thomas E. McDonnell, "Retroactivity: Policy and Practice", in *2006 Conference Report*, Toronto, Canadian Tax Foundation, 2007, p. 2:1-33, page 2:22).

7 In this regard, article 1474 of the *Civil Code of Québec* stipulates that a person may not exclude or limit his liability in cases of intentional or gross fault. A gross fault is a fault which shows gross recklessness, gross carelessness or gross negligence.

Lastly, in view of the significant financial benefits that may arise from the sale of such off-the-shelf tax products, tax intermediaries may be strongly motivated to create new ATP schemes.

1.2.2 Characteristics of the tax system that have an impact on the development of ATP

Some characteristics of the tax system have an impact on the development of ATP. These characteristics also have a direct effect on how the tax administration can go about fighting against ATP.

This subsection deals with certain passages of legal decisions that have clarified important points that must be taken into consideration in efforts to curb ATP. These points concern the legitimacy of tax planning, the interpretation of the tax laws and the role of the courts in tax matters.

Besides these, other points or characteristics specific to Québec's tax system or to ATP itself also limit the action of the tax authorities in fighting against ATP: among others, the fact that the tax system is based on self-assessment by taxpayers, the fact that an ATP scheme frequently involves multiple tax jurisdictions and, lastly, the fact that the description of ATP schemes is sometimes covered by lawyer or notary professional secrecy, though this is not specific to the tax system. These points will be reviewed briefly.

❑ Self-assessment

One of the prime characteristics that makes fighting against ATP difficult is the fact that Québec's tax system is a self-assessment system, i.e. a reporting system in which the taxpayer himself determines his tax payable.

Since the taxpayer himself determines his tax payable, it is up to the tax administration to review the taxpayer's tax return, check the facts on which his return is based and, if need be, adjust the amount of tax it considers he owes.

Self-assessment has the advantage of affording substantial savings in terms of tax system management and administration costs. Still, in the context of ATP, this feature of Québec's tax system can, to some degree, make things easier for taxpayers who want to venture into ATP.

❑ The legitimacy of tax planning

A second feature of the tax system that influences efforts to fight against ATP concerns the legitimacy of tax planning. The courts have acknowledged that a taxpayer can legitimately organize his affairs in such a manner as to pay as little tax as possible.

This precedential principle, known as the Duke of Westminster principle, has been recognized for a long time in Canadian tax law and is cited frequently as a basic principle of tax planning in Canada.

Mr. Justice Estey of the Supreme Court of Canada (Supreme Court) acknowledged it in these words in the *Stubart Investments Ltd*. decision:

> What then is the law in Canada as regards the right of a taxpayer to order his affairs so as to reduce his tax liability without breaching any express term in the statute? [...]
>
> [...]
>
> In the field of taxation itself the traditional position was re-echoed in *Inland Revenue Commissioners v. Duke of Westminster*, [1936] A.C. 1, at pp. 19c20, where it was stated:
>
>> Every man is entitled if he can to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax.[8]

While in the past there has been some ambiguity as to scope and true meaning of this principle in Canada's tax law, the Supreme Court clarified the situation, in particular in the *Shell Canada Ltd*. decision:

> However, this Court has made it clear in more recent decisions that, <u>absent a specific provision to the contrary</u>, it is not the courts' role to prevent taxpayers from relying on the sophisticated structure of their transactions, arranged in such a way that the particular provisions of the Act are met, on the basis that it would be inequitable to those taxpayers who have not chosen to structure their transactions that way. [...] The courts' role is to interpret and apply the Act as it was adopted by Parliament. *Obiter* statements in earlier cases that might be said to support a broader and less certain interpretive principle have therefore been overtaken by our developing tax jurisprudence. <u>Unless the Act provides otherwise</u>, a taxpayer is entitled to be taxed based on what it actually did, not based on what it could have done, and certainly not based on what a less sophisticated taxpayer might have done.[9] [Underlining added]

8 *Stubart Investments Ltd.* v. *The Queen*, [1984] 1 S.C.R. 536, 552.

9 *Shell Canada Ltd.* v. *Canada*, [1999] 3 S.C.R. 622, par. 45.

However, this principle has never been absolute[10] and the general anti-avoidance rule (GAAR)[11] tempers it by establishing a line between legitimate tax planning and abusive tax avoidance. Therefore, the adoption of GAAR does not mean that the Duke of Westminster principle has been scrapped since, as Chief Justice McLachlin and Justice Major argue, on behalf of the Supreme Court, in one of its first two decisions on the GAAR:

> According to the Explanatory Notes, Parliament recognized the Duke of Westminster principle "that tax planning — arranging one's affairs so as to attract the least amount of tax — is a legitimate and accepted part of Canadian tax law" (p. 464). Despite Parliament's intention to address abusive tax avoidance by enacting the GAAR, Parliament nonetheless intended to preserve predictability, certainty and fairness in Canadian tax law. Parliament intends taxpayers to take full advantage of the provisions of the *Income Tax Act* that confer tax benefits. Indeed, achieving the various policies that the *Income Tax Act* seeks to promote is dependent on taxpayers doing so.[12]

Because tax planning is an accepted dimension of Canada's tax law, tax legislation requires a high degree of clarity. For this reason in particular, it contains many details as well as a large number of specific anti-avoidance provisions. Such details and specific provisions add complexity to the tax legislation, leading to increased recourse to interpretation.

❑ Rules of interpretation in tax matters

The rules of interpretation, in taxation, have a major influence on the choice of tools the tax authorities may use in fighting against ATP. Accordingly, a review of these rules of interpretation is useful.

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10 *Lipson* v. *Canada*, 2009, SCC 1, par. 21 (Justice LeBel).

11 This rule, added to the tax legislation in 1988, is designed to prevent abusive tax avoidance. It is considered in greater details in subsection 2.2.2.

12 *Canada Trustco Mortgage Co.* v. *Canada*, [2005] 2 S.C.R. 601, par. 31.

Historically, the courts have adopted a literal approach to interpretation in taxation. In the *Stubart Investments Ltd.* decision,[13] the Supreme Court substituted the "entire context approach" for it, which had previously been adopted for other areas of law. Subsequently, in the *Corporation Notre-Dame de Bon-Secours* decision,[14] the Supreme Court adopted the "purposive approach" to interpret the tax laws. In some decisions, the Court opted for the "ordinary meaning approach" when faced with clear and detailed statutory provisions.[15] More recently, the Supreme Court clarified the rules of interpretation that apply depending on the nature of the tax provisions under examination. Accordingly, in the following passage from the *Placer Dome Canada Ltd.* decision, Justice LeBel, speaking on behalf of the Supreme Court, aptly summarizes the state of Canadian law regarding the interpretation of the tax legislation:

> In *Stubart Investments Ltd. v. The Queen*, [1984] 1 S.C.R. 536, this Court rejected the strict approach to the construction of taxation statutes and held that the modern approach applies to taxation statutes no less than it does to other statutes. That is, "the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament" (p. 578): see 65302 *British Columbia Ltd.* v. *Canada*, [1999] 3 S.C.R. 804, at para. 50. However, because of the degree of precision and detail characteristic of many tax provisions, a greater emphasis has often been placed on textual interpretation where taxation statutes are concerned: *Canada Trustco Mortgage Co.* v. *Canada*, [2005] 2 S.C.R. 601, 2005 SCC 54, at para. 11. Taxpayers are entitled to rely on the clear meaning of taxation provisions in structuring their affairs. Where the words of a statute are precise and unequivocal, those words will play a dominant role in the interpretive process.
>
> On the other hand, where the words of a statute give rise to more than one reasonable interpretation, the ordinary meaning of words will play a lesser role, and greater recourse to the context and purpose of the Act may be necessary: *Canada Trustco*, at para. 10. Moreover, as McLachlin C.J. noted at para. 47, "[e]ven where the meaning of particular provisions may not appear to be ambiguous at first glance, statutory context and purpose may reveal or resolve latent ambiguities." The Chief Justice went on to explain that in order to resolve explicit and latent ambiguities in taxation legislation, "the courts must undertake a unified textual, contextual and purposive approach to statutory interpretation".

13 See note 8 above.

14 *Québec (Communauté urbaine)* v. *Corp. Notre-Dame de Bon-Secours*, [1994] 3 S.C.R. 3.

15 See in particular *Friesen v. Canada*, [1995] 3 S.C.R. 103.

> The interpretive approach is thus informed by the level of precision and clarity with which a taxing provision is drafted. Where such a provision admits of no ambiguity in its meaning or in its application to the facts, it must simply be applied. Reference to the purpose of the provision "cannot be used to create an unexpressed exception to clear language": see P.W. Hogg, J.E. Magee and J. Li, *Principles of Canadian Income Tax Law* (5th ed. 2005), at p. 569; *Shell Canada td.* v. *Canada*, [1999] 3 S.C.R. 622. Where, as in this case, the provision admits of more than one reasonable interpretation, greater emphasis must be placed on the context, scheme and purpose of the Act. Thus, legislative purpose may not be used to supplant clear statutory language, but to arrive at the most plausible interpretation of an ambiguous statutory provision.[16]

The tax legislation must accordingly be interpreted using a unified textual, contextual and purposive approach that makes it possible to take the purpose of a given provision into account. However, where a statutory text has a high degree of accuracy, a more literal approach is indicated, unless the statutory provision admits of more than one reasonable interpretation, in which case greater emphasis must be placed on the context, scheme and purpose of the statutory text to give it the most plausible interpretation.

Simply put, given a detailed text like that of most provisions of the tax legislation, a literal approach to interpretation is to be preferred, unless the text presents real ambiguity. Since an ATP scheme usually fulfils the letter of the law, this interpretive approach makes the job of the tax administration more difficult.

❑ The role of the courts

The role of the courts in taxation is another point that must be taken into consideration in the context of the efforts to fight against ATP.

Indeed, the belief might be widespread that given an interpretation of a statutory text that leads to significant negative consequences for the public treasury, as well as an inequitable situation for other taxpayers, and that in all likelihood does not comply with the fiscal policy sought by the tax authorities, the courts would be justified in remedying deficient legislation to prevent a result that is inappropriate for public finances. However, a review of court decisions shows that such is not the case.

In *Stubart*, Mr. Justice Estey, on behalf of the majority of the Supreme Court, noted the traditional role of the courts that must avoid construing the provisions of tax law to counter tax planning arrangements that some may see as inappropriate:

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16 *Placer Dome Canada Ltd.* v. *Ontario (Minister of Finance)*, [2006] 1 S.C.R. 715, par. 21-23. To the same effect: *Canada Trustco Mortgage Co.*, note 12 above, par. 10-13; *Mathew* v. *Canada*, [2005] 2 S.C.R. 643, par. 42; A.Y.S.A. *Amateur Youth Soccer Association* v. *Canada (Revenue Agency)*, [2007] 3 S.C.R. 217, par. 16. (Justice Rothstein); *Lipson* v. *Canada*, note 10 above, par. 26 (Justice LeBel).

> The question comes back to a determination of the proper role of the court in construing the *Income Tax Act* in circumstances such as these where the Crown relies on the general pattern of the Act and not upon any specific taxing provision. The Act is to be construed, of course, as a whole, including s. 137 but, for reasons already noted, without applying that section specifically to these assessments. The appellant stands to save taxes if its program is successful. The Crown loses revenue it might otherwise receive. At least in theory, the burden falls on other taxpayers to make up the lost revenue. Lord Simon of Glaisdale had this to say in not dissimilar circumstances (*Ransom* v. *Higgs* (1974), 50 Tax Cas. 1, at p. 94):
>
>> It may seem hard that a cunningly advised taxpayer should be able to avoid what appears to be his equitable share of the general fiscal burden and cast it on the shoulders of his fellow citizens. But for the Courts to try to stretch the law to meet hard cases (whether the hardship appears to bear on the individual taxpayer or on the general body of taxpayers as represented by the Inland Revenue) is not merely to make bad law but to run the risk of subverting the rule of law itself. Disagreeable as it may seem that some taxpayers should escape what might appear to be their fair share of the general burden of national expenditure, it would be far more disagreeable to substitute the rule of caprice for that of law.
>
> All this may reflect the tradition of annual amendments to the *Income Tax Act* when to government budget for the ensuing year is presented to Parliament for approval. Perhaps the facility of amendment to the *Income Tax Act* is one of the sources of the problem since the practice does not invite the courts to intervene when the legislature can readily do so.[17]

As mentioned previously, this position was taken in the *Shell Canada Ltd* decision.[18] Madame Chief Justice McLachlin and Mr. Justice Major, on behalf of the Supreme Court, also reiterated it in the *Canada Trustco Mortgage Co.* decision:

> [...] 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, requiring judges to perform a task to which they are unaccustomed and for which they are not equipped. Did Parliament intend judges to formulate taxation policies that are not grounded in the provisions of the Act and to apply them to override the specific provisions of the Act? Notwithstanding the interpretative challenges that the GAAR presents, we cannot find a basis for concluding that such a marked departure from judicial and interpretative norms was Parliament's intent.[19]

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17 See note 8 above, p. 578-579.

18 See note 9 above.

19 See note 12 above, par. 41.

Lastly, in the *McLarty* decision, Mr. Justice Rothstein, writing on behalf of the majority of the Supreme Court, pointed out that the role of the courts is not to protect government revenue:

> [...] In reassessment cases, the role of the court is solely to adjudicate disputes between the Minister and the taxpayer. It is not a protector of government revenue. The court must decide only whether the Minister, on the basis on which he chooses to assess, is right or wrong. [...][20]

Consequently, it is the responsibility of the tax authorities, not the courts, to protect government revenue.

❑ Multiplicity of jurisdictions

It has already been indicated that one of the characteristics of ATP schemes is to exploit shortcomings or weaknesses in one, if not many statutes at the same time, and that such schemes often involve the use of entities or financial instruments that are treated differently depending on the tax jurisdiction.

While ATP schemes do not always involve a multiplicity of jurisdictions, many are designed specifically to be used in such a context. Accordingly, often as part of a series of transactions, lack of liaison between the national legislation of various countries, or between tax jurisdictions within the same country, as is the case with the various tax jurisdictions in Canada, will be exploited.

In addition, by involving more than one tax jurisdiction in an ATP scheme, part of the details of the planning can be kept hidden from scrutiny by the tax administration, which sometimes has difficulty obtaining a complete picture of the tax planning in order to understand and estimate the resulting tax consequences.

To overcome the difficulties arising from the multiplicity of jurisdictions, Québec's tax administration must in particular participate in exchange of information agreements with the tax administrations involved. However, despite the effectiveness of such agreements, the involvement of more than one tax jurisdiction in planning usually increases the length of time needed to deal with a case. As previously mentioned, the existence of a limitation period, generally of three or four years after the first notice of assessment is sent, is one factor in favour of a taxpayer who participates in an ATP scheme.

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20 *R.* v. *McLarty*, 2008 SCC 26, par. 75. A few years earlier, at an annual conference of the Canadian Tax Foundation, Mr. Justice Rothstein, who was then on the panel of the Federal Court of Appeal, made the following remarks in this regard: "If bad drafting leaves a loophole that people will take advantage of, the question is whether the courts should be closing the loophole. In my view, they shouldn't be. Perhaps I should say arguably they shouldn't be. The role of the court is as arbitrator between the minister and the taxpayer. We are the protectors of neither the public nor the private purse". See Brian ARNOLD, Judith FREEDMAN, Al MEGHJI, Mark MEREDITH, Hon. Marshall ROTHSTEIN, "The Future of GAAR", *2005 Conference Report*, Canadian Tax Foundation, p. 4:7.

Moreover, while Québec's tax administration has significant powers of investigation and audit to maintain the integrity of the tax system, these powers normally do not apply outside Québec's borders. Similarly, a judgement obtained by Québec's tax administration against a taxpayer is not immediately enforceable beyond Québec's borders.

As can be seen, the multiplicity of jurisdictions can result in difficulties in detecting and dealing with ATP schemes and imposes significant limits on the action of the tax administration.

❑ Lawyer or notary professional secrecy

In Québec, professional secrecy is governed by a number of statutory provisions. The most important provision is in section 9 of the *Charter of Human Rights and Freedoms*[21] that acknowledges that every person has a right to professional secrecy and that no person bound to professional secrecy by law may, even in judicial proceedings, disclose confidential information revealed to him by reason of his position or profession, unless he is authorized to do so by the person who confided such information or by an express provision of the law. The *Professional Code*[22] imposes observance of professional secrecy on all the members of the professional orders it governs, not just on lawyers[23] and notaries.[24] Article 2858 of the *Civil Code of Québec* strengthens the obligation to maintain professional secrecy by stipulating that the court must of its own motion bring up any breach of professional secrecy and reject any evidence obtained as a result thereof.

In taxation, professional secrecy is limited by sections 46 and 53.1 of the *Act respecting the ministère du Revenu*[25] that stipulate that only a lawyer or a notary may refuse to have a document in his possession examined or seized under that act if he considers that such examination or seizure would constitute a breach of professional secrecy. Other professionals, including accountants, cannot refuse to have a document in their possession examined or seized under that act on the grounds that such examination or seizure would constitute a breach of their professional secrecy.

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21 R.S.Q., c. C-12.

22 R.S.Q., c. C-26, s. 60.4.

23 Lawyers are also bound under section 131 of the *Act respecting the Barreau du Québec*, R.S.Q., c. B-1.

24 Notaries are also bound under section 14.1 of the *Notaries Act*, R.S.Q., c. N-3.

25 R.S.Q., c. M-31.

Determining the bounds within which the lawyer's or the notary's confidentiality obligation applies can, at times, cause problems. Suffice it to say here that the space within these bounds is not limited to the opinion, advise or counsel given by the lawyer or the notary.[26]

In the course of an investigation of a specific ATP scheme, the lawyer's or notary's professional secrecy may limit the action of the tax administration in seeking information to help understand the ATP scheme.

Accordingly, the lawyer's or notary's professional secrecy places limits on the action of the tax administration and must be taken into consideration in choosing legislative tools that can be deployed to fight against ATP.

1.3 Issues relating to ATP

1.3.1 Public finances

Generally, the chief objective of a tax is to collect revenues needed to fund public services. Consequently, the primary effect of ATP schemes is to upset public finances by unduly reducing government revenue.

Moreover, since the very purpose of an ATP scheme is to reduce, indeed avoid tax, it is not possible to accurately quantify the overall cost of these tax planning schemes. However, the size of the amounts involved in ATP schemes uncovered by the tax authorities over the last ten years does make it possible to identify trends and estimate the relative scope of the ATP phenomenon.

To illustrate the size of the amounts at issue, it is useful to point out that were it not for the actions taken by the tax authorities in recent years to put an end to certain ATP schemes and certain disputes mentioned in subsection 1.1.2, the losses to Québec's public finances would have been roughly half a billion dollars, as shown below:

Amendment to the QST system in 2001:	$100 million
Amendment to the QST system in 2002:	$87 million
Charitable donations 2003:	$15 million
Truffles 2006:	$230 million[27]
Desynchronization 2008:	$70 million[28]

26 See in particular the decisions *Foster Wheeler Power Co.* v. *Société intermunicipale de gestion et d'élimination des déchets (SIGED) inc.*, [2004] 1 S.C.R. 456 and *Maranda* v. *Richer*, [2003] 3 S.C.R. 193.

27 Québec's share. The losses for all the provinces involved could amount to more than $500 million.

28 This is an estimated minimum concerning Québec's share.

Concerning Québec Shuffle transactions and those that could be done before a large number of distinct Québec elections were withdrawn on December 20, 2006, the financial impact of the modifications to counter these ATP schemes cannot be accurately quantified since the amendments to the legislation were not retroactive as was the case in the situations mentioned above. However, as with the latter cases, it is reasonable to think that the financial impact of these amendments on Québec's public finances also figures in the tens of millions of dollars.

Turning to the federal tax authorities, the Canada Revenue Agency (CRA) launched a major initiative in 2004 to fight against ATP. In its 2006-2007 annual report submitted to the Parliament of Canada in January 2008, commenting on its activities to fight against ATP, the CRA pointed out:

> During 2006-2007, the CRA issued about 14,600 reassessments related to $1.4 billion in additional identified taxes, due in part to our focus on the early analysis and identification of tax shelter planning schemes.[29]

It can therefore be concluded that ATP have a negative impact on public finances and that the impact is substantial.

1.3.2 The fairness and the integrity of the tax system

Since ATP is usually associated with high-income taxpayers who can afford sophisticated professional services, the proliferation of ATP schemes raises serious issues of fairness among taxpayers.

If the government wants to maintain a balanced budget, it will nonetheless have to collect, from other taxpayers, the tax revenue lost through ATP which directly violates one of the basic principles of our social organization, i.e. that everyone participates in funding the state on the basis of his ability to contribute.

Such a transfer of tax burden among taxpayers is worrisome in itself since it can foster a feeling of unfairness and injustice among taxpayers. As previously mentioned, Québec's tax system is a self-assessment system, i.e. a reporting system in which the taxpayer himself determines his tax payable. Like a vicious circle, the perceived unfairness and injustice in such a system are such as to discourage the taxpayers to comply with the law, and consequently, increase the chances of damaging the integrity of the system.

Accordingly, the impact of the proliferation of ATP schemes on such fundamentals as taxpayers' feelings of fairness and justice, poses a real threat to Québec's tax base.

29 CANADA REVENUE AGENCY, 2006-2007 *Canada Revenue Agency Annual Report*, p. 59.

Lastly, ATP have a long history and it is unrealistic to think that they will completely disappear one day. However, in view of its consequences and the feelings it gives rise to among taxpayers, the question the tax authorities face is not so much whether they should act but rather whether they can afford not to act.

1.4 Observations

What emerges from the preceding is that ATP has significant financial and social consequences for Québec society.

On the one hand, the tax revenue lost to the public treasury because of ATP schemes amounts to hundreds of millions of dollars and gives rise to an equivalent transfer of the tax burden among taxpayers. On the other hand, this transfer of the tax burden can undermine the feeling of trust among taxpayers in the tax system and gives rise to feelings of injustice and unfairness that, in turn, increase the chances of damage to the integrity of the tax system.

It has also been shown that ATP is not a new phenomenon in Québec's taxation landscape and that over the last twelve years, Québec's tax authorities have intervened with legislation a number of times to put an end to ATP schemes. In addition, in 2006, Québec's tax authorities made a more sweeping amendment to the legislation by eliminating almost 80 Québec elections that were separate from the corresponding federal elections.

Moreover, the proliferation of ATP schemes is not limited to Québec, but rather affects all Western economies. Although many factors can explain the proliferation of ATP, economic and commercial factors stimulate both the supply of and demand for ATP, while certain factors, some specific to the tax system, others to the legal system, set limits on the defensive action the tax authorities can take.

Observation of these factors and these characteristics shows us however that Québec's tax authorities have little or no sway over the various constraints that limit their defensive actions, or over the various external economic and commercial factors that foster the proliferation of ATP, like trade globalization.

Consequently, if they want to curb the use of ATP, Québec's tax authorities must concentrate their efforts on the endogenous economic and commercial factors, namely the risk/reward ratio of ATP schemes and the new business model of certain tax intermediaries.

As the jurisprudence shows, the responsibility to protect Québec's tax base and ensure that public revenues are maintained lies with the tax authorities which, within the limits imposed on them, must see that they have the statutory tools and means of control necessary for the defence of the integrity of the tax system.

By announcing in the 2008-2009 Budget Speech the implementation within Revenu Québec of a specialized unit to fight against ATP, Québec's tax authorities clearly indicated that they wanted the resources needed to curb ATP.

With the tabling of this discussion paper on the review of available statutory tools to fight against ATP, Québec's tax authorities are aiming to equip themselves with the statutory tools that will enable them to carry out defensive actions against ATP, and also to take the offensive against these tax planning schemes that undermine the integrity of the tax system.

2. EFFORTS TO FIGHT AGAINST ATP IN QUÉBEC

In the 2008-2009 Budget Speech, Québec announced a strategy to fight against ATP. Under this strategy, Québec's tax authorities would intervene at two levels, namely at the level of the tax administration and that of fiscal policy.

More specifically, regarding the tax administration, it was announced that additional financial resources of nearly $16 million over three years would be allocated to Revenu Québec to enhance its expertise regarding ATP, upgrade its computer systems tools for detecting ATP and take the appropriate steps to vigorously fight against ATP that are identified, in particular by setting up a team specializing in managing, detecting and curbing ATP.

At the fiscal policy level, it was announced that the legislative tools currently available to fight against ATP would be assessed and, if necessary, adjusted, and certain legislative tools used in other jurisdictions would be studied to determine whether they would be useful in the context of Québec's tax system.

This section briefly describes the organization of Revenu Québec in fighting against ATP schemes and provides a short description of the situation in partner tax administrations. This is followed by a description and an assessment of the legislative tools currently available to Québec's tax administration to fight against ATP. Lastly, the needs of Québec's tax authorities for fighting against ATP are discussed and the contextual items that have an influence on fiscal policy in this regard are described.

2.1 The tax administration

2.1.1 A central unit specializing in fighting against ATP

Following the announcement of additional funding for a team formed to fight against ATP, Revenu Québec has set up, in recent months, a central unit specializing in fighting against such schemes.

Reporting directly to the Deputy Minister of Revenue, this central unit, dedicated exclusively to fighting against ATP, coordinates all the organization's activities in this matter. This specialized unit is also supported by all the resources of the tax administration depending on their expertise and their respective mission.

Ultimately, this central unit will consist of specialized resources with the following mandates:

- coordinate activities concerning efforts to fight against ATP for the entire organization;
- carry out risk analyses;

- elaborate new methods to detect ATP and determine the groups at risk;
- come up with strategies to curb identified ATP schemes;
- propose legislative amendments to effectively fight against ATP.

2.1.2 Cooperation among jurisdictions

As explained in the last section, because in particular it allows some of the details of an ATP scheme to be kept beyond the knowledge of the tax administration, the multiplicity of jurisdictions can result in difficulties in detecting and dealing with ATP schemes and imposes significant limits on the action of the tax administration.

To remedy this difficulty, it is essential that tax administrations maintain free-flowing channels of communication and exchange, harmonize certain practices that help detect ATP schemes and their users and, if need be, take part in common actions.

To that end, Revenu Québec's new specialized unit is responsible for establishing and maintaining links with other tax jurisdictions in Canada to, in particular, exchange information and design multi-jurisdiction intervention strategies when they prove necessary.

In this regard, it is important to point out that almost all the provinces do not collect their income taxes directly. Rather, they leave this responsibility to CRA under a tax collection agreement. Apart from Québec, which collects all its own taxes, CRA collects the tax revenues for all other jurisdictions in Canada regarding personal income tax, and all other jurisdictions in Canada other than Alberta regarding corporate income tax.

Like Québec's tax administration, CRA and the Alberta tax administration have each set up a specialized unit to manage, detect and curb ATP schemes. Such specialized units make it possible for the various tax administrations to work closely together on matters of tax avoidance.

The following passage from the Alberta budget presented in 2007 is a good illustration of the importance of cooperation among jurisdictions in fighting against inter-provincial ATP schemes:

> Some corporations have begun to use provincial tax avoidance schemes that exploit technical elements of tax laws in ways that are contrary to their object and spirit. <u>In cooperation with other provinces and the federal government</u>, Alberta has been able to identify four specific schemes, involving a number of corporations that operate in the province. It is estimated that over $200 million in provincial tax revenue is at risk to date.

> The increased use of these schemes puts our low tax rates at risk and is unfair to the vast majority of Albertans and Alberta businesses who comply with the letter and the spirit of the tax laws. Over the next year, Alberta Finance will take steps to protect the provincial tax base by dedicating more resources to address these types of schemes.[30] [Underlining added]

Ontario already participates in a tax collection agreement regarding, in particular, personal income tax and, since January 2009, has transfered collection of most corporate taxes to CRA. Regarding inter-provincial tax avoidance, the agreement reached by the governments of Canada and Ontario stipulates, in particular, in section 5:

> 5. Inter-provincial Tax Avoidance
>
> 5.1 During the period 2006-07 to 2009-10, CRA will develop and implement a national initiative comprising
>
> (a) enhanced audits of provincial allocation of taxable income by corporations,
>
> (b) enhanced targeting of inter-provincial tax avoidance by corporations, and
>
> (c) the additional workload relating to issues under paragraphs (a) and (b) in the areas of rulings and technical interpretations. [...][31]

Against this background, CRA set up a national team in 2007 to head its inter-provincial tax avoidance activities. Like its strategy for fighting against international ATP schemes,[32] CRA assigned more auditors to identify new inter-provincial avoidance schemes and their users. In addition, as part of the multi-jurisdiction cooperation in fighting against inter-provincial ATP schemes, CRA shares the results of its analyses with provincial tax administrations to foster the development of common strategies in fighting against them.

It can be concluded from the above that inter-jurisdiction cooperation is a key factor in fighting against inter-provincial ATP schemes and that tax administrations have implemented the necessary structures to optimize this cooperation.

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30 ALBERTA, *Budget 2007*, *Managing our growth*, *Alberta Tax Advantage*, April 19, 2007, p. 141-142.

31 *Memorandum of Agreement Concerning a Single Administration of Ontario Corporate Tax*, Annex C: *Memorandum of Understanding Concerning Administration of Ontario Corporate Taxes*, clause 5.1, online: <http://www.fin.gc.ca/toc/2006/TxMOA-eng.asp> (viewed January 19,2009).

32 In 2004, CRA identified ATP as one of the four main risks to the integrity of the tax system. In 2005, CRA's budget was increased by $30 million to, in particular, set up eleven centres of expertise that work as a team to detect and assess ATP schemes and international ATP schemes, as well as to identify the participants in and promoters of these schemes.

2.2 Legislative tools currently available

2.2.1 Specific anti-avoidance rules

Tax law consists in managing the tax consequences arising from events, transactions or situations whose nature is determined by virtue of civil law. In this sense, it is said that tax law is essentially incidental law whose essence is to govern and stipulate the tax effects of realities that exist otherwise.

At times, the tax system pursues objectives other than the collection of the revenue needed for government operations, for instance at the socio-economic level. Accordingly, it no longer manages just the consequences of transactions otherwise carried out, but is at the source of the actions taken. In these cases, the incidental nature mentioned above then becomes central and the nature of the relevant items for achieving these objectives is determined by the tax system itself.

The tax system consists of various generic rules. Once the reality targeted by these rules is identified, they stipulate various resulting consequences.

Taxpayers sometimes divert these generic rules from their objective.

Accordingly, to prevent such diversions and protect the fairness and integrity of the tax system, special rules are sometimes needed, which can be described as "specific anti-avoidance rules".[33] These rules, which are stipulated in the legislation, set out in advance the consequences of a suspected or undesirable situation, to better secure compliance with tax policy.

❑ The advantages and disadvantages of specific anti-avoidance rules

The main advantage of a specific anti-avoidance rule is that its field of application is relatively clearly defined. In general, such a rule adds an element of certainty and fosters better understanding of the object, spirit and purpose of the legislation.

On the other hand, since they apply only to stipulated or suspected situations, specific anti-avoidance rules cannot prevent avoidance transactions not previously detected. Indeed, it is difficult to predict all possible avoidance techniques.

33 For example, the existing legislation stipulates specific rules to prevent the use of tax-free inter-corporate dividends to reduce the capital gain resulting from the sale of stock. There are also specific rules to prevent the conversion of dividends into non-taxable repayments of capital or into capital gains eligible for the capital gains exemption allowed by the tax system or, in other words, to prevent the tax-free stripping of corporate surplus.

In addition, when a new technique is detected and a specific anti-avoidance rule is introduced to deal with it, the rule generally suffers from the disadvantage of applying to new situations and not affecting avoidance transactions carried out before the rule became effective.

❑ Coexistence of specific anti-avoidance rules and the GAAR

When a specific anti-avoidance rule is introduced to prevent an undesirable result in a particular situation of abuse, the taxpayers that benefited from this undesirable result tend to invoke the introduction of the new rule to try to argue that the result in question did not violate either the object or the spirit of any pre-existing rule. This argument was made in the *Water's Edge Village Estates (Phase II) Ltd.* case[34] in which Mr. Justice Noël of the Federal Court of Appeal rejected it as follows:

> Counsel argued that the prospective addition of subsection 96(8) demonstrates unequivocally that the transactions in issue did not offend the object and spirit of the Act at the time when they took place. I rather think that this amendment demonstrates that Parliament moved as quickly as it could to close the loophole exploited by the appellants precisely because the result achieved was anomalous having regard to the object and spirit of the relevant provisions of the Act.

Consequently, where all the conditions are satisfied for the purposes of the GAAR, the forward-looking introduction of tighter legislation by means of a specific anti-avoidance rule cannot be used to block the application of the GAAR on the grounds that the amendment covers a situation that was not specially prohibited.

It is also acknowledged that the GAAR can apply to abusive transactions that circumvent the application of a specific anti-avoidance rule:

> [...] 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 [...].[35]

34 *Water's Edge Village Estates (Phase II) Ltd.* v. *Canada*, [2003] 2 F.C. 25, par. 47.

35 *Canada Trustco Mortgage* v. *Canada*, note 12 above, par. 45. A similar position was taken by the Privy Council regarding the general anti-avoidance rule of New Zealand. See *Challenge Corporation* v. *IRC*, [1986] 2 NZLR 513 (P.C.).

Moreover, where it is shown that the conditions for the application of a specific anti-avoidance rule are satisfied, the remedy it stipulates must be applied. The tax authorities cannot then invoke the GAAR to substitute a remedy they consider more suitable.[36]

❑ Specific anti-avoidance rules are useful and effective

Where applied to stipulated or suspected situations,[37] specific anti-avoidance rules are one of the best tools for fighting against tax avoidance in particular because they are easy to apply.

When they are introduced to the legislation following discovered avoidance transactions, like the Québec Shuffles, Truffles and the elimination of separate elections, their effectiveness depends on the speed with which the legislator acts to eliminate the loophole.

Specific anti-avoidance rules are therefore useful and have a proven track record.

2.2.2 The general anti-avoidance rule

As explained above, a specific anti-avoidance rule is not a legislative tool designed to counter an avoidance scheme that does not stem from a particular type of transaction and that, in the view of the tax administration, results in an abusive tax position with respect to the objectives of the legislation.

To counter such schemes, tax administrations tend rather to turn either to the approach based on the presence of a general anti-avoidance rule in the legislation, or to that based on the recognition by the courts of anti-abuse legal doctrines. Since 1988, the federal and Québec income tax laws have contained a GAAR.[38]

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36 This is the dissenting opinion of Mr. Justice Rothstein in *Lipson* v. *Canada*, note 10 above, where he wrote in par. 108: "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 other judges did not rule on the application of the specific anti-avoidance rule, paragraph 74.5(11) of the *Income Tax Act* to be specific, because both parties to the dispute maintained from the beginning that it did not apply having regard to the facts (Mr. Justice LeBel, for the majority, at par. 43-46 and Mr. Justice Binnie, dissenting, at par. 61). In the *Canada Trustco Mortgage* v. *Canada* decision, note 12 above, par. 21, Madam Chief Justice McLachlin and Mr. Justice Major, on behalf of the Supreme Court, indicated that the GAAR is a provision of last resort.

37 As in the cases mentioned in note 32.

38 The Canadian and Québec legislation regarding sales tax also include a GAAR similar to the income tax GAAR. See sections 478 to 485 of the *Act respecting the Québec sales tax*, R.S.Q., c. T-0.1 and section 274 of the *Excise Tax Act*, R.S.C., 1985, c. E-15.

❑ Brief history of the GAAR

At the time of the 1987 tax reform, the Department of Finance Canada (Finance Canada) said it was concerned by tax avoidance and noted that the law in Canada regarding tax avoidance did not allow the tax administration to attack schemes on the basis of the absence of business purpose.

In addition, regarding the applicable legislation at the time, Finance Canada considered that it did not allow the tax administration to deal effectively with certain tax avoidance mechanisms.

Consequently, Finance Canada considered that a change was necessary.[39]

In the *Canada Trustco Mortgage* decision, Madam Chief Justice McLachlin and Mr. Justice Major, on behalf of the Supreme Court, summarized the circumstances leading to the introduction of the GAAR as follows:

> The GAAR was enacted in 1988, principally in response to *Stubart Investments Ltd.* v. *The Queen*, [1984] 1 S.C.R. 536, which rejected a literal approach to interpreting the Act. At the same time, the Court rejected the business purpose test, which would have restricted tax reduction to transactions with a real business purpose. Instead of the business purpose test, the Court proposed guidelines to limit unacceptable tax avoidance arrangements. Parliament deemed the decision in *Stubart* an inadequate response to the problem and enacted the GAAR.[40]

Following the adoption of the GAAR at the federal level, the Minister of Finance of Québec announced that Québec's tax legislation would be harmonized with the new federal provisions concerning the GAAR.[41]

Since its adoption, the federal GAAR has been amended only once to, in particular, specify that the abusive situations covered by the rule also include cases of abuse in the application of the provisions of the *Income Tax Regulations*, the *Income Tax Application Rules* and a tax treaty.[42]

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39 DEPARTMENT OF FINANCE CANADA, *Tax reform 1987*, *Income tax reform*, Chapter 6 "Tax avoidance and compliance", June 18, 1987, p. 129-130.

40 See note 12 above, par. 14.

41 MINISTÈRE DES FINANCES DU QUÉBEC, Information Bulletin 88-8, "Minister's statement concerning a supplementary deduction of 33 ⅓ percent for surface mining exploration expenses incurred in Québec and other fiscal measures, December 22, 1988, Appendix, p. 6, measure 13. See *an Act to again amend the Taxation Act and other fiscal legislation,* S.Q. 1990, c. 59, sec. 351.

42 *Budget Implementation Act, 2004, n° 2, S.C. 2005, c. 19, sec. 52*.

In the 2004-2005 Budget Speech, the Minister of Finance of Québec announced that Québec's tax legislation would be harmonized with the amendments to the federal GAAR.[43]

❑ The objectives of the GAAR

The introduction of a general anti-avoidance provision sought to prevent degradation of the tax base and discourage aggressive tax planning, by distinguishing between legitimate tax planning and abusive tax avoidance, while satisfying taxpayers' need for certainty in planning their affairs.[44]

Madame Chief Justice McLachlin and Mr. Justice Major, on behalf of the Supreme Court, described the objects of the GAAR in *Canada Trustco Mortgage*:

> The GAAR draws a line between legitimate tax minimization and abusive tax avoidance. The line is far from bright. The GAAR's purpose is to deny the tax benefits of certain arrangements that comply with a literal interpretation of the provisions of the Act, but amount to an abuse of the provisions of the Act. But precisely what constitutes abusive tax avoidance remains the subject of debate. Hence these appeals.[45]

The same judges also commented as follows on the importance of balance in the application of the GAAR:

> A proper approach to the wording of the provisions of the *Income Tax Act* together with the relevant factual context of a given case achieve balance between the need to address abusive tax avoidance while preserving certainty, predictability and fairness in tax law so that taxpayers may manage their affairs accordingly. Parliament intends taxpayers to take full advantage of the provisions of the Act that confer tax benefits. Parliament did not intend the GAAR to undermine this basic tenet of tax law.[46]

Accordingly, the GAAR essentially seeks to strike a balance between protection of the tax base and taxpayers' need for certainty by drawing a line between legitimate tax planning and abusive tax avoidance.

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43 MINISTÈRE DES FINANCES DU QUÉBEC, *2004-2005 Budget*, *Additional Information on the Budgetary Measures*, March 30, 2004, Section 1, p. 179. See an *Act to amend the Taxation Act and other legistative provisions*, S.Q. 2006, c. 13, sec. 203 to 205.

44 DEPARTMENT OF FINANCE CANADA, *Explanatory Notes to Proposed legislation*, June 1988, sec. 186, p. 461.

45 See note 12 above, par. 16.

46 *Id.*, par. 61.

❑ Standards of application of the GAAR

■ Preliminary considerations

Given that the jurisprudence dealt with in this sub-section deals more with the federal legislation that Québec legislation, the presentation of a concordance table between the subsections of section 245 of the *Income Tax Act* (I.T.A.)[47] and the corresponding provisions of Québec's *Taxation Act* (Q.T.A.)[48] is useful:

I.T.A.	Q.T.A.	I.T.A.	Q.T.A.	I.T.A.	Q.T.A.	I.T.A.	Q.T.A.
245(1)	1079.9	245(3)	1079.11	245(5)	1079.13	245(7)	1079.15
245(2)	1079.10	245(4)	1079.12	245(6)	1079.14	245(8)	1079.16

Accordingly, in this sub-section, a reference to a provision of the federal legislation is also valid for a reference to the corresponding provision of Québec's legislation.

Moreover, before examining the standards of application of the GAAR, it is also useful to give its principle:

Subsection 245(2) I.T.A.	Section 1079.10 Q.T.A.
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.	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 Title, would result, directly or indirectly, from that transaction or from a series of transactions that includes that transaction.

47 R.S.C. 1985, c. I (5th supp.).

48 R.S.Q., C. I-3.

To date, the Supreme Court has ruled on the application of the GAAR three times. In October 2005, in decisions related to *Canada Trustco Mortgage,*[49] in which it decided that the GAAR did not apply, and *Mathew,*[50] in which it ruled that it did apply, the Supreme Court unanimously set out the framework of analysis for determining whether or not there is abusive tax avoidance. More recently, the Court was called on to clarify this framework of analysis in the case of a series of transactions giving rise to more than one tax benefit. On January 8, 2009, in a majority decision, it ruled, in the *Lipson* case,[51] that the GAAR did apply. The standards of application of the GAAR will therefore be examined in light of this case-law.

■ A three-step process

As mentioned previously, the GAAR seeks to draw a line between legitimate tax planning and abusive tax avoidance. However, drawing such a line is not easy. To do so, the Supreme Court formulated a three-step process in *Canada Trustco Mortgage*:

> The application of the GAAR involves three steps. The first step is to determine whether there is a "tax benefit" arising from a "transaction" under s. 245(1) and (2). The second step is to determine whether the transaction is an avoidance transaction under s. 245(3), in the sense of not being "arranged primarily for *bona fide* purposes other than to obtain the tax benefit". The third step is to determine whether the avoidance transaction is abusive under s. 245(4). All three requirements must be fulfilled before the GARR can be applied to deny a tax benefit.[52]

Thus, according to the Supreme Court, three elements, defined according to the meaning they are given by the relevant provisions of the legislation, must be present for the GAAR to apply, namely a tax benefit, an avoidance transaction and an abuse.

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49 See note 12 above.

50 See note 16 above. This decision is generally known as the "Kaulius" decision.

51 See note 10 above. Mr. Justice LeBel wrote the reasons for the majority judgment, with the agreement of Justices Fish, Abella and Charron. Mr. Justice Binnie wrote the minority's reasons, with the agreement of Madam Justice Deschamps. Mr. Justice Rothstein also wrote a dissenting opinion.

52 See note 12 above, par. 17.

- **The tax benefit**

The first step in applying the GAAR is to determine whether there is a tax benefit arising from a transaction or series of transactions of which the transaction is part.[53] According to Québec's legislation, the expression "tax benefit" is defined as follows:

> "**tax benefit**" means a reduction, avoidance or deferral of the tax or of another amount payable under this Act or an increase in a refund of tax or of another amount under this Act, including a reduction, avoidance or deferral of the tax or of another amount that would be payable under this Act but for a tax agreement, and an increase in a refund of tax or of another amount under this Act that results from a tax agreement;[54]

The expression "transaction", for its part, includes an arrangement or event.[55] As for the expression "series of transactions", the Supreme Court has specified, in *Canada Trustco Mortgage*, that such a series involves a number of transactions that are pre-ordained in order to produce a given result with no practical likelihood that the pre-planned events would not take place in the order ordained.[56]

Moreover, the tax legislation stipulates that where there is a reference to a series of transactions or events, the series is deemed to include any related transactions or events completed in contemplation of the series.[57] In this regard, the Supreme Court specified that the words "in contemplation" are used not in the sense of actual knowledge, but in the broader sense of "because of" or "in relation to" the series. According to the Supreme Court, these words can apply to events either before or after the avoidance transaction.[58]

Lastly, if a transaction or a series of transactions confers many tax benefits, the GAAR analysis should be conducted in respect of each of those tax benefits.[59]

- **Avoidance transaction**

The second step is to determine whether the transaction constitutes an avoidance transaction covered by the GAAR,[60] in the sense that it was not carried out mainly for *bona fide* purposes, other than obtaining a tax benefit.[61]

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53 *Id.*, par. 18; *Mathew* v. *Canada*, note 16 above, par. 33.

54 Sec. 1079.9 Q.T.A. See to the same effect subsection 245(1) I.T.A.

55 *Id.*

56 See note 12 above, par. 25.

57 Sec. 1.5 Q.T.A. and par. 248(10) I.T.A.

58 *Canada Trustco Mortgage* v. *Canada*, see note 12 above, par. 26.

59 *Lipson* v. *Canada*, see note 10 above, par. 22 (Mr. Justice LeBel).

60 Sec. 1079.11 Q.T.A. and par. 245(3) I.T.A.

61 *Canada Trustco Mortgage v. Canada*, see note 12 above, par. 21.

According to the Supreme Court, what is needed at this stage is an objective assessment of the relative importance of the driving forces of the transaction. Accordingly, if there are both tax and non-tax purposes to a transaction, it must be determined, based on the relative importance of the driving forces, whether it was reasonable to conclude that the non-tax purpose was primary.[62]

Lastly, according to the Supreme Court, if at least one transaction in a series of transactions is an avoidance transaction, then the tax benefit that results from the series may be denied under the GAAR.[63]

- **Abuse**

After establishing the existence of a tax benefit resulting from an avoidance transaction, the third step is to demonstrate that the transaction is abusive for the purposes of the GAAR.[64] According to the Supreme Court, this is the major difficulty in the interpretation and application of the GAAR:

> It is this requirement that has given rise to the most difficulty in the interpretation and application of the GAAR. A number of features have provoked judicial debate. The section is cast in terms of a double negative, stating that the GAAR does "not apply to a transaction where it may reasonably be considered that the transaction would not result directly or indirectly in a misuse … or an abuse". It is tempered by the word "reasonably", suggesting some ministerial and judicial leeway in determining abuse. It does not precisely define abuse or misuse. […][65]

According to the Supreme Court, the third step requires a two-part examination:

> In summary, s. 245(4) imposes a two-part inquiry. The first step is to determine the object, spirit or purpose of the provisions of the *Income Tax Act* that are relied on for the tax benefit, having regard to the scheme of the Act, the relevant provisions and permissible extrinsic aids. The second step is to examine the factual context of a case in order to determine whether the avoidance transaction defeated or frustrated the object, spirit or purpose of the provisions in issue.[66]

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62 *Id.*, par. 27-28.

63 *Id.*, par. 34.

64 Sec. 1079.12 Q.T.A. and par. 245(4) I.T.A.

65 *Canada Trustco Mortgage* v. *Canada*, see note 12 above, par. 37.

66 *Id.,* par. 55. See to the same effect: *Lipson* v. *Canada,* see note 10 above, par. 25 (Mr. Justice LeBel).

The first part of the inquiry, i.e. the determination of the object, spirit or purpose of the provisions that are relied on for the tax benefit, is a question of law that must be examined using a unified textual, contextual and purposive approach to interpretation in order to find meaning that harmonizes the wording, object, spirit and purpose of the provisions of the legislation.[67]

Concerning the second part of the examination, i.e. the examination of the facts to determine whether the avoidance transaction defeats or frustrates the object, spirit or purpose of the provisions in question, this is a question of fact the answer to which can be in the affirmative only where the opposite conclusion – that the avoidance transaction was consistent with the object, spirit or purpose of the provisions that are relied on by the taxpayer – cannot be reasonably entertained;[68] the benefit of the doubt in this regard goes to the taxpayer.[69]

In the case of a series of transactions, the examination of abuse must take into account the remarks of Mr. Justice LeBel, on behalf of the majority, in the *Lipson* case:

> 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.[70]

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67 *Canada Trustco Mortgage* v. *Canada*, see note 12 above, par. 47 and *Lipson* v. *Canada,* see note 10 above, par. 26 (Mr. Justice LeBel).

68 *Canada Trustco Mortgage* v. *Canada,* see note 12 *above, par. 62.*

69 *Canada Trustco Mortgage* v. *Canada,* see note 12 above, par. 66 and *Mathew v. Canada,* see note 16 above, par. 31.

70 *Lipson* v. *Canada,* see note 10 above, par. 34. See also par. 68 and 86 (Mr. Justice Binnie, dissenting).

According to the Supreme Court, the need for consistency, predictability and fairness in tax law means that it is possible to withdraw a tax benefit using the GAAR only in cases where the abusive nature of transaction in question is clear.[71]

To clarify the circumstances where it would be reasonable to conclude that a situation of abusive tax avoidance exists, the Supreme Court makes the following comments:

> 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 [...].[72]
>
> [...]
>
> [...] However, abusive tax avoidance may be found where the relationships and transactions as expressed in the relevant documentation lack a proper basis relative to the object, spirit or purpose of the provisions that are purported to confer the tax benefit, or where they are wholly dissimilar to the relationships or transactions that are contemplated by the provisions.[73]

Lastly, according to the Supreme Court, unless the Minister can establish that the avoidance transaction frustrates or defeats the purpose for which the tax benefit was intended to be conferred, it is not abusive.[74]

■ The burden of proof

Concerning the burden of proof, the Supreme Court is of the view that the initial obligation is on the taxpayer to refute the Minister's factual assumptions by contesting the existence of a tax benefit or by showing that a *bona fide* non-tax purpose primarily drove the transaction.[75]

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71 *Canada Trustco Mortgage* v. *Canada,* see note 12 above, par. 50 and *Lipson* v. *Canada*, see note 10 above, par. 98 (Mr. Justice Binnie, dissenting).

72 *Canada Trustco Mortgage* v. *Canada*, see note 12 above, par. 45. See to the same effect: *Lipson* v. *Canada*, see note *10* above, par. 40 (Mr. Justice LeBel).

73 *Canada Trustco Mortgage* v. *Canada,* see note 12 above, par. 60. See to the same effect: *Mathew v. Canada*, see note 16 above, par. 57.

74 *Canada Trustco Mortgage* v. *Canada,* see note 12 above, par. 52 and *Mathew* v. *Canada*, see note 16 above, par. 56 and 62.

75 *Canada Trustco Mortgage* v. *Canada,* see note 12 above, par. 63.

Where the taxpayer fails to refute the Minister's assumptions, it is then for the Minister to prove abuse:

> For practical purposes, the last statement is the important one. The taxpayer, once he or she has shown compliance with wording of a provision, should not be required to disprove that he or she has thereby violated the object, spirit or purpose of the provision. It is for the Minister who seeks to rely on the GAAR to identify the object, spirit or purpose of the provisions that are claimed to have been frustrated or defeated, when the provisions or the Act are interpreted in a textual, contextual and purposive manner. The Minister is in a better position than the taxpayer to make submissions on legislative intent with a view to interpreting the provisions harmoniously within the broader statutory scheme that is relevant to the transaction at issue.[76]

The Supreme Court summarized the rules applicable to the burden of proof as follows:

> 2. The burden is on the taxpayer to refute (1) and (2), and on the Minister to establish (3).
>
> 3. If the existence of abusive tax avoidance is unclear, the benefit of the doubt goes to the taxpayer.[77]

In *Lipson*, Mr. Justice LeBel, on behalf of the majority, specified that the Minister of Revenue had to prove, based on the balance of probabilities, that the avoidance transaction results in abuse and misuse within the meaning of the general anti-avoidance provision.[78]

■ Consequences of the application of the GAAR

Where the GAAR applies, the legislation stipulates that the tax attributes of the taxpayer must be determined as is reasonable in the circumstances in order to deny a tax benefit that, in the absence of the GAAR, would result, directly or indirectly, from the avoidance transaction or from a series of transactions that includes that avoidance transaction.[79] It also stipulates that any other taxpayer is entitled to ask the Minister of Revenue to establish an assessment or proceed to determine an amount regarding him concerning the same transaction.[80] However, the legislation does not stipulate a penalty further to the application of the GAAR.

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76 *Id.,* par. 65.

77 *Canada Trustco Mortgage* v. *Canada,* see note 12 above, par. 66 and *Mathew* v. *Canada*, see note 16 above, par. 31.

78 See note 10 above, par. 21.

79 Sec. 1079.10 and 1079.13 Q.T.A.; subs. 245(2) and (5) I.T.A. See the comments on this subject by Mr. Justice LeBel, for the majority, in *Lipson* v. *Canada*, note 10 above, par. 51.

80 Sec. 1079.14 Q.T.A. and subs. 245(6) I.T.A.

Considering the possible application of penalties further to the application of the GAAR, Madam Justice Campbell of the Tax Court of Canada had the following comments in the *Copthorne Holdings Ltd.* decision:

> [...] I do not think that a GAAR assessment can give rise to penalties for non-compliance with the technical sections of the *Act*. First, the GAAR is not a penalty provision. If a transaction, or series of transactions, runs afowl of GAAR, the remedy specified in subsection 245(2) is that tax consequences will be determined that are reasonable in the circumstances in order to deny a tax benefit that would otherwise result from the transaction. Subsection 245(2) does not indicate that a successful GAAR assessment will cure the deficiency in the scheme of the *Act* but merely that the tax benefit resulting from the technical application of the section will be denied.[81]

In *Lipson*, Mr. Justice LeBel, on behalf of the majority, wrote that the GAAR was "neither a penal provision nor a hammer to pound taxpayers into submission".[82]

Being put back into the situation in which he would have been placed had he not carried out an obviously abusive avoidance transaction is therefore the only consequence that applies to the taxpayer against whom the tax administration successfully applies the GAAR. Accordingly, no penalty can apply, as the law currently stands, because of the application of the GAAR.

■ An anticipated decision: OGT Holdings Ltd.

The *Ogt Holdings Ltd*.[83] case is currently before the Appeal Court of Québec. In this case, the essential question was to determine whether the Court of Québec was right to apply the GAAR to a classic case of the Québec Shuffle.[84]

The decision of the Appeal Court of Québec should no doubt contribute to further clarifying the standards of application of the GAAR regarding inter-provincial tax planning schemes, for the benefit of both the tax administration and that of taxpayers.

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81 *Copthorne Holdings Ltd.* v. *The Queen*, 2007 TCC 481, par. 77 (decision appealed, F.C.A., n° A-416-07).

82 See note 10 above, par. 52.

83 *Ogt Holdings Ltd.* v. *Québec (Deputy Minister of Revenue)*, 2006 QCCQ 6328; C.A. Montréal, n° 500-09-016944-068.

84 See sub-section 1.1.2 for a description of a Québec Shuffle transaction.

❑ The GAAR committee

It should be pointed out that the GAAR is a measure the tax authorities apply very cautiously since its application is subject to examination by a committee mandated to ensure that the GAAR is applied consistently and evenly within the tax administration. Accordingly, an assessing division that wants to apply the GAAR must submit a file to this committee, which decides whether or not to apply it.

There is such a committee at both Québec and federal level.

❑ The GAAR and the notion of *bona fide* purposes

As mentioned above, the purpose of Québec's GAAR is to eliminate the tax benefit resulting from an avoidance transaction considered abusive. Under the existing legislation, the notion of avoidance transaction is defined as follows:

> **Section 1079.11** An avoidance transaction is any transaction that, but for this Title, would result, directly or indirectly, in a tax benefit, or that is part of a series of transactions, which series, but for this Title, would result, directly or indirectly, in a tax benefit, unless the transaction in either case may reasonably be considered to have been undertaken or arranged primarily for *bona fide* purposes other than to obtain the tax benefit. [Underlining added]

In addition, as mentioned above,[85] a tax benefit is, briefly, "[...] a reduction, avoidance or deferral of the tax [...] payable under this Act [...]".

Because of the wording of the definitions of avoidance transaction and tax benefit, an argument could be made that a transaction undertaken mainly to obtain a reduction of tax payable under a law other than the *Income Tax Act* is a transaction undertaken mainly for a *bona fide* purpose other than that of obtaining a tax benefit, even if a purpose of such transaction was also to reduce tax payable under the *Income Tax Act*. For instance, this argument could be invoked by a taxpayer who carries out a transaction to reduce his taxable income, at both the federal and Québec levels, by an identical amount, while his federal tax rate would be appreciably higher than his Québec tax rate. If this argument were upheld, the transaction would not be considered an avoidance transaction and would be subject to Québec's GAAR even if the transaction were, by assumption, abusive.

85 See the "Tax benefit" heading in this sub-section for the full definition.

To counter this type of argument, the tax legislation of many provinces excludes from the notion of *bona fide* purposes not only the obtaining of a tax benefit under the law that encompasses their GAAR, but also the obtaining of a tax benefit resulting from another law of a province or a federal law. Accordingly, in 2007, the Manitoba's legislation defines an avoidance transaction as follows:

> **"avoidance transaction"** means a transaction:
>
> (a) that, but for this section, would result, directly or indirectly, in a 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;
>
> but does not include a transaction that may reasonably be considered
>
> (c) to have been undertaken or arranged primarily for bona fide purposes other than
>
> i. to obtain a tax benefit,
>
> ii. <u>to reduce, avoid or defer a tax, or an amount payable as or in respect of tax, under any other Act of the Legislature or under any Act of Parliament or of any other legislature in Canada,</u>
>
> iii. <u>to increase a refund of tax, or of an amount in respect of tax, under any Act referred to in subclause (ii), or</u>
>
> iv. <u>any combination of the purposes mentioned in subclauses (i) to (iii); or</u>
>
> (d) to be a transaction that would not result, directly or indirectly, in
>
> v. a misuse of the provisions of this Act or the regulations, or
>
> vi. an abuse having regard to those provisions, other than this section, read as a whole.[86] [Underlining added]

Ontario's new GAAR, which applies since January 1, 2009,[87] provides two definitions relating to tax benefits: a definition of "tax benefit" that applies, in particular, to the notion of avoidance transaction and includes the tax benefit resulting from the tax legislation of another province of Canada stipulating a tax similar to the one levied by the Ontario legislation or from the *Income Tax Act* (Canada), and a definition of "Ontario tax benefit" limited to the benefits resulting from Ontario's tax legislation and applicable, in particular, for the purposes of eliminating the tax benefit stipulated by Ontario's GAAR.

In doing so, Ontario's legislation also closes the door on the type of argument mentioned above.

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86 *Income Tax Act*, C.C.S.M., c. I-10, sec. 53.1 amended by S.M. 2007, c. 6, sec. 45. See, to largely the same effect: *Income Tax Act*, R.S.B.C. 1996, c. 215, s. 68.1; *Alberta Corporate Tax Act*, R.S.A. 2000, c. A-15, s. 72.1; *Income Tax Act*, *2000* S.N.L. 2000, c. I-1.1, s. 88.1; *Income Tax Act*, R.S.N.S. 1989, c. 217, s. 80A.

87 *Taxation Act, 2007*, S.O. 2007, c. 11, Annex A, sec. 110.

❑ Observations

Introduced 20 years ago, Québec's GAAR seeks to strike a balance between protection of the tax base and taxpayers' need for certainty by drawing a line between legitimate tax planning and abusive tax avoidance.

There are three steps in applying this rule. While the first two involve determining the existence of a tax benefit and an avoidance transaction, the third consists in determining whether the avoidance transaction identified is clearly abusive.

The burden of proof concerning the first two steps is on the taxpayer, who must refute the Minister's factual assumptions by contesting the existence of a tax benefit or by showing that a *bona fide* non-tax purpose primarily drove the transaction.

As for the third step, where the burden of proof, according to the balance of probabilities, lies with the tax administration, it requires answering the following two questions:

- What is the object, spirit or purpose of the provisions invoked to obtain the tax benefit?
- Does the avoidance transaction frustrate or defeat the object, spirit or purpose of the provisions invoked to obtain the tax benefit?

According to the Supreme Court, the need for consistency, predictability and fairness in tax law means that a conclusion of abuse is justified only where concluding to the contrary would be unreasonable, i.e. that the avoidance transaction complies with the object, spirit or purpose of the provisions invoked by the taxpayer. In other words, the Supreme Court points out, in order to answer the second question in the affirmative, that the abusive nature of the transaction must be clear.[88]

Moreover, despite the burden of proof imposed on the tax administration and although application of the GAAR is subject to examination by a committee and is limited to clearly abusive situations, the legislation stipulates no penalty pursuant to the application of the GAAR.

Moreover, the case-law of the Supreme Court in relation to the application of the GAAR is recent and the courts will continue to be called on to further clarify the standards of its application.

Lastly, it is worth pointing out that many provinces have stipulated that obtaining a tax benefit under a provincial or federal law does not constitute a *bona fide* purpose with a view to determining whether a transaction is an avoidance transaction.

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88 *Canada Trustco Mortgage v. Canada,* see note 12 above, par. 62.

2.2.3 Registration of tax shelters

In 1987, the rules for registration and reporting information concerning tax shelters were presented as a component of a set of measures, including the GAAR, whose dual objective was to improve compliance with the law and fight against tax avoidance.[89] In general, Québec's rules in this area[90] are harmonized with the federal rules[91] and they apply regarding an interest in a tax shelter acquired after May 31, 1990.[92]

Briefly, the rules for reporting information concerning tax shelters require a promoter of a tax shelter to obtain an identification number for the shelter from the tax authorities and file an information return, including in particular the name, address and social insurance number or business number of each investor, as well as the amount paid for the tax shelter.

In this regard, a promoter of a tax shelter means any person who, in the course of carrying on a business, issues or sells the tax shelter, promotes it or acts as mandatary or advisor regarding the issuing, sale or promotion of the tax shelter. A tax shelter is defined as a property (including any right to an income) for which, in light of the statements or announcements made or contemplated in connection with such property, it is stipulated that the acquirer may claim deductions or losses in the four years following the acquisition of the property for an amount equal to or greater than the cost of the property actually assumed by the acquirer.

Moreover, to bolster the obligation to report information, these rules stipulate that the promoter may not sell a tax shelter before having obtained the identification number, on pain of a large penalty. Investors must provide the identification number of the tax shelter in order to claim or deduct an amount concerning such shelter. Furthermore, if the promoter has not obtained the identification number, in addition to the penalty applicable to him, the investors are entitled to no deduction until the promoter has paid the penalty.

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89 DEPARTMENT OF FINANCE CANADA, *Tax reform 1987, Income tax reform*, préc., note 39, p. 131-132.

90 Sec. 1079.1 to 1079.8 Q.T.A.

91 MINISTÈRE DES FINANCES DU QUÉBEC, *Information Bulletin* 87-8, "Minister's statement concerning tax reform ", December 18, 1987, p. 13, par. 67.

92 *An Act to again amend the Taxation Act and other fiscal legislation*, S.Q. 1990, c. 59, sec. 350.

❑ The advantages and disadvantages of registration of tax shelters

■ Advantages

The reporting requirements rules concerning tax shelters have a number of advantages, the most obvious of which is increased control over compliance with the law. In particular, this control makes it possible to detect situations of abuse of the law more quickly than would be possible using random audits, and acceleration legislative initiatives to better target these situations and correct them. In addition, such control helps prevent recourse to the courts and reduce litigation.

Accordingly, these rules have contributed to the introduction of restrictions in the tax legislation associated with the deductions that may be claimed regarding certain tax shelters. Here are a few examples.

▪ Rules on tax shelter investments

The rules on tax shelter investments were introduced in 1994 in Québec's tax legislation to reduce the cost or the amount of the expense relating to the acquisition of a tax shelter by any limited-recourse amount and any at-risk adjustment. Essentially, a limited-recourse amount means the unpaid principal of a debt for which recourse is limited, now or in the future, whether conditionally or not, while an at-risk adjustment targets the benefits the investor (or a taxpayer not at arm's length with him) is entitled to receive and whose purpose is to eliminate or reduce the effect of a loss attached to a tax shelter investment.[93]

▪ Matchable expenditure rules

Matchable expenditure rules, introduced in 1996, apply to financial transactions that have proven to be a new type of tax shelter that may elude the definition of tax shelter employed for the purposes of the information return, as well as the rules on tax shelter investments. Accordingly, matchable expenditure rules seek to counter a new type of tax shelter targeting the lack of concordance between expenditures and products. Briefly, these rules restrict the deductibility of an expenditure by spreading it over the entire economic lifetime of the right to a product to which it relates, though such lifetime may in no case be less than five years. Accordingly, matchable expenditure rules are an extension of the rules limiting deductions related to tax shelters investments, and make the rules on tax shelter investments applicable to these new shelters provided they also include mechanisms similar to them.[94]

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93 Sec. 851.38 Q.T.A.

94 Sec. 158.1. Q.T.A.

- **The rules on computer software tax shelter property**

The rules on computer software tax shelter property were introduced in 1997. These rules are an extension of the rules on tax shelter investments. Computer software property is defined as software that is depreciable property and qualifies as a tax shelter investment or that is obtained by a partnership in which a participation qualifies as a tax shelter investment. In short, according to these rules, a taxpayer cannot deduct an amount, on account of depreciation regarding computer software tax shelter property, that exceeds the net income from the business in which such software is used. Accordingly, this is an additional restriction compared to the rules on tax shelter investments that, as described above, reduce the cost of a tax shelter (and consequently the depreciation) by the amounts that are not genuinely at risk or for which recourse is limited.[95]

Disadvantages

The reporting requirements rules concerning tax shelters have certain disadvantages. First, they create an administrative burden for promoters of tax shelters as well as, to a lesser degree, for investors. In addition, they add complexity to the tax system, because they add tax provisions designed to counter situations that the tax administration considers inappropriate. Moreover, some investors may have the false impression that registration of a tax shelter constitutes confirmation by the tax administration of entitlement to the announced tax benefits.

Accordingly, like any specific rule, the registration and information disclosure rules concerning tax shelters have a limited field of application, because they target only arrangements that qualify as tax shelters and, by the same token, can be circumvented. The definition of the items on which these rules are based, i.e. the definition of a promoter and of a tax shelter, can prompt some tax planners and promoters to develop new arrangements to avoid these rules.

Accordingly, the narrow focus of the registration and information disclosure rules concerning tax shelters is both a strength, because it enables more targeted intervention, and also a weakness, because they are vulnerable to arrangements that can lie beyond the field of application of these rules.

95 *Regulation respecting the Taxation Act*, R.R.Q., 1981, c. I-3, r.1, sec. 130R55.6.6 and 130R55.6.7.

❑ An effective measure

Experience therefore shows that the registration and information reporting rules concerning tax shelters improve the information available to the tax administration and enable the latter to intervene more quickly and more precisely to take the corrective legislative action needed to improve compliance with the law and fight against tax avoidance, as a complement to the GAAR.

2.2.4 The penalty regime

Québec's tax legislation stipulates various administrative penalties applicable to taxpayers who contravene to their obligations and to third parties who make false statements or participate therein.

❑ Penalties on taxpayers

The major penalties applicable to taxpayers are:

- the penalty for failing to file a tax return on time;
- the penalty for omitting to deduct, withhold or collect an amount;
- the penalty for omitting to pay or remit an amount;
- the penalty for repeated failure to report income;
- the penalty for a false statement or omission;[96]
- the penalty for failing to file a return on time or for failing to comply with a requirement.

❑ Penalties on third parties

In general, the administrative penalty relating to misleading tax information provided by a third party targets situations in which third parties knowingly make false statements or participate therein.

96 Any person who, knowingly or in circumstances equivalent to flagrant negligence, makes a false statement or an omission in a return is liable to a penalty that corresponds essentially to the greater of $100 or 50% of the additional tax resulting from the false statement or the omission.

The objective of this penalty is fundamentally to deter or curb certain fraudulent behaviour. More specifically, it must be established that there has been "culpable conduct"[97] before a penalty can be imposed on third parties. Accordingly, regarding this penalty, Revenu Québec mentions that:

> This penalty does not apply to tax-planning arrangements that comply with the TA, honest mistakes or actual oversights, activities that are administratively acceptable to the Ministère du Revenu, or differences of interpretation (for example, where the issue is not well-settled in jurisprudence).[98]

However, there is an important difference between the Québec and federal legislation. Whereas federal legislation stipulates two separate penalties, i.e. a preparer penalty and a planner penalty, Québec's legislation only stipulates the first penalty.[99]

■ The preparer penalty

Despite its name, the preparer penalty can apply to any person, whether he is a preparer or not.

This penalty covers persons who advise other persons to file their return on the basis of false or misleading data. It also covers persons who tolerate false or misleading data provided by their clients or who omit information affecting the *Taxation Act*.[100]

The penalty[101] corresponds to the greater of $1 000 or the lesser of the penalty for which the taxpayer would have been liable for a false statement[102] had he made the false statement himself or the total of $100 000 and the gross remuneration[103] of the person making the false statement at the time a notice of assessment concerning the penalty is sent to the latter.

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97 Culpable conduct is defined in section 1049.0.3 Q.T.A.

98 REVENU QUÉBEC, *Interpretation Bulletin* IMP. 1049.0.5-1, "Penalty for Misleading Information Provided by a Third Party", May 31, 2004, par. 2.

99 The planner penalty was not adopted, because Québec's tax system was considered satisfactory in view of the existence of the penalty for false statement in respect of a tax shelter. Moreover, since the federal planner penalty corresponds generally to all the amounts a person is entitled to receive or to obtain in relation to the activity he is alleged to have engaged in, it did not seem advisable to stipulate a new Québec penalty that would be in addition to the federal penalty. See MINISTÈRE DES FINANCES DU QUÉBEC, *1999-2000 Budget, Additional Information*, March 9, 1999, p. 100-101, dealing with the partial harmonization with federal measures. See also "Table ronde sur la fiscalité provinciale" in *Congrès 2001*, Montréal, Association de planification fiscale et financière, 2002, p. 44:21-91, question 4.7, p. 44:71-73, giving the reasons for this partial harmonization.

100 See note 98 above, par. 1.

101 Sec. 1049.0.5 Q.T.A.

102 *Supra, note* 96.

103 In general, the gross remuneration of a person corresponds to the amounts he is entitled to receive regarding a statement, before or after a given time, conditionally or not.

■ The planner penalty

Although Québec's tax legislation does not stipulate a planner penalty, it is relevant to give the basic features of this penalty for the purposes of federal tax legislation.

Essentially, the planner penalty targets persons who design, or participate in designing, tax shelters or similar arrangements, or who sell them, promote them or participate in them.[104]

The federal planner penalty applies to a false statement made in particular in the course of a planning activity that can be taken to mean, among others, the fact of organizing or creating an arrangement, entity, mechanism, plan or system, or helping in its organization or its creation, or the fact of participating, directly or indirectly, in the sale of a right in an arrangement, property, entity, mechanism or system, or in the promotion of an arrangement, entity, mechanism, plan or system.[105]

If the statement is made during a planning activity, the amount of the penalty corresponds to the greater of $1 000 or the total of the payment entitlements[106] of the person who makes a false statement at the time a notice of assessment concerning the penalty is sent to such person and, in other cases, to $1 000.

❑ The penalty relating to a tax shelter

A promoter of a tax shelter must apply to the Minister of Revenue for an identification number for such tax shelter because he cannot issue or sell the tax shelter or accept any consideration regarding it until such a number has been assigned. In addition, the promoter must inform the persons who acquire the tax shelter of its identification number.

For the purposes of the provisions concerning the obtaining of a tax shelter identification number, a promoter, regarding the tax shelter, is defined as a person who, in the course of carrying on a business:

- either issues or sells, or promotes the issuance, sale or acquisition of, the tax shelter;
- acts as a mandatary or adviser in respect of the issuance or sale, or the promotion of the issuance, sale or acquisition, of the tax shelter;
- or accepts consideration in respect of the tax shelter.

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104 CANADA REVENUE AGENCY, *Information Circular* IC 01-1, "Third-Party Civil Penalties", September 18, 2001, par. 6.

105 Definition of the expression "planning activity" in paragraph 1 of section 163.2 I.T.A. The penalty also applies regarding an assessment activity that constitutes any act carried out by a person in the course of determining the value of a good or a service.

106 In general, a person's entitlements to payment correspond to the amounts he is entitled to receive regarding a planning activity, before or after a given time, conditionally or not.

In general, a person who provides the Minister of Revenue with false or misleading information in the application for a tax shelter identification number or who issues or sells a tax shelter or accepts consideration in respect of a tax shelter before obtaining such number incurs a penalty equal to the greater of $500 or 25% of the consideration received or receivable in respect of the tax shelter before the corrected information is supplied to the Minister or before an identification number is assigned to the tax shelter.[107]

2.2.5 Retroactive legislative amendments

In addition to the legislative tools discussed in the above sub-sections, it is appropriate to note that the government can always intervene through the adoption of retroactive legislative amendments,[108] in particular in any situation where it is tempting to divert fiscal policy from its objective.

In cases where such amendments penalize certain taxpayers, they are often received very poorly and harshly criticized, particularly by representatives of the legal community.

However, such amendments remain necessary in certain circumstances.

❑ The arguments against retroactive legislative amendments

Those who oppose retroactive legislative amendments raise various arguments in support of their position.[109]

For example, some maintain that such amendments are contrary to the principle of the primacy of law, even the *Canadian Charter of Rights and Freedoms*. However, the courts have never agreed with them.

Apart from legal arguments, objections of a more political nature or that raise the issue of fairness are made. Accordingly, it is argued that through the adoption of retroactive legislative amendments, the government is rejecting the verdict of the courts and is setting itself up as both judge and defendant.

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107 Sec. 1079.7.4 Q.T.A.

108 The expression "retroactive legislative amendment" is used here in the sense generally given to it in the Canadian tax context and therefore means a legislative amendment applicable at a date prior to its announcement. In fields other than taxation, a law generally is applicable as of the date it enters into effect or at a later date, so that any legislative amendment applicable on a date prior to its coming into effect is considered retroactive. In the taxation field, however, parliamentary tradition has it that legislative amendments are retroactive to the date they are announced (in a Budget Speech for example), which is necessarily prior to the date the legislation giving effect to it comes into effect.

109 See, among others, Thomas E. McDonnell, note 6 above; Ève-Marie Gigantès, "La rétroactivité des lois au Canada", (2006), vol. 27, n° 3 *Revue de planification fiscale et successorale*, p. 485-536.

The climate of uncertainty, the instability and the potential loss of confidence in the judicial system that would take hold following such amendments are often invoked.

Above all, retroactive legislative amendments raise the anger of persons who consider that by acting this way, the government "is changing the rules of the game in midstream".

❑ The arguments for retroactive legislative amendments

Although some arguments against retroactive legislative amendments may have some merit, nonetheless, in some circumstances, such amendments are the best solution.

That may be the case, for example, where taxpayers try to take advantage of a weakness or ambiguity in the legislation to develop schemes considered abusive because they are clearly contrary to the objectives of fiscal policy.

Where the persons using these schemes try to interpret the legislative provisions in a way they never have been before, it may be maintained that a retroactive legislative amendment creates certainty rather than uncertainty, since it confirms the validity of the generally accepted interpretation.

Obviously, such an amendment often has the merit of preventing substantial amounts of public finances – intended for the public as a whole – from being diverted for the benefit of a restricted number of especially aggressive taxpayers and – often for substantial shares – tax advisers specializing in developing such schemes. Accordingly, when studied from this angle, a retroactive legislative amendment can be seen as creating more fairness than unfairness.

❑ Circumstances leading to the establishment of criteria for adopting retroactive legislative amendments

In his 1993 report, the Auditor General of Canada criticized the federal government for not having acted quickly enough to clarify the regulations passed under the *Income Tax Act* that would have, in his view, prevented or at least limited the loss of some $1.2 billion following litigation with a taxpayer.

Briefly, the matter concerned regulatory provisions applicable as of taxation year 1974 and covering a deduction relating to resources.

The question at issue was whether the taxpayer, Gulf Canada to be specific, had to deduct its scientific research expenses and certain other depreciation deductions in calculating its earnings relating to resources. Because the deduction relating to resources was based on earnings relating to resources, the higher the latter, the higher the reduction in income tax.

Gulf Canada was reassessed in August 1979 for its 1974 taxation year and in September 1980 for its 1975 taxation year and contested these reassessments in court.

The trial division of the Federal Court, in October 1990,[110] as well as the Federal Court of Appeal, in January 1992,[111] ruled in favour of Gulf Canada. On July 2, 1992, the Supreme Court denied authorization to appeal.

On July 23, 1992, the Department of Finance Canada proposed an amendment to clarify the application of the *Income Tax Act* on this matter as of that date.

On the basis of these court decisions, some 40 other resource sector companies claimed tax refunds for the period from 1974 to 1992, hence the size of the amounts lost.

The Standing Committee on Public Accounts[112] studied the part of the report of the Auditor General of Canada on the "Gulf case" and submitted its own report on the matter.[113]

This report by the Standing Committee on Public Accounts contains a series of recommendations to improve assessment and achieve more judicious management of the risks to the tax base arising from conflicts in the interpretation of the relevant legislation.

This is the backdrop to the report's treatment of the issue of retroactive amendments. Though rather long, it seems useful to quote the following passage in its entirety, if only because it reflects the context of the period, when the government was sharply criticized for not having made adopt such amendments:

> However, the Committee has serious reservations that this method be regarded as the only means of resolving disputes between the government and taxpayers. Litigation in itself may be risky, as well as lengthy and costly, in that it may open — rather than close — government's exposure to risk. These dangers were clearly demonstrated by the Gulf case.

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110 *Gulf Canada* v. *The Queen*, 90 D.T.C. 6622.

111 *The Queen v. Gulf Canada,* 92 D.T.C. 6123.

112 Like the 23 other standing committees established by the *Standing Orders of the House of Commons*, the Standing Committee on Public Accounts is formed of MPs. In particular, this committee is mandated to study and report to the House of Commons on all reports of the Office of the Auditor General of Canada. When the Auditor General presents a report to the House of Commons, it is automatically referred to the Public Accounts Committee, which is Parliament's standing audit committee. The Standing Committee on Public Accounts thus has similarities with the Commission de l'administration publique of the National Assembly.

113 CANADA, House of Commons, *Seventh Report of the Standing Committee on Public Accounts*, parliamentary document n° 8510-351-79, Ottawa, February 10, 1995.

When an assessment determines that potential risk is high and the likelihood of litigation producing a satisfactory resolution doubtful, other courses of action must be considered. Although there was an objections and appeals process that took place prior to the Gulf case litigation, we are anxious that the opportunity for resolution be exploited in other ways. Accordingly, the Committee recommends that

> **All options for resolving disputes over interpretation of tax law be examined before litigation is commenced.**

Should efforts to resolve disputes fail, there is one other mechanism that can be used as an alternative to litigation. This mechanism consists of making retroactive amendments to sections of legislation under dispute. In the Gulf case, it was clear to the government as early as 1979 that the sections of the *Income Tax Act* dealing with the resource allowance rebate presented a problem. At that stage, steps could have been taken to amend those sections of the Act on a retroactive basis.

The Department of Finance argues that it would be inappropriate to introduce tightening changes to the law on a retroactive basis. However, it was brought to the Committee's attention that the department has made changes of this sort in the past. On 30 April 1993, retroactive legislation (to 1 January 1991) was introduced to clarify GST provisions relating to input tax credits. In announcing this amendment, the government indicated that the amendments reflected a "long-standing policy intent in this area that is well understood by businesses and their advisors." The circumstances surrounding the Gulf case are similar. As the Department of National Revenue stated in its reply to the Auditor General's findings, "most of the resource industry had been filing their income tax returns in a manner consistent with the Department's interpretation of the law." Thus, a retroactive amendment would have reflected government's intent and been in accord with the way the resource sector was already interpreting the law.

The Department of Finance also argued that it would have been inadvisable to introduce clarifying amendments to the *Income Tax Act* before the termination of the Gulf case: such a move might have prejudiced the government's appeal. Although this assertion appears to make sense, the Committee makes two observations. The first is that this argument does not rule out the possibility of making a change to the law before an appeals stage is reached. Secondly, it has come to our attention that the government has previously amended sections of the law under litigation. Thus, this is a means of risk management that should be actively considered.

> The Committee makes these observations in order to assert that government is not without options when it manages risk to the tax base. The difficulty, from the Committee's perspective, is that there are no apparent criteria that establish when these steps can and should be taken. It is imperative that such criteria be developed. Therefore the Committee recommends that
>
> > The Department of Finance develop the criteria it will use to determine when it is appropriate to introduce clarifying changes to the law on a retroactive basis.
> >
> > **The Department of Finance develop the set of criteria it will use to determine when it is appropriate to clarify legislation prior to the conclusion of litigation.** [Underlining added]

❑ The criteria established by the government of Canada

Further to the first of these recommendations, it was in its detailed response to the seventh report of the Standing Committee on Public Accounts (the Response) that the government of Canada listed the main criteria that the Department of Finance would use to determine if the legislation needed to be amended retroactively to make it clearer.[114]

From the outset, the Response indicates that these criteria constitute a series of factors to be assessed depending on the specific circumstances and facts of each case, while noting that the decision to make retroactive amendments is, at the end of the day, a political decision that is up to the government and Parliament to make after considering the specific circumstances of each case.

The Response also underscores that it bears only on retroactive amendments intended to clarify the law, i.e. amendments to the tax laws designed to correct the results of an unintended interpretation and that enter into force on a date prior to when they are made public.

The criteria listed by the federal government and bearing on the assessment of the advisability of proceeding with such retroactive amendments are as follows:

— Retroactive clarifying amendments should only be made in exceptional situations.

114 CANADA, *Comprehensive response of the government to the seventh Report of the Standing Committee on Public Accounts*, parliamentary document n° 8512-351-79, Ottawa, September 18, 1995.

— It may be appropriate to adopt retroactive clarifying changes where:

  — the amendments reflect a long-standing well-known interpretation of the law by the Department of National Revenue (now the Canada Revenue Agency);

  — the amendments reflect a policy that is clear from the relevant provisions that is well-known and understood by taxpayers;

  — the amendments are intended to prevent a windfall benefit to certain taxpayers;

  — the amendments are necessary to preserve the stability of the Government's revenue base;

  — the amendments are corrections of ambiguous or deficient provisions that were not in accordance with the object of the Act.

It is important to mention that the Response indicates that these factors must not, other than the very last one, be taken in isolation but applied in a complementary way. They can also be changed if need be to deal with unforeseen situations.

❑ Application of the same criteria by the Québec government

In June 2002, the ministère des Finances du Québec announced that three declaratory amendments would be made to the Québec sales tax system.[115]

In the course of the discussions following this announcement, the ministère des Finances indicated the criteria considered for assessing the advisability of making a retroactive amendment.[116] In fact, the criteria applied by the Québec government are exactly the same as those stated by the government of Canada in its detailed response to the seventh report of the Standing Committee on Public Accounts.

Like the federal government, the Québec government considers that the decision to amend the legislation retroactively is first and foremost a political decision that is up to the government and the National Assembly to make after having considered the specific circumstances of each case.

115 MINISTÈRE DES FINANCES DU QUÉBEC, *Information Bulletin* 2002-7, "Declaratory amendments to the QST system", June 26, 2002.

116 "Table ronde provinciale (questions et réponses)" in Congrès 2002, Montréal, Association de planification fiscale et financière, 2003, p. 54:1-60, question 5.5, p. 54:43-46.

2.3 The needs of Québec's tax authorities and the contextual factors that influence fiscal policy in fighting against ATP

2.3.1 The needs of Québec's tax authorities

In sub-section 1.2, it was mentioned that among the factors contributing to the proliferation of ATP, there are exogenous economic and commercial factors as well as endogenous. A risk/reward ratio that favours the taxpayer and a new business model for tax intermediaries were then identified as endogenous factors.

It was established in sub-section 1.4 that these two endogenous factors were the factors that contributed to the proliferation in ATP on which Québec's tax authorities should focus on.

Given, on the one hand, that the tax authorities want to reduce the use of ATP by taxpayers and, on the other, that the endogenous economic and commercial factors are the factors contributing to the proliferation of ATP on which the tax authorities must focus on, the needs of Québec tax authorities in terms of fighting against ATP essentially consist of implementing measures that can alter the taxpayer's risk/reward ratio and discourage tax intermediaries from using a new business model based on the design and distribution of off-the-shelf tax products.

2.3.2 The contextual factors that influence fiscal policy in fighting against ATP

Québec's tax system is part of a political and economic system featuring a variety of factors that must be taken into consideration in the development of fiscal policy.

Canadian fiscal federalism, the cooperation of various tax administrations in Canada and demands relating to Québec's policy on regulatory and administration streamlining are contextual factors that influence fiscal policy in fighting against ATP.

Consequently, any proposal designed to meet the needs of Québec's tax authorities in fighting against ATP must necessarily fit into the particular context of Québec's tax system.

❑ Canadian fiscal federalism

Canadian fiscal federalism is characterized, in particular, by the fact that many jurisdictions have the capacity to tax the same tax base in the hands of the same taxpayer.

That means, for example, that since a taxpayer's income is taxable at both the federal level and the provincial level, both tax administrations could define their own tax concepts and develop rules that ignore those developed by the other level of taxation and thus force taxpayers to master the rules and concepts of two different tax systems to ensure that they meet their tax obligations.

Despite this legislative capacity, Canada's tax jurisdictions, wishing to avoid a tax jungle for taxpayers, have instead decided to follow the principle of harmonization of tax legislations. Accordingly, because of this principle, the Canadian provinces have generally harmonized their income tax legislation with that of the federal government. Accordingly, the same concepts and the same rules are generally shared by tax laws across the country and the same logic lies at the heart of these laws.

In addition, as a result of the harmonization principle, where one jurisdiction wants to introduce a measure that does not exist in the other jurisdictions, or not in the desired form, it normally will ensure that the new rules fit harmoniously into the existing legislation, both from the standpoint of applicable concepts and that of the general consistency of the system.

Harmonization of tax legislations in Canada avoids needless complexity and fosters better understanding of the tax systems among taxpayers. Accordingly, harmonization of tax legislations in Canada fosters compliance and observance of tax obligations.

Canadian fiscal federalism is therefore an important item that must be taken into consideration in developing fiscal policy and implementing rules to fight against ATP.

❑ Cooperation among tax administrations in Canada

In addition to avoiding adding complexity to tax legislations, their harmonization helps develop, especially in the field of tax administration, practices and ways of doing things that are based on this reality and take the tax situation of taxpayers in other jurisdictions in Canada into consideration.

For instance, there is a procedure for the systematic exchange of information between the CRA and Revenu Québec, known by practitioners as the exchange of federal T7W-C documents and TP7W documents in Québec. The usefulness for tax administrations of this arrangement is based in large part on the harmonization of tax legislation.

This type of cooperation among tax administrations helps to define their priorities and, consequently, has an appreciable influence on the organization of their work. This cooperation allows them to combine their strengths and obtain a degree of synergy. Ultimately, cooperation among tax administrations facilitates, at lower cost, the administration of the tax system and boosts its efficiency.

In terms of fighting against ATP, inter-jurisdiction cooperation is seen as a key element in detecting ATP schemes and their users.

Consequently, cooperation among tax administrations is also an essential factor that must be taken into consideration in developing fiscal policy and implementing rules to fight against ATP.

❑ Demands relating to Québec's policy regulatory and administration streamlining

The Québec government's policy on regulatory and administration streamlining is based on seeking a fair balance between implementation of the most effective regulatory standards possible and maintaining a business climate that fosters business competitiveness.

Essentially, this policy enables the government to ensure that the effects of regulation on businesses and on Québec's economy are correctly assessed by government departments and organizations.

While the policy on regulatory streamlining does not apply to the tax rules, it does apply to the administrative requirements that can accompany these rules.[117]

Accordingly, the administrative requirements that result from measures that may be adopted to respond to the risks presented by ATP must, in addition to taking the minimization of implementation costs into consideration, be focused on achieving results, limited to what is necessary and adapted to the capacity of businesses to comply with them. They must also be competitive in a North American context.[118]

Consequently, the Québec's policy on regulatory and administrative streamlining is also a factor that must be taken into consideration in developing fiscal policy and implementing rules to fight against ATP.

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117 *Décret 111-2005 concernant l'organisation et le fonctionnement du Conseil exécutif*, (2005) 137 G.O. II, 861. See Appendix C, « Règles sur l'allégement des normes de nature législative ou réglementaire », sec. 1, *in fine*, p. 866 (in french only).

118 *Id.*, sec. 4, p. 867.

3. EXAMINATION OF LEGISLATIVE TOOLS USED IN OTHER COUNTRIES TO FIGHT AGAINST ATP

The growth of ATP is a global phenomenon, so it is important to examine measures taken by foreign tax authorities to combat these practices.[119] These measures focus on detection of ATP schemes and strategies to crack down on them.

As mentioned earlier, in working to fight against ATP, Québec's tax authorities must concentrate their efforts on the endogenous economic and commercial factors, namely the risk/reward ratio of ATP schemes and the new business model of certain tax intermediaries, while taking the characteristics of the tax system into account.

In this context, our examination of experience in other countries has focused on particular legislative tools used in the early detection of ATP schemes and in curbing them. Accordingly, foreign initiatives without legislative support or, although having such support, not satisfying the current needs of Québec's tax authorities, were not considered.[120]

More specifically, this section deals briefly with ATP detection strategies that require disclosure of certain transactions and have been implemented by the United Kingdom and the United States.[121] It also briefly examines strategies to curb ATP used in certain countries whose tax legislation stipulates application of a GAAR, namely Australia, New Zealand and Ireland. It is also important to note that the descriptions, in this section, of the detection strategies and the strategies to curb ATP are intended to provide but a general idea of how they operate.

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119 The examination of experience in other countries takes into account, for each country, legislation in force on November 17, 2008.

120 Such is the case for measures designed to oversee tax intermediaries and, more particularly, Circular 230 that stipulates that advisors be accredited with the American tax authorities and sets out the standards to which accredited advisors are subject when they file certain types of opinions. (31 *Code of Federal Regulations* (hereunder "C.F.R"), Subtitle A, Part 10 (2007)).

121 Even though they are note examined in this section, detection strategies have been recently introduced in South Africa and Portugal. Briefly, the tax legislations of South Africa and Portugal have required, since March 1, 2005 and May 15, 2008, respectively, disclosure of certain types of arrangements giving rise to a tax benefit. Responsibility for disclosing the arrangement lies with the promoter and, as the British system stipulates, this responsibility lies with the user of the arrangement where there is no promoter or if the promoter does not reside in South Africa or Portugal, as the case may be. Lastly, penalties are stipulated where the promoter of an ATP scheme or its user neglects to file the required report.

3.1 A detection strategy: early ATP disclosure systems

Aggressive tax planning is one of the risks tax administrations must deal with and, in managing this risk, obtaining information plays an essential role.

Among other things, tax administrations rely on legislative provisions to quickly obtain information from taxpayers or their advisors on transactions that carry a risk of avoidance.

While, as is the case in Canada, the American tax system has for many years required the disclosure of information relating to certain tax shelters, it is only recently that the British system has incorporated in its legislation the requirement that promoters or taxpayers disclose certain ATP schemes.

3.1.1 The American system

Since 1984, the American tax system has stipulated that tax shelters must be registered and has required promoters of potentially abusive tax shelters to keep a list of persons investing in such shelters.[122]

In recent years, the relevant legislative and regulatory provisions have been substantially amended first, by raising the number and broadening the nature of arrangements that must be disclosed and second, by requiring not only corporations but also other taxpayers to disclose their participation in such arrangements. Accordingly, penalties have been introduced regarding taxpayers who fail to file an information return while the penalties applicable to promoters that fail to maintain a list have been increased.

❑ Reportable transactions

A taxpayer who participates in a reportable transaction[123] must disclose such transaction on a form attached to his tax return. The reportable transactions are included under five categories[124]:

122 For the legislative and regulatory provisions dealing with American disclosure rules, see the *Internal Revenue Code of 1986* as amended. §§ 6011, 6111, 6112, 6501(a) (10), 6662A, 6664, 6707, 6707A and 6708 as well as 26 C.F.R. §§ 1.6011-4, 301.6111-3 and 301.6112-1.

123 The Internal Revenue Service can make a determination in published guidance that a transaction is not subject to the reporting requirements.

124 Two categories of transactions have been removed by final regulations, effective August 3, 2007, namely transactions with a significant book-tax difference and transactions with a brief asset holding period.

- Listed transactions; this category includes a transaction that is the same as or substantially similar to one of the types of transactions that the Internal Revenue Service (IRS) has determined to be a tax avoidance transaction and identified by notice, regulation, or other from of published guidance as a listed transaction.[125] Where the taxpayer does not file the information return regarding such a transaction, the period of limitation, which is normally three years, ends one year after whichever of the following dates occurs first: the date on which the information is sent to the IRS or the date on which a material advisor provides the information required further to a request from the tax administration;

- Confidential transactions; this category includes a transaction that is offered by an advisor under conditions of confidentiality and for which a minimum fee is paid;[126]

- Transactions with contractual protection; this category includes a transaction for which a taxpayer or a related party has the right to a full refund or partial refund of fees if all or part of the intended tax consequences from the transaction are not sustained or a transaction for which fees are contingent on the realization of the tax benefits from the transaction;

- Loss transactions; this category includes a transaction that results in a corporation claiming a loss of at least $10 million (in a single tax year) or $20 million (in any combination of tax years). For an individual, a trust, a partnership (excluding partnerships with only corporations as partners) or an S corporation,[127] the thresholds are respectively $2 million and $4 million;

- Transactions of interest; this category includes a transaction that is the same as or substantially similar to a transaction that the IRS has identified by notice, regulation, or other form of public guidance as a transaction of interest. A transaction of interest is a transaction that the IRS or the United States Department of the Treasury believes has a potential for tax avoidance or evasion, but for which there is not enough information for a definitive ruling.

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125 Thirty-four transactions are listed on the IRS website, <http://www.irs.gov/businesses/corporations/article/0,,id=120633,00.html>, (viewed January 19, 2009.)

126 These fees are US$250 000 for a corporation and US$50 000 in other cases. However, where the taxpayer is a partnership or a trust and all the partners or beneficiaries are corporations, the minimum fees are then US$250 000.

127 Briefly, an S corporation is a U.S. corporation with no more than 100 shareholders who are individuals resident in the United States or, under certain conditions, exempt organizations or trusts, whose capital stock consists of only one class of shares, and that makes an election to be an S corporation. Where a corporation elects to be considered as an S corporation, its income is taxed in the hands of the shareholders as it is earned.

❑ Material advisor's information return

A material advisor[128] must file a complete information return for a reportable transaction which must be filed no later than the last day of the month following the end of the quarter during which the advisor became a material advisor regarding such transaction. The return must describe, in particular, the transaction as well as the tax benefits expected from it.[129]

The tax administration then issues a reportable transaction number for the transaction thus disclosed. The material advisor must send this number to the taxpayers involved in the transaction when it is concluded or, if it was concluded before the transaction number was received, within 60 days of the date the transaction number was mailed.

❑ Penalties

A taxpayer who fails to disclose a reportable transaction that is not a listed transaction is subject to a penalty of US$10 000 for an individual, and US$50 000 otherwise; for a listed transaction, these penalties are US$100 000 and US$200 000 respectively.[130]

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128 Briefly, a material advisor is a person who provides material aid, assistance or advice regarding the organization, management, promotion, sale or implementation of a reportable transaction and who, directly or indirectly, derives gross income from it in excess of US$50 000 in the case of a transaction whose benefits are attributed to an individual or US$250 000 in the case of a transaction whose benefits are attributed to a corporation, a trust or a partnership. Regarding a listed transaction or a transaction of interest, the gross income thresholds are US$10 000 and US$25 000 respectively.

129 To be considered complete, the information return must: a) describe the expected tax treatment and all potential tax benefits expected to result from the transaction, b) describe any tax result protection with respect to the transaction, c) identify and describe the transaction in sufficient detail for the IRS to be able to understand the tax structure of the reportable transaction and d) identify any material advisor whom the material advisor knows or has reason to know acted as a material advisor with respect to the transaction.

130 A public corporation must indicate these penalties in the return it files with the Securities and Exchange Commission. A penalty can be cancelled by the IRS Commissioner unless it is calculated regarding a listed transaction.

In addition, a taxpayer may be liable for a penalty of 20% of the amount of understated tax where such understatement is attributable to a listed transaction or to another reportable transaction if, in the latter case, tax avoidance was a significant purpose of such a transaction.[131] The penalty is raised to 30% of the amount of understated tax where the taxpayer does not disclose the relevant facts relating to the tax treatment of the item that was understated.

A material advisor who fails to file an information return is subject to a penalty of US$50 000 for a transaction other than a listed transaction. Failure to file the information return for a listed transaction can lead to the imposition of a penalty of US$200 000 or 50% of the gross income the material advisor earned from the listed transaction, whichever is greater.[132]

Furthermore, a material advisor must keep a list for each reportable transaction.[133] To avoid a penalty, the material advisor must make this list available upon written request within 20 business days of the date of such request.[134]

3.1.2 The British system

To make it easier to identify transactions with a risk of tax avoidance, the tax legislation in the United Kingdom introduced, in 2004, an early detection mechanism for two types of arrangements, i.e. arrangements relating to arrangements involving specified employment and financial products, for the purposes of Income Tax, Corporation Tax and Capital Gains Tax. A separate mechanism was also introduced for Value Added Tax.

In 2005, the disclosure system was broadened to the Stamp Duty Land Tax for arrangements relating to commercial properties whose market value is at least £5 million.

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131 However, this penalty will not apply to a taxpayer if he can show that he acted in good faith, that he disclosed the relevant facts concerning the transaction covered by the disclosure rules, that he relied on recognized legal and administrative sources to claim the tax benefits and that it was reasonable for him to hold the view that the tax treatment claimed complied, in all likelihood, with the law or case law. In this regard, in general, the taxpayer cannot rely on the opinion of his material advisor if he participated in the organization, management, promotion or sale of the transaction or on the opinion of a tax advisor whose remuneration depends, in whole or in part, on the transaction's expected tax benefit. It should be pointed out that this penalty related to reportable transactions applies instead of the general penalty for substantial understatement of tax.

132 The rate is raised to 75% in the case of a voluntary omission. The penalty can be cancelled by the IRS Commissioner unless it is set regarding a listed transaction.

133 In particular, this list must identify all those for whom the advisor acted as material advisor, the amount invested in each transaction, the date when the taxpayer entered the transaction and a detailed description of the expected tax treatment.

134 The applicable penalty is then US$10 000 for each day following the 20-day period that the list is not provided. However, a material advisor can avoid this penalty if there is reasonable cause for the list not being provided.

In 2006, the disclosure rules were extensively changed so that they were no longer limited to arrangements involving employment and financial products.

Lastly, in 2007, the disclosure system was extended to National Insurance contributions.[135]

The disclosure rules in the United Kingdom[136] apply primarily to the promoter of a hallmarked scheme and, in certain circumstances, to the user of such scheme.

❑ Hallmarked schemes

An arrangement includes any scheme, transaction or series of transactions. An arrangement must be disclosed where it enables, or could enable, a person to obtain a tax benefit, where such tax benefit is the main benefit or one of the main benefits arising from the arrangement, and the arrangement is a hallmarked scheme.

Hallmarked schemes are included under seven categories:

— an arrangement for which it might reasonably be expected that a promoter would wish the way in which the elements of this arrangement secure a tax advantage to be kept confidential from any other promoter, or from the tax administration if, in this case, the reason for doing so is to facilitate repeated or continued use of the same element in the future;

— an arrangement from which the tax advantages expected to be obtained arises, to more than an incidental degree, from the inclusion of a financial product, in which a promoter, or a person connected with the promoter, becomes party and the price of the financial product differs significantly from similar financial products in the open market;

135 This section deals only with the items and the characteristics applicable to arrangements covered by income tax, corporate tax and capital gains tax.

136 For the legislative and regulatory provisions dealing with disclosure rules in the United Kingdom, see *Finance Act 2004* (UK), 2004, c.12 (sections 306 to 319), *Finance Act 2007* (UK), 2007, c. 11 (section 108), *Finance Act 2008* (UK), 2008, c. 9 (section 116 and schedule 38), *Taxes Management Act 1970* (UK), 1970, c. 9 (sections 98C, 100 and 100C), *The Tax Avoidance Schemes (Information),* Regulations 2004 (SI 2004/1864), Regulations 2005 (SI 2005/1869), Regulations 2006 (SI 2006/1544), Regulations 2007 (SI 2007/2153 and SI 2007/3103), Regulations 2008 (SI 2008/1947), *The Tax Avoidance Schemes (Prescribed Descriptions of Arrangements),* Regulations 2006 (SI 2006/1543), *The Tax Avoidance Schemes (Promoters and Prescribed Circumstances),* Regulations 2004 (SI 2004/1865 and SI 2004/2613) and *The Tax Avoidance Schemes (Penalty)* Regulations 2007 (SI 2007/3104).

- an arrangement that is a standardized tax product, i.e. an arrangement that has standardized, or substantially standardized documentation, is made available for implementation by a promoter for more than one taxpayer and for which it would be reasonable for an informed observer (having studied the arrangement) to conclude that the main benefit of the arrangement is to enable the taxpayers to obtain a tax advantage;
- an arrangement implemented by a promoter for more than one individual and for which an informed observer (having studied the arrangement) could reasonably conclude that its main purpose is the provision of deductible losses;
- an arrangement for which it might reasonably be expected that a promoter, or a person connected with a promoter, would be able to obtain a premium fee, attributable to the tax advantage or contingent upon the obtaining of the tax advantage, from a person experienced in receiving services of the type being provided;
- an arrangement related to a high value plant or machinery lease,[137] whose term is more than two years and that meets one of the following conditions:
  - the lease is entered into by one party that is not within the charge to corporation tax;
  - the arrangement involves the removal of risk from the lessor if payments due under the lease are not made in accordance with its terms;
  - the arrangement is designed to consist of a sale and finance leaseback or a lease and finance leaseback;
- an arrangement that is an in-house scheme and where no promoter is involved and for which the intended user of the arrangement, which is a business that is not a small or medium-sized enterprise[138], wishes the way in which the elements of the arrangement that secure the tax advantage to be kept confidential from the tax administration and the reason for doing so is to facilitate repeated or continued use of the arrangement in the future.

137 To be covered by the disclosure rules, the leased asset must have a rental cost or market value (the lesser of the two amounts) of at least £10 million or the total of the cost of the leased assets or of their market value (the lesser of the two amounts) must be at least £25 million.

138 Briefly, a small or medium-sized enterprise is an enterprise that has fewer than 250 employees and either has sales of no more than €50 million, or a total annual balance sheet of no more than €43 million.

In addition, where they are in-house schemes and, consequently, no promoter is involved, arrangements relating to the lease of property and those stipulating a commission contingent on obtaining a tax benefit constitute hallmarked schemes only if their user is not an individual or a small or medium-sized enterprise.

Although the British rules share some similarities with the American rules, in particular regarding arrangements of a confidential nature or for which a promoter may receive a commission contingent on the value of the expected tax benefits, they differ, on the one hand, by requiring the presence of a tax benefit that is a main benefit of the arrangement and, on the other, by excluding small and medium-sized enterprises with respect to in-house schemes.

❑ The promoter of the arrangement

The promoter of a hallmarked scheme is covered by disclosure rules where he is responsible, to any degree whatsoever, for the design or for the realization of such a scheme ready to be implemented by one or more persons. However, to be subject to these rules, the promoter must be a person involved in the provision of tax services (lawyer, accountant), banking services or brokering services.[139]

Briefly, the disclosure must indicate the regulatory provision under which the arrangement constitutes a hallmarked scheme, explain each item of the arrangement (including how it is structured) and mention the tax provisions on which the expected tax benefit is based.

The promoter must send the required return within five days following the day the arrangement becomes available for implementation by another person or the day when the promoter first becomes aware of the realization of one of the transactions that is part of the arrangement, whichever occurs first.

The tax administration issues a registration number to the promoter within 30 days after receiving the return. The promoter must then provide this registration number to any taxpayer using the arrangement no later than 30 days following the day such number was sent to him.

❑ The user of the arrangement

In certain circumstances, it is up to the user of the arrangement to disclose the required information to the tax administration. Accordingly, where the arrangement was implemented by a taxpayer for his own use, the tax administration must be notified within 30 days following the day the first transaction relating to the arrangement is carried out.

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139 A person is not considered a promoter if he satisfies any of the following three tests: he is not involved in the design of any part of the arrangement or, if he is involved, he does not give a tax opinion in this regard or does not have enough information to enable him to conclude that the arrangement must be disclosed.

It is also up to the user of an arrangement to disclose its details to the tax administration where professional privilege[140] applies and no other promoter not subject to professional privilege files the return or where the promoter does not reside in the United Kingdom and does not disclose the arrangement. Disclosure must then be made within five days following the day the first transaction relating to the arrangement is carried out.

❑ Penalties

The promoter or a taxpayer who does not file the required return within the stipulated period and in the prescribed form incurs an initial penalty of £5 000. A penalty of £600 may be imposed for each day the return is not filed after the day the initial penalty is applied.[141]

A taxpayer who fails to include his registration number on the tax return covered by the arrangement incurs a penalty of £100. This penalty can reach £500 or £1 000 where the taxpayer has previously failed to file such a number regarding another arrangement within 36 months prior to this repetition. The promoter and the taxpayer can appeal the penalty.

The tax administration can ask a promoter to provide certain information where it is reasonable to believe that the promoter should have filed a return. Accordingly, it has power to require the promoter to justify its reasons for considering that the tax benefits of the arrangement covered by the request do not represent the main benefit of the arrangement, the method used to measure the relative weight of the various benefits expected from the arrangement, the reasons why the arrangement in question is not similar to a hallmarked scheme and the reasons why the promoter considers it is not subject to the disclosure rules. Should the tax administration not to be satisfied with the replies then they can request an order from a Tribunal that a disclosure must be made. Failure to comply with such an order carries penalties at a rate of £5 000 per day of continued failure.

3.2 A strategy to curb ATP: the GAAR, penalties and the period of limitation

The GAAR can be used by a tax administration to withdraw the tax effects of an avoidance stratagem. Accordingly, like Canada, Australia, New Zealand and Ireland have incorporated a GAAR in their tax legislation.

140 We are referring here to lawyer-client privilege.

141 This penalty also applies where the promoter omits to provide users of the arrangement with the registration number or provide the tax administration with information. The penalty must be imposed by Special Commissioners.

This sub-section deals with the GAAR applicable in each of these three countries as well as two items relating to its application, namely the imposition of penalties and the period of limitation. In this regard, a new deterrent used by the Australian administration, namely the system of penalties applicable to promoters of tax exploitation schemes, will also be examined.

3.2.1 The Australian system

❑ The Australian GAAR

Briefly, the Australian GAAR[142] applies to a scheme[143] that satisfies two criteria:

- the taxpayer has obtained a tax benefit[144] that would not have been available if the scheme had not been entered into;
- having regard to objective factors, it would be reasonable to conclude that the person entered into or carried out the scheme for the sole or dominant purpose of obtaining the tax benefit.

The determination must be based on eight criteria that can be divided into three categories: how the scheme was set up, its impacts and the nature of the relations between the taxpayer and the other persons involved in the scheme. These criteria are:

- the manner in which the scheme was entered into or carried out;
- its form and its substance;
- the time at which it was entered into and the length of the period during which it was carried out;
- the result achieved by the scheme under the income tax law if the GAAR did not apply;

142 The Australian tax system has three GAAR. However, for the purposes of this analysis, the GAARs stipulated in the *Fringe Benefits Tax Assessment Act 1986* and in *A New Tax System (Goods and Services Tax) Act 1999* are not considered. For the Australian legislative provisions relating to the GAAR (income tax), see the *Income Tax Assessment Act 1936* (Cth.) (sections 170 and 177A to 177G) and the *Taxation Administration Act 1953* (Cth.) (Schedule 1, divisions 284 and 298).

143 A scheme means any agreement, arrangement, understanding, promise or undertaking, whether express or implied, and whether or not enforceable and any scheme, plan, proposal, action, course of action or course of conduct.

144 A tax benefit means an amount not included in the calculation of income, a deduction allowed in the calculation of income, a capital loss or foreign tax reduction, which benefit it is reasonable to believe that the taxpayer could not have enjoyed without the scheme. The tax benefits arising from making an election specially stipulated by the legislation are not covered by the GAAR.

- any change in the financial position of the taxpayer that has resulted, will result, or may reasonably be expected to result from the scheme;
- any change in the financial position of any person who has, or has had, any connection (whether of a business, family or other nature) with the taxpayer, that has resulted, will result, or may reasonably be expected to result, from the scheme;
- any other consequences for the taxpayer, or for any person who has, or has had, any connection with the taxpayer, of the scheme having been entered into or carried out;
- the nature of any connection (whether of a business, family or other nature) between the taxpayer and any other person concerned.

Where Australia's GAAR applies, the taxpayer may be denied the tax benefit arising from the scheme by the tax administration.

❑ The penalty associated with the application of the GAAR and the period of limitation

Where the GAAR is applied to withdraw a tax benefit, the taxpayer is subject to a penalty of 50% of the amount of income tax attributable to such benefit. This penalty is reduced to 25% of the amount of tax attributable to the tax benefit if it is reasonably arguable that the GAAR might not have applied. This test is met where, taking recognized sources into account,[145] it would be reasonable to conclude that the taxpayer's position was about as likely to be correct as incorrect or more likely to be correct than incorrect than that of the tax administration.

This penalty can be increased or decreased in certain circumstances. Accordingly, it can be increased by the tax administration where the taxpayer has acted to prevent the administration from discovering the amount of the tax benefit. It can be reduced where the taxpayer has voluntarily disclosed information concerning the scheme. In addition, the tax administration may, at its discretion, reduce or withdraw this penalty like any other penalty.[146]

145 Recognized sources include a tax law, any document that makes it possible to clarify the scope of the law and avoid an unreasonable result, Australian and foreign case law and rulings made by the Australian Taxation Office (ATO).

146 TOOMA, Rachel Anne, *Legislating Against Tax Avoidance*, Amsterdam, IBFD, 2008, page 158.

Lastly, for tax avoidance, the period of limitation is four years.[147] The normal period of limitation is two years for individuals who do not carry on a business and for taxpayers carrying on a small business.[148] It is generally four years for other taxpayers.

❑ Penalty applicable to promoters of a tax exploitation scheme

Unlike the American and British systems, the Australian tax system does not stipulate disclosure rules for arrangements designed by promoters. However, to discourage the promotion of tax exploitation schemes, the Australian tax administration has implemented penalties that apply to promoters of such schemes.

This new system of penalties, which became effective April 6, 2006, targets two situations in particular, namely where:

- an entity engages in conduct that results in that or another entity being a promoter of a tax exploitation scheme;
- an entity engages in conduct that results in a scheme that has been promoted on the basis of conformity with a product ruling being implemented in a way that is materially different from that described in the product ruling.[149]

An entity, including a natural person, is a promoter of a tax exploitation scheme if, at the same time:

- the entity markets the scheme or otherwise encourages the growth of the scheme or interest in it;
- the entity or an associate of the entity receives (directly or indirectly) consideration in respect of that marketing or encouragement;
- it is reasonable to conclude that the entity has had a substantial role in respect of that marketing or encouragement.[150]

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147 There is no period of limitation in cases of evasion or where certain tax provisions are invoked.

148 Briefly, a small enterprise is one with total sales of less than AUS$2 million including the sales of related and affiliated entities.

149 The ATO introduced a product rulings system in 1998. Under the system, a tax intermediary can ask the ATO to make a ruling on a product intended for sale to a number of users.

150 However, an entity is not a promoter merely because the entity provides advice about the scheme. An employee is not to be taken to have a substantial role in respect of that marketing or encouragement merely because the employee distributes information or material prepared by another entity.

Briefly, a scheme is a tax exploitation scheme if it is reasonable to conclude that the entity implementing the scheme does so for the sole or main purpose of obtaining a tax benefit and it cannot be reasonably maintained that such a benefit can be obtained under the tax legislation. A tax exploitation scheme can constitute tax avoidance or tax evasion depending on the circumstances.

Three types of measures can be taken against a promoter of a tax exploitation scheme and, in choosing the measure to take, the past compliance behaviour of the promoter, his degree of cooperation with the tax authorities as well as the losses and the damages sustained by participants are some of the criteria considered.

First of all, the tax administration can accept a voluntary undertaking from the promoter where he is prepared, among other things, to provide a full statement regarding his activities and to correct its behaviour including by reimbursing participants in the scheme.

Where the tax administration considers there is little likelihood of the undertaking being honoured in view of the promoter's past conduct in terms of compliance or the promotion of other tax exploitation schemes, it can then ask the Federal Court of Australia to issue an injunction to halt the implementation or promotion of the scheme or remedy an apparent violation of the law.

Lastly, the tax administration can ask the Federal Court of Australia to consider applying a penalty. The maximum amount of the penalty that can be applied is the greater of the following two amounts:

- 5 000 or 25 000 units (i.e. currently AUS$550 000 or AUS$2 750 000) depending on whether the promoter is a natural person or a legal person; or
- twice the amount received or receivable by the promoter from the tax exploitation scheme.

The Federal Court of Australia must not order the promoter to pay a civil penalty if the promoter satisfies the Court:

- that the conduct in respect of which the proceedings were instituted was due to a reasonable mistake of fact; or
- that this conduct is due to the act or default of another entity (not being an employee or agent of the entity), to an accident or to some other cause beyond the promoter's control and the promoter took reasonable precautions and exercised due diligence to avoid the conduct.

The tax administration must not make an application for the imposition of a penalty upon a promoter more than four years after the promoter last engaged in conduct in relation to promotion or implementation of the tax exploitation scheme, unless the scheme involves tax evasion. In the latter case, there is no time limit.

3.2.2 The New Zealand system

❑ New Zealand's GAAR

According to New Zealand's tax legislation,[151] a tax avoidance arrangement is considered void for the purposes of income tax and consequently, the tax administration can withdraw the tax benefit obtained from such arrangement.

A tax avoidance arrangement means an arrangement,[152] whether or not contracted by the person covered by the arrangement that, directly or indirectly:

- has tax avoidance as its purpose or effect; or
- has tax avoidance as one of its purposes or effects, whether or not any other purpose or effect is referable to ordinary business or family dealings, unless the tax avoidance purpose or effect is merely incidental.

The notion of tax avoidance is not defined exhaustively. It includes:

- directly or indirectly altering the incidence of any income tax;
- directly or indirectly relieving a person from liability to pay income tax or from a potential or prospective liability to future income tax;
- directly or indirectly avoiding, postponing or reducing any liability to income tax or any potential or prospective liability to future income tax.

❑ The penalty associated with the application of the GAAR and the period of limitation

A taxpayer who uses a tax avoidance arrangement is subject to a penalty of up to 100% of the resulting tax shortfall.[153]

The penalty is 100% where the position the taxpayer defends is an abusive tax position, i.e. one based on an unacceptable tax position and whose main purpose is tax avoidance. A taxpayer takes an unacceptable tax position[154] where, objectively, his position, at the time he takes it, is as likely as not to be correct as that of the tax administration.

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151 For the legislative provisions relating to New Zealand's GAAR, see the *Income Tax Act 2007* (sections BG 1 and GA 1).

152 An arrangement means an understanding, contract, plan or agreement, whether enforceable or not, including any stage or transaction by which it is implemented.

153 New Zealand's system includes five categories of penalties, namely the penalty attributable to not taking reasonable care (20% rate), to an unacceptable tax position (20% rate), to gross carelessness (40% rate), to an abusive tax position (100% rate) and to evasion (150% rate). The provisions relating to the penalties are found in the *Tax Administration Act 1994*, Part 9 (see in particular sections 141, 141A, 141B, 141C, 141D, 141EB, 141FB and 141G).

154 An unacceptable tax position can lead to a penalty of 20% if the understated tax is greater than both NZ$50 000 and 1% of the taxpayer's total tax for the reporting period concerned.

New Zealand's legislation stipulates various situations in which penalties can be reduced. Accordingly, a penalty can be reduced by 50% where a penalty was not imposed on the taxpayer concerned within the last four years.

Similarly, the 100% penalty may be reduced by 75% if the taxpayer makes a voluntary disclosure before being notified that an audit will be carried out, or by 40% if the disclosure occurs after such notice but before the start of the audit.

Lastly, the 100% penalty is reduced to 20% where the taxpayer participates in an arrangement for which the promoter is subject to a penalty.[155]

Moreover, there is no specific provision as to the period of limitation applicable to tax avoidance. Accordingly, the tax administration can exercise its assessment authority only within the four-year period of limitation.

❑ The promoter

A promoter is subject to a penalty where he offers, sells or promotes an arrangement to ten or more people regarding a taxation year and where such an arrangement constitutes an abusive tax position. This penalty is currently calculated by applying a rate of 39% to the sum of the tax shortfalls the investors could have obtained.

3.2.3 The Irish system

❑ Ireland's GAAR

Ireland introduced its GAAR in 1989. Accordingly, under the existing legislation, a transaction is an avoidance transaction where, taking the results of the transaction into account, as well as its use as a way to achieve these results and any other way by which all or part of these results would have been achieved, the Revenue Commissioners are of the view that it gives rise to a tax benefit and was not undertaken mainly for purposes other than that of obtaining a tax benefit.[156]

To that end, the Revenue Commissioners must consider:

- the form of the transaction;
- the substance of the transaction;

155 For this reduction to apply, the amount of tax attributable to the tax benefit obtained by the taxpayer and the persons affiliated with him must be less than NZ$50 000 and the taxpayer must file an independent opinion to the effect that his tax position is not abusive.

156 For the legislative provisions relating to the Irish GAAR, see the *Taxes Consolidation Act* 1997 (sections 811 and 811A).

— the substance of any other transaction to which the transaction can be reasonably considered as being directly or indirectly connected or associated;

— the final result of the transaction and of any combination of the other transactions connected or associated with it.

However, and although the purpose of the transaction could have been achieved by another transaction that would have resulted in a heavier tax burden, the commissioners must conclude that a transaction is not an avoidance transaction where they consider that it was carried out for a commercial purpose in the course of carrying on the taxpayer's business and was not carried out mainly to obtain a tax benefit. Similarly, a transaction will not be considered an avoidance transaction where it was carried out for the purpose of benefiting from an abatement, allowance or relief stipulated by a provision in the legislation and does not result, directly or indirectly, in an abuse of such provision taking the purposes for which it was stipulated into account.

Where the tax administration considers a transaction to be an avoidance transaction, it issues a notice of opinion to the taxpayer concerned. The taxpayer can then contest this notice before the Appeal Commissioners and the Circuit Court and the High Court.[157]

❑ The surcharge associated with the application of the GAAR and the period of limitation

Until quite recently, Ireland's legislation did not stipulate a surcharge when the GAAR was applied. However, in 2006, two amendments were made to the tax legislation to encourage taxpayers to disclose information on transactions that the tax administration could potentially consider as avoidance transactions.

First, it announced that a 10% surcharge would be applied to the tax attributable to an avoidance transaction. At the same time, a protective notification mechanism was introduced to enable a taxpayer who files such notification, within 90 days after a transaction that could be considered an avoidance transaction begins to be carried out, to avoid the application of such a surcharge as well as application of interest assuming it is eventually determined that the transactions is indeed an avoidance transaction.

Since the tax administration received few protective notifications, changes were made in 2008 to the protective notification rules, the rate of the surcharge and the criterion applicable in a taxpayer's appeal.

157 These bodies may confirm in whole or in part the opinion of the Revenue Commissioners that the transaction is an avoidance transaction or reject this opinion.

Accordingly, the fact of filing a protective notification limits the period during which the tax administration can give its opinion on the avoidance transaction. In such a case, the tax administration has two years following the day when a complete protective notification is filed to give such an opinion. Without a protective notification, the tax administration can issue an opinion on the transaction at any time.[158]

In addition, the surcharge that may be applied regarding an avoidance transaction for which there is no protective notification was increased from 10% to 20%.

Moreover, where no protective notification has been filed, the role of the Appeal Commissioners and of the Circuit Court and High Court, regarding the transaction covered by an opinion of the tax administration, will be to determine if there are reasons why such transaction can be reasonably considered an avoidance transaction whereas, in the case where the protective notification would have been filed, this role will be to decide whether the transaction is indeed an avoidance transaction.

3.3 Observations

In recent years, the United Kingdom, South Africa and Portugal[159] have put in place an early disclosure system, while the United States has made substantial changes to the application conditions of their system introduced in 1984. Since they make it possible to quickly obtain information on transactions that carry a risk of avoidance, these disclosure mechanisms considerably reduce the time required for tax administrations to respond to ATP schemes and, consequently, can make ATP less attractive.

Like Canada, Australia, New Zealand and Ireland have incorporated a GAAR in their tax system. However, the tax legislation in Australia and New Zealand differs from the Canadian tax system by also stipulating a system of penalties for taxpayers and promoters involved in tax avoidance transactions while the Irish tax administration has chosen an approach that seeks more particularly to influence the behaviour of taxpayers.

The examination of legislative tools in other countries leads to the observation that interventions focusing on ATP seek to deter taxpayers and promoters from using it, in particular by changing the risk/reward ratio of ATP and the new business model of tax intermediaries.

158 Note that the normal period of limitation is four years (sub. 955(2) of the *Tax Consolidation Act*, 1997).

159 *Supra*, note 121.

4. ACTIONS UNDER CONSIDERATION

In the preceding sections, it was shown that a favourable risk/reward ratio for the taxpayer and the development of a new business model based on designing and distributing off-the-shelf tax products, were among the factors with the most influence on the proliferation of ATP and on which the tax authorities can act. It was also shown that certain characteristics inherent in Québec's tax system have an impact on the development of ATP schemes.

Moreover, it was mentioned that certain contextual factors have a major influence on fiscal policy in terms of fighting against ATP, in particular Canadian fiscal federalism and the high degree of harmonization of provincial tax systems.

The examination of the GAAR showed that many provinces have specified that obtaining a tax benefit under a provincial or federal law does not constitute a *bona fide* purpose for determining whether a transaction is an avoidance transaction.

The examination of legislative tools in place in the United States and Great Britain with respect to early disclosure regime shows that, in addition to the disclosure of specific arrangements or transactions, these two regimes also require disclosure of transactions carried out in a context where the contract between the taxpayer and the tax intermediary includes certain components frequently associated with ATP schemes.

The examination of the legislative tools used in Australia, New Zealand and Ireland indicates that the application of the GAAR can be strengthened by introducing a penalty regime and by extending the period of limitation.

Accordingly, on the basis of these observations and in this context, this section describes the actions under consideration by the ministère des Finances to improve the detection and dissuasion legislative tools available to Québec's tax administration in the fight against ATP schemes.

4.1 A mandatory early disclosure mechanism

Some taxpayers develop tax planning schemes that do not correspond to the object, spirit and purpose of the tax legislation, but nonetheless comply with its wording. It is then important that the tax administration quickly detect this type of planning to ensure compliance with the object, spirit and purpose of the tax legislation. However, such promptness is difficult to achieve in a self-assessment system.

Accordingly, to make ATP schemes less attractive, the tax legislation could be amended to reduce the interval between the time a taxpayer implements an ATP and the time the scheme is identified by the tax administration.

Québec's tax legislation already has information reporting rules concerning tax shelters.[160] These rules seek to achieve control and compliance with the law and enable the tax administration to become aware more quickly of transactions[161] consisting of tax shelters.

These rules successfully fulfil the role for which they were introduced. Accordingly, extending their scope is not under consideration because that would imply a change to the existing concept of tax shelter, which would inevitably lead to differences with the federal tax legislation, both sets of legislation generally being harmonized on this matter.

Neither should the mechanism it would be appropriate to introduce to enable the tax administration to quickly detect other tax avoidance transactions bear on the attributes of such transactions, as rules on tax shelters do. Rather, it should bear on the contextual elements of their implementation.

4.1.1 Mandatory early disclosure rules adapted to Québec's tax system

Other tax jurisdictions have developed early disclosure rules to detect tax avoidance transactions at an early stage.[162] For instance, in the United Kingdom, these rules seek in particular to detect the presence of a tax benefit in a hallmarked scheme and to determine whether such tax benefit is the main or one of the main benefits of the scheme. In the United States, an approach targeting risks of tax avoidance based on circumstantial factors and listed transactions is preferred.

❑ The British and American approaches

The British approach to early disclosure is similar to the a priori application of a GAAR. It is based on the assessment of the presence of a "predominant" tax benefit in a hallmarked scheme and, in so doing, it leaves more room for interpretation, with the potential for disputes on the existence of such a tax benefit and creating uncertainty concerning whether or not early disclosure is required. Accordingly, this is not the preferred approach for the introduction of an early disclosure rule.

160 Sub-section 2.2.3 provides a brief description.

161 In sub-section 4.1, the expression "transaction" includes a series of transactions.

162 On this subject, see section 3.

Turning to the American approach, many categories of transactions are subject to the disclosure requirement. These include confidential transactions and those in which remuneration for services is conditional on an event occurring or a result being obtained. Since these two categories of transactions involve behaviour frequently associated with tax avoidance transactions, they would be targeted.[163]

The characteristics frequently associated with an ATP scheme include the confidentiality of its existence and the conditional aspect of the remuneration paid to its instigator or promoter.[164]

■ Confidentiality undertakings are frequently included in ATP schemes

Confidentiality of a tax avoidance transaction is demanded in a context where the instigator or promoter of a transaction wants to maximize his gains from it before anyone else can copy it, or before the tax administration discovers it and amends the tax legislation to put an end to it.

Accordingly, the essential driver for confidentiality is the instigator's or promoter's desire to make repeated or continued use of the transaction in the future.

■ Conditional remuneration is prohibited in certain cases

The supply of and demand for ATP can be influenced by payment of remuneration that is conditional or proportional to the tax benefit obtained. Accordingly, a taxpayer might be more inclined to implement an ATP scheme proposed by an advisor if no fees are payable or if the fees he must pay are reduced in the event that the proposed transaction does not produce the expected tax benefit.

Since March 26, 2008, this type of remuneration contingent on an event occurring or a result being obtained is strictly regulated in the United States in regard to tax professionals authorized to deal with the IRS.[165] Except for a few situations, such tax professionals cannot enter into conditional fee agreements. The ban targets in particular planning and consulting services, tax return preparation, as well as claims for refunds or tax credits, and covers most aspects connected with the tax administration.

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163 Such transactions may also be hallmarked schemes for the purposes of British early disclosure rules.

164 UNITED STATES, Department of the Treasury, *The Problem of Corporate Tax Shelters, Discussion, Analysis and Legislative Proposals*, July 1999, p. 11.

165 UNITED STATES, Treasury Department, *Circular* N° 230 (Revised 4-2008), s. 10.27. In order to represent a taxpayer before the federal tax authorities, a tax professional must be accredited by the IRS. He thus becomes subject to a set of standards described in that circular.

In the same vein, the Québec and federal laws provide an example of such a ban regarding lobbying activities. The *Lobbying Transparency and Ethics Act*[166] bans consultant lobbyists and enterprise lobbyists from carrying out their activities in return for compensation that is contingent on the achievement of a result or depends on the degree of success of their activities. The federal legislation now has the same intent.[167] Before July 2, 2008, the federal legislation[168] did not ban conditional fees but required, as the statutes of Ontario,[169] Nova Scotia[170] and Newfoundland and Labrador[171] still do, that a consultant lobbyist indicate in his return whether his remuneration depends, in whole or in part, on how successful his activities are.

Although the ban on remuneration contingent on an event occurring or a result being achieved was introduced by the American government in certain tax cases, and was also introduced in the legislation at the Québec and federal levels regarding lobbying activities, it does not appear desirable, for now, to add a similar ban to Québec's tax legislation since that would require the implementation of administrative structures to regulate tax practice. Since that would be counter to the government's position favouring the regulatory and administrative streamlining, the disclosure requirement seems preferable.

❑ Québec early disclosure rules

Under the American early disclosure system, confidential transactions and those involving remuneration contingent on an event occurring or on a result being obtained are among the transactions covered by a disclosure requirement. Such transactions may also be hallmarked schemes for the purposes of British early disclosure rules.

This aspect of the American and British early disclosure systems could be adapted as part of Québec early disclosure rules that would be based on an approach targeting behaviour frequently associated with tax avoidance arrangements. The introduction of such rules would be more in line with the government policy to limit the complexity of Québec's tax system and streamline the system's administrative rules.

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166 R.S.Q., c. T-11.011, sec. 26.

167 *Lobbying Act*, R.S.C. 1985 (4th Supp.), c. 44, sec. 10.1. This section has entered into force July 2, 2008.

168 *Lobbyists Registration Act*, R.S.C. 1985 (4th Supp.), c. 44, s. 5(2)g).

169 *Lobbyists Registration Act, 1998,* S.O. 1998, c. 27, par. 4(4) (item 10).

170 *Lobbyists' Registration Act*, S.N.S. 2001, c. 34, par. 5(4)(j).

171 *Lobbyist Registration Act*, S.N.L., c. L-24.1, par. 5(4)(j).

■ The person who would be required to make early disclosure

The early disclosure mechanism that could be introduced to the Québec tax legislation would target taxpayers whose behaviour is considered at risk of being associated with an ATP scheme, and only they would be required to make early disclosure, not the advisors or other tax intermediaries.

Limiting this requirement to taxpayers whose behaviour is considered at risk of being associated with an ATP would avoid an excessive increase to the task of the tax administration because it would not have to handle many early disclosures filed by the taxpayer as well as by other persons.

Moreover, this requirement on the taxpayer to disclose a transaction to the tax administration would implicitly include a requirement that the advisor at the source of the transaction advise the taxpayer of his obligation to make early disclosure and inform him of the purposes of such disclosure.

The purposes of early disclosure would be to enable the tax administration to more easily target taxpayers whose behaviour is considered at risk of being associated with an ATP, to undertake with promptness an audit of the affairs of these taxpayers, and to correct Québec's tax legislation more quickly in order to counter ATP, if any.

■ Transactions that must be disclosed

As mentioned above, the circumstantial factors relating to a contractual relation between a taxpayer and his advisor allow to identify two patterns of behaviour that may be associated with tax avoidance transactions that a taxpayer could be required to disclose at an early stage.

▪ Confidential transaction

The first behaviour pattern concerns the confidentiality the taxpayer undertakes to keep in relation to a transaction that provides a tax benefit. More specifically, the tax legislation could be amended so that where a taxpayer retains the services of an advisor concerning a transaction providing a tax benefit, and the contract between the taxpayer and the advisor includes an undertaking of confidentiality by the taxpayer towards other persons or the tax administration in relation to the transaction, the taxpayer would henceforth be required to disclose such transaction at an early stage to the tax administration.

To that end, the expression “advisor”, regarding a transaction, would mean a person, including a partnership, who provides help, assistance or advice regarding the design or implementation of the transaction or who commercializes or promotes it.

- **Transaction with conditional remuneration**

The second risky behaviour pattern concerns the conditional terms of remuneration of a contract a taxpayer enters into with an advisor regarding a transaction. The conditional aspect of the remuneration could take one or the other of the following forms:

- the remuneration paid to the advisor is conditional, in whole or in part, on obtaining a tax benefit resulting from the transaction or is dependent, in whole or in part, on such tax benefit;
- the remuneration paid to the advisor is refundable, in whole or in part, to the taxpayer if the tax benefit expected from the transaction does not materialize;
- the remuneration is acquired, in whole or in part, to the advisor only after the expiry of the period of limitation applicable to the taxation year or the taxation years during which the transaction takes place.

A taxpayer who would undertake to pay such form of conditional remuneration to an advisor concerning the implementation of a transaction would henceforth be required to disclose the transaction at an early stage to the tax administration.

For this purpose, the expression "advisor" would have the same meaning as for a confidential transaction.

- **Content of and filing deadline for early disclosure**

To make the early disclosure mechanism more effective, the tax legislation would be amended so that the content of the disclosure is sufficiently detailed to provide the tax administration with all the information that would allow it to identify and analyze the transaction. The taxpayer would therefore be required to provide the tax administration with all this information using a prescribed form made available to him.

In addition, early disclosure would have to be made within a very short deadline. Accordingly, a taxpayer would be required to file this disclosure no later than 30 days after the transaction begins to be carried out.

4.1.2 Penalty for failing to file mandatory early disclosure

A taxpayer who fails to disclose, within the stipulated deadline of 30 days, a transaction associated with one of the risky behaviour patterns identified would be liable for a penalty. This penalty, that would include a minimum amount, would rise up to a maximum amount that would be established on the basis of the number of days late in filing the prescribed form for the disclosure.

Accordingly, the minimum penalty could be $10 000. This penalty would rise by $1 000 per day late, as of the second day late, to a maximum of $100 000.

4.1.3 Suspension of the period of limitation regarding an undisclosed transaction

A taxpayer's failure to disclose at an early stage a transaction associated with one of the risky behaviour patterns identified could also have an impact on the period of limitation that would otherwise apply regarding the tax consequences arising from the undisclosed transaction.

Accordingly, for a taxpayer who omits to file the prescribed form for disclosure of such a transaction, the period of limitation applicable to the tax consequences arising from the undisclosed transaction would be suspended until the time the prescribed form for disclosure of the transaction is filed. This would also apply to any person associated with or related to the taxpayer.

More specifically, the tax legislation could be amended so that the limitation in relation to a taxation year during which tax consequences arise from a transaction that must be disclosed by a taxpayer corresponds, in relation to these tax consequences, for the taxpayer and for any person associated with or related to the taxpayer, to the normal period of limitation applicable for such taxation year (in particular the periods of three, four, six or seven years stipulated by the tax legislation), that would begin however on the later of the following two days: the day of mailing the first notice of assessment for the year or the day the prescribed form for disclosing the transaction is filed.

Consequently, no period of limitation would henceforth apply regarding the tax consequences arising from such an undisclosed transaction.

4.1.4 Actions under consideration

The ministère des Finances is considering the introduction of mandatory early disclosure rules with the following parameters:

— would be subject to a disclosure requirement a confidential transaction, i.e. a transaction providing a tax benefit regarding which a taxpayer retained the services of an advisor, where the contract between the taxpayer and the advisor includes an undertaking of confidentiality by the taxpayer towards other persons or the tax administration in relation to the transaction;

- in addition, a transaction would be subject to a disclosure requirement if it is a transaction regarding which the remuneration of the advisor takes any of the following forms:
  - it is conditional, in whole or in part, on obtaining a tax benefit resulting from the transaction, or it is established, in whole or in part, on the basis of such tax benefit;
  - it is refundable, in whole or in part, to the taxpayer if the expected tax benefit from the transaction does not materialize;
  - it is acquired, in whole or in part, to the advisor only after the expiry of the period of limitation applicable to the taxation year or to the taxation years during which the transaction takes place;
- the expression "advisor", regarding a transaction, would mean a person, including a partnership, who provides help, assistance or advice regarding the design or implementation of the transaction or who commercializes or promotes it;
- the taxpayer would be the person required to make early disclosure;
- the taxpayer would have to send information, using a prescribed form, that is sufficiently detailed for the tax administration to be able to identify and analyze the transaction relating to the risky behaviour pattern;
- early disclosure would have to be made within a deadline of 30 days after the transaction begins to be carried out;
- a penalty, that would rise to a maximum amount established on the basis of the number of days late in filing the prescribed form for the disclosure, would be imposed. The minimum penalty would be $10 000. It would rise by $1 000 per day late, as of the second day late, to a maximum of $100 000;
- for a taxpayer who omits to file the prescribed form for early disclosure and any person associated with or related to the taxpayer, the period of limitation applicable to the tax consequences arising from the undisclosed transaction would be suspended until the time the prescribed form is filed.

4.2 A clarification to the GAAR

4.2.1 The GAAR and the concept of economic substance

When the Minister of Finance of Canada introduced the GAAR, the detailed explanatory notes accompanying the new legislation included the following clarifications to the concept of abuse stipulated in paragraph 245(4) I.T.A.:[172]

> Subsection 245(4) recognizes that the provisions of the Act are intended to apply to transactions with real economic substance, not to transactions intended to exploit, misuse or frustrate the Act to avoid tax. It also recognizes, however, that a number of provisions of the Act either contemplate or encourage transactions that may seem to be primarily tax-motivated. The so-called "butterfly" reorganization is a good example of such transactions. It is not intended that section 245 will apply to deny the tax benefits that result from these transactions as long as they are carried out within the object and spirit of the provisions of the act read as a whole. Nor is it intended that tax incentives expressly provided for in the legislation would be neutralized by this section.[173] [Underlining added]

❑ Doctrine and case-law

For some authors, including professor Jinyan Li, by enacting the GAAR, the legislator wanted the concept of economic substance[174] to be taken into consideration in deciding whether an avoidance transaction is abusive:

> The statutory context of section 245 also makes it important to consider economic substance under the abuse analysis pursuant to subsection 245(4). The GAAR was intended to be a provision of last resort and would apply only to transactions that otherwise complied with all of the other relevant provisions of the Act. Since the economic substance of a transaction is generally irrelevant in applying the provisions of the Act other than section 245, the transactions giving rise to the tax benefit must be characterized in accordance with their legal form and substance. In addition, recharacterizing transactions on the basis of economic realities is generally prohibited under subsection 245(3) in determining whether a transaction is an avoidance transaction. [...][175] [Underlining added]

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172 Sec. 1079.12 Q.T.A.

173 See note 44 above, p. 464.

174 The expression "economic substance" refers to a legal doctrine recognized mainly by the courts of certain common law jurisdictions, in particular the United States.

175 Jinyan Li, *"Economic Substance": Drawing the Line Between Legitimate Tax Minimization and Abusive Tax Avoidance*, (2006), vol. 54, n° 1 *Canadian Tax Journal*, p. 36.

In the *Canada Trustco Mortgage* decision, the Chief Justice McLachlin and Mr. Justice Major, on behalf of the Supreme Court, commented as follows regarding the concept of economic substance:

> Courts have to be careful not to conclude too hastily that simply because a non-tax purpose is not evident, the avoidance transaction is the result of abusive tax avoidance. Although the Explanatory Notes make reference to the expression "economic substance", s. 245(4) does not consider a transaction to result in abusive tax avoidance merely because an economic or commercial purpose is not evident. As previously stated, the GAAR was not intended to outlaw all tax benefits; Parliament intended for many to endure. The central inquiry is focussed on whether the transaction was consistent with the purpose of the provisions of the *Income Tax Act* that are relied upon by the taxpayer, when those provisions are properly interpreted in light of their context. Abusive tax avoidance will be established if the transactions frustrate or defeat those purposes.
>
> Whether the transactions were motivated by any economic, commercial, family or other non-tax purpose may form part of the factual context that the courts may consider in the analysis of abusive tax avoidance allegations under s. 245(4). However, any finding in this respect would form only one part of the underlying facts of a case, and would be insufficient by itself to establish abusive tax avoidance. The central issue is the proper interpretation of the relevant provisions in light of their context and purpose. When properly interpreted, the statutory provisions at issue in a given case may dictate that a particular tax benefit may apply only to transactions with a certain economic, commercial, family or other non-tax purpose. The absence of such considerations may then become a relevant factor towards the inference that the transactions abused the provisions at issue, but there is no golden rule in this respect.[176] [Underlining added]

In the *Lipson* case, Mr. Justice LeBel, on behalf of the majority, wrote that:

> [...] 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).[177]

176 See note 12 above, p. 57-58.

177 See note 10 above, par. 38.

The approach taken by the Supreme Court to the economic substance doctrine, as part of the application of the GAAR, has been harshly criticized by professor Brian J. Arnold, in whose view a GAAR that is not based in part on the concept of economic substance cannot be truly effective:

> Any GAAR or general anti-avoidance doctrine must consider the economic substance of transaction if it is to be effective. However, vague references to economic substance are a poor substitute for a rigorous analysis of transactions on the basis of objective criteria such as a comparison of the pre-tax profit and the tax benefits. In the hands of Canadian courts, there is a serious risk that economic substance may degenerate into a smell test.
>
> Despite clear statements in the Explanatory Notes that the GAAR is intended to ensure that the provisions of the Act apply to transactions with real economic substance, the Supreme Court held that economic substance is relevant under the GAAR only if the provisions in question contemplate or refer to economic substance. Even if they do, the lack of economic substance is only one factor to be considered and is insufficient by itself to establish abusive tax avoidance. Very few statutory provisions explicitly refer to economic substance; therefore, economic substance is unlikely to be an important factor in the application of the GAAR if the Supreme Court's approach is adhered to strictly by the lower courts.[178] [Underlining added]

That is why professor Arnold believes a change to the GAAR is needed to require the courts to use the economic substance test in applying the GAAR and to clarify the notion of economic substance:

> Amendments to the GAAR are necessary to eliminate the major deficiencies in the case law. In particular, the GAAR should be amended to require the courts to consider the economic substance of the transaction in question and should provide some guidance to the courts as to the meaning of economic substance.[179]

As mentioned above, professor Jinyan Li is of the view that the concept of abuse stipulated in paragraph 245(4) I.T.A. requires that economic substance be examined. In addition, according to professor Li, the Supreme Court in *Mathew*[180] acknowledged a degree of relevance of the economic substance concept for the purposes of the provisions of the GAAR:

178 Brian J. ARNOLD, *The Canadian Experience with General Anti-Avoidance Rule*, Beyond Boundaries "*Developing Approaches to Tax Avoidance and Tax Risk Management*", Judith Freedman (ed.), Oxford University, Centre for Business Taxation, 2008, p. 31.

179 *Id.*, p. 32.

180 See note 16 above.

> Thus, contrary to what Dickson CJ had anticipated in *Bronfman Trust*, there was no trend in Canadian tax cases "towards attempting to ascertain the true commercial and practical nature of the taxpayer's transactions." For that reason, the Supreme Court's new stance on economic substance in *Canada Trustco* could be viewed as a shift in judicial thinking. The Supreme Court did not dismiss the relevance of the economic substance concept, and in the following statement in *Mathew*, the court seemed to contemplate the possibility that a transaction with legal substance may nevertheless be found to be abusive under subsection 245(4):
>
>> [A]busive tax avoidance may be found where the relationships and transactions as expressed in the relevant documentation lack a proper basis relative to the object, spirit or purpose of the provisions that are purported to confer the tax benefit, or where they are wholly dissimilar to the relationships or transactions that are contemplated by the provisions. [Paragraph 31]
>
> However, it would be wrong to suggest that the shift in thinking is a fundamental one, because the court appears to have limited the economic substance analysis to the GAAR context. In that sense, little has changed since *Shell*. Nevertheless, it is clear that the economic substance of transactions is potentially relevant in GAAR cases.[181]

Thus, despite the limited application of the economic substance concept in the GAAR context, professor Li is of the view that the following approach would be appropriate in the application of the GAAR and would help establish whether, following a transaction or series of transactions, the taxpayer's economic situation is meaningfully different or not:

> With respect to the determination of economic substance, the inquiry should emphasize the economic result and outcome, as well as the "economic relations." If the taxpayer's economic position was not meaningfully altered by the transaction, or if there was no real economic reason for the transaction (other than tax-saving considerations), it is difficult to find economic substance in the transaction. Therefore, a transaction lacks economic substance if "the financial position of the taxpayer is unaffected (save for the costs of devising and implementing the arrangement)." In other words, a transaction lacks economic substance if [*sic*] did not expose the taxpayer to any economic risk, or offer the taxpayer any opportunity for profit, that was meaningful in relation to the resulting tax benefit [...].[182]

Moreover, regarding economic substance, the Irish GAAR provides a particularly interesting example, notably because of the similarities between it and Québec's GAAR.

181 See note 175 above, p. 33.

182 *Id*., p. 45.

As explained in sub-section 3.2.3, according to the Irish GAAR, a transaction is an avoidance transaction where, taking the results of the transaction into account, its use as a way to achieve these results and any other means by which all or part of these results could have been achieved, the Revenue Commissioners are of the view that it gives rise to a tax benefit and was not undertaken mainly for purposes other than that of obtaining a tax benefit.

In the assessment they must make regarding a given transaction, the Irish Revenue Commissioners must take certain factors into account including the form, substance and result of the given transaction and transactions connected or associated with it. In short, when assessing a given transaction to determine whether or not it is an avoidance transaction, the Irish legislation requires that the economic substance of the given transaction be examined.

❑ Unilateral addition of the economic substance concept is not desirable

As mentioned in sub-section 2.3.2, a number of contextual factors influence Québec's fiscal policy in fighting against ATP. These include Canadian fiscal federalism and cooperation among tax administrations in Canada.

In the context of a change to a provision of Québec's tax system like the GAAR, which originates in the harmonization of Québec's tax legislation with federal tax legislation, these contextual factors cannot be ignored without notable changes to the administration of the system.

For example, if Québec's GAAR was changed by adding an economic substance test without a corresponding change being made to the federal GAAR and, to a lesser degree, to the GAAR of the other provinces, certain current administrative practices of the Québec and federal tax authorities, regarding the exchange of information and the issuing of assessments further to assessments of another jurisdiction, in particular, could be upset.

Essentially, the objective of these administrative practices is to facilitate the administration of the tax system, make it more efficient and reduce its cost. Consequently, the potential gain in effectiveness in the fight against ATP that may arise from changing Québec's GAAR as outlined above must be assessed by taking disturbances in terms of tax administration into account.

In addition, such a change implemented unilaterally by Québec could also limit the possibilities for concerted action with other jurisdictions in Canada in fighting against ATP and, in this sense, potentially prove counter-productive.

Lastly, such a change could, to a certain degree, make part of the case-law in this area inapplicable. It took 17 years before the Supreme Court had to rule on the application of the GAAR. It is reasonable to believe that adding an economic substance test to the provisions of the GAAR could call into question the relevance, regarding a modified GAAR, of part of the case-law, depriving the tax administration, taxpayers and the courts of significant clarifications on the scope and application of the GAAR and thus generating legal uncertainty that could last for a rather long period.

Accordingly, Québec's unilateral addition of an economic substance test to the provisions of Québec's GAAR is not desirable.

4.2.2 The GAAR and the notion of *bona fide* purposes

As mentioned in sub-section 2.2.2, the tax legislation of many provinces excludes from the notion of *bona fide* purposes not only the obtaining of a tax benefit under the law that encompasses their GAAR, but also the obtaining of a tax benefit resulting from another law of a province or a federal law. Québec's GAAR should be amended to specify the notion of *bona fide* purposes so that cannot be considered *bona fide* purposes for the application of the definition of avoidance transaction:

a) the obtaining of a tax benefit;

b) the reduction, avoidance or deferral of tax or other amount payable under a Québec law other than the *Taxation Act*, a law of another province of Canada or a federal law;

c) the increase in a refund of tax or of another amount under a Québec law other than the *Taxation Act*, a law of another province of Canada or a federal law;

d) any combination of the purposes mentioned above.

This change would put Québec's GAAR in tune with those of many other provinces.

4.2.3 Actions under consideration

The ministère des Finances does not intend to propose changes to the GAAR other than to the definition of avoidance transaction where it would be specified that the following are not *bona fide* purposes:

— the obtaining of a tax benefit;

— the reduction, avoidance or deferral of tax or other amount payable under a Québec law other than the *Taxation Act*, a law of another province of Canada or a federal law;

— the increase in a refund of tax or of another amount under a Québec law other than the *Taxation Act*, a law of another province of Canada or a federal law;

— any combination of the purposes mentioned above.

4.3 Extending the period of limitation when the GAAR applies

4.3.1 Existing rules concerning the period of limitation

❑ First assessment

According to the existing tax legislation, the Minister of Revenue may at any time assess the tax, interest and penalties for a taxation year regarding a taxpayer.[183]

However, where the taxpayer files a tax return for a taxation year, the Minister must act with dispatch and examine the tax return the taxpayer sent him for the taxation year. As part of this examination, the Minister notes the tax that the taxpayer was required to estimate, assesses his tax, then sends a notice of assessment to the taxpayer.

❑ A period of three years or four years to reassess tax

The Minister may again assess the tax for which an earlier assessment was made. In this case, the Minister can exercise his power of reassessment only within a period of limitation of three years beginning the day the notice of original assessment is sent,[184] or of four years beginning that day where the taxpayer is a mutual fund trust or a corporation other than a Canadian controlled private corporation.[185]

The Minister may consider all the relevant items relating to the determination of the tax payable by the taxpayer, both for the original assessment and for a reassessment issued subsequently within the period of limitation of three years or four years, as the case may be.

183 Par. 1010(1) Q.T.A.

184 Sub-par. 1010(2)*a*) Q.T.A.

185 Sub-par. 1010(2)*a.0.1*) Q.T.A.

❑ No limitation period for reassessment in cases of waiver or fraud

Even if a period of limitation has expired, the Minister may reassess at any time where the taxpayer waives the period of limitation[186] or where he misrepresents the facts through neglect or wilful default or commits fraud in filing his return or in supplying information provided for in the tax legislation.[187]

In these circumstances, the reassessment can, however, only bear on the items relating to the waiver of limitation or the misrepresentations, as the case may be.[188]

❑ An additional period of three years applies in some cases

In some cases, an additional period of limitation is allowed to the Minister to reassess.

For instance, the Minister is allowed an additional three years to make a reassessment where it is required to be made as a consequence of a transaction involving a taxpayer and a person not resident in Canada with whom such taxpayer is not dealing at arm's length,[189] or where a reassessment is required to be made, in certain circumstances, in the case of a taxpayer who is not resident in Canada but carries on a business in Canada.[190] In both cases, the reassessment can relate only to the items concerned by the situations in question.[191]

In these situations, the period of limitation of three years or four years, as the case may be, was not considered enough to allow the Minister to act.

4.3.2 An additional period of three years could be added to the period of limitation where the GAAR applies

As in the case of reassessment relating to certain situations involving persons not resident in Canada, the tax legislation could be amended to provide for a period in addition to the period of limitation where a taxpayer carries out in a taxation year a transaction or series of transactions leading to the application of the GAAR by the Minister of Revenue.

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186 Sub-par. 1010(2)*b*)(ii) Q.T.A.

187 Sub-par. 1010(2)*b*)(i) Q.T.A.

188 Sec. 1011 Q.T.A.

189 Sub-par. 1010(2)*a.1*)(vi) Q.T.A.

190 Sub-par. 1010(2)*a.1*)(vii) Q.T.A.

191 Par. 1010(3) Q.T.A.

What characterizes often these transactions is the complexity of the legal structures on which they are based. In addition, the Minister of Revenue's task is made more difficult since he must detect these transactions within a self-assessment system. Accordingly, the Minister can only become aware of these transactions as a result of a thorough examination of the tax return filed by the taxpayer.

The current period of limitation of three years or four years, as the case may be, is often not enough, particularly because of the sophistication of these transactions. In this context, it would be appropriate to give to the Minister an additional period of three years to enable him to make a reassessment when it applies the GAAR. This approach was recently adopted by Alberta.[192]

Accordingly, like the above-mentioned examples, the period of limitation would henceforth be six years or seven years, as the case may be, for application of the GAAR by the Minister of Revenue, and the reassessment could relate only to the items covered by the application of the GAAR.

4.3.3 Taxpayers' need for certainty

One of the basic principles of our tax system is to enable each taxpayer to know his tax burden as quickly as possible with a reasonable degree of certainty in relation to a given situation.

In this regard, the three-year extension of the period of limitation to enable the Minister to make a reassessment where the GAAR applies could raise the level of uncertainty for the taxpayers.

There is currently a way to guard against this type of uncertainty, by applying for and receiving an advance ruling from Revenu Québec. While an advance ruling is nothing more than an administrative practice put in place by Revenu Québec, it is binding on Revenu Québec nonetheless.

Concerning taxpayers who, without an advance ruling, want to guard against the uncertainty that could result from this extension of the period of limitation, the tax legislation could be amended to allow them, if they disclose to Revenu Québec a transaction or series of transactions regarding which the GAAR would likely apply, to avoid extending the period of limitation.

192 *Alberta Corporate Tax Amendment Act, 2008*, S.A. 2008, c. 29, par. 13(1)(a) and (b).

❑ The advance ruling mechanism

An advance ruling consists of a statement that Revenu Québec makes to a person informing him in advance of the tax treatment that will apply to one or more specific transactions that a taxpayer expects to carry out. This statement binds Revenu Québec in relation to the specific transactions brought to its attention and carried out within the periods mentioned in the advance ruling application.[193]

Accordingly, a taxpayer who plans to carry out, within a taxation year, a transaction or series of transactions for which he wishes to obtain assurance that the GAAR will not apply can apply to Revenu Québec for an advance ruling.

Besides the taxpayer's identification, the advance ruling application must include a complete and detailed description of the facts, accompanied by all the relevant documents, disclosure of the purpose of the planned transactions and a clear statement of the questions on which a ruling is requested. The advance ruling application must also indicate the provisions of the *Taxation Act* regarding which the ruling is requested as well as the taxpayer's interpretation of them. Furthermore, where the application bears on the GAAR, it must indicate the reasons for concluding that the transaction would not produce a tax benefit resulting directly or indirectly from an abuse of the provisions of the *Taxation Act*.[194]

❑ Introduction of a preventive disclosure mechanism

In addition to the advance ruling mechanism already available to taxpayers, the tax legislation could be amended to include a preventive disclosure mechanism to enable a taxpayer making use of it to avoid application of the additional three-year period when the GAAR applies.

Since this additional period of limitation is made necessary to allow Revenu Québec to detect a transaction or series of transactions regarding which the GAAR would likely apply for a taxation year, this period would not be required in situations where a taxpayer discloses this transaction or series of transactions to Revenu Québec.

Like the advance ruling mechanism, such disclosure would have to clearly identify the taxpayer who is the object of the disclosure and include a complete and detailed description of the facts (including such a description of the transaction or series of transactions disclosed, its objects and effects) accompanied by all the relevant documents allowing Revenu Québec to thoroughly analyze it.

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193 REVENU QUÉBEC, *Interpretation Bulletin* ADM. 2/R7, "Advance Rulings", June 30, 2000.

194 *Id.*, par. 10.

Such preventive disclosure could be made no later than the statutory filing date of the tax return for the taxation year in which the transaction or series of transactions takes place. In these circumstances, the additional period of three years would not apply.

❑ The mandatory early disclosure mechanism

In sub-section 4.1, the ministère des Finances considers the implementation of a mandatory early disclosure mechanism, applicable to a transaction resulting in a tax benefit regarding which:

— either a taxpayer retained the services of an advisor, where the contract between the taxpayer and the advisor, in relation to the transaction, includes an undertaking of confidentiality by the taxpayer towards other persons or the tax administration in relation to the transaction;

— or the remuneration of the advisor is conditional, in whole or in part, on obtaining a tax benefit resulting from the transaction, is established, in whole or in part, on the basis of such tax benefit, is refundable, in whole or in part, to the taxpayer if the expected tax benefit does not materialize or is acquired, in whole or in part, to the advisor only after the expiry of the period of limitation applicable to a taxation year or to the taxation years during which the transaction takes place.

As with the preventive disclosure mechanism, a taxpayer who files the prescribed form for a mandatory early disclosure by the deadline set for such disclosure would avoid application of the additional three-year period.

4.3.4 Actions under consideration

The ministère des Finances is considering the following actions, concerning the period of limitation, where the GAAR applies:

— the normal periods of limitation for application of the GAAR by the Minister of Revenue would be extended by three years, and the reassessment could relate only to the items covered by the application of the GAAR;

— this additional three-year period would not apply to a transaction or series of transactions where the taxpayer discloses such transaction or series of transactions to Revenu Québec, in accordance with the preventive disclosure rules, no later than the statutory filing date of the tax return for the taxation year in which the transaction or series of transactions occurs;

— neither would the additional three-year period apply to a transaction where the taxpayer discloses such transaction to Revenu Québec in the course of mandatory early disclosure and the form prescribed for that purpose is filed no later than the statutory filing date of the tax return for the taxation year in which the transaction occurs.

4.4 A penalty regime where the GAAR applies

4.4.1 Introduction

The objective of a penalty regime in the taxation field is to curb or, better still, deter certain behaviour patterns by increasing the monetary risk a taxpayer and, in certain circumstances, a third party, exposes himself to.

More specifically, a penalty regime, in an ATP context, should seek to achieve this result in respect of a taxpayer, where he participates in an ATP scheme, and in respect of a person promoting it.

Currently, no penalty is attached to the application of the GAAR to an avoidance transaction, whether in respect of the taxpayer who participated in the avoidance transaction or its promoter.

Introduction of a penalty contingent on the application of the GAAR is under consideration. As a result of such a penalty, not only would the taxpayer be liable for the tax he should have paid in any event had he not abused the object, spirit or purpose of the law, but he would also have to pay an amount because of the abusive tax approach he adopted.

Besides, a taxpayer may have used an ATP scheme proposed by a promoter. By contributing to the ATP phenomenon, the promoter could, like the taxpayer, be required to pay a penalty.

This section studies the usefulness of introducing into the tax legislation penalties contingent on the application of the GAAR that would apply to taxpayers and promoters.

4.4.2 A penalty on the taxpayer contingent on the application of the GAAR

❑ The GAAR as it is currently applied

In Québec, as in Canada, a transaction must, to be subject to the application of the GAAR, have resulted in a taxable benefit to the taxpayer and constitute an avoidance transaction in the sense that it was not carried out primarily for *bona fide* purposes, other than obtaining a tax benefit. In addition, the tax administration must show that the transaction is clearly abusive.

As was shown in sub-section 2.2.2, the Supreme Court, in *Canada Trustco Mortgage,*[195] clearly indicated that, for the GAAR to be successfully invoked, clear abuse must be present in the application of the tax legislation, abuse that the Minister must prove:

> As discussed above, the practical burden of showing that there was abusive tax avoidance lies on the Minister. The abuse of the Act must be clear, with the result that doubts must be resolved in favour of the taxpayer. The analysis focusses on the purpose of the particular provisions that on their face give rise to the benefit, and on whether the transaction frustrates or defeats the object, spirit or purpose of those provisions.[196]

Furthermore, if the GAAR applies, the only consequence for the taxpayer is that his tax attributes are determined by the tax administration in order to deny the tax benefit resulting from the avoidance transaction.

❑ The relevance of a penalty on the taxpayer

It is appropriate to recall that the taxes not paid to the public treasury because of ATP schemes amount to hundreds of millions of dollars and give rise to an equivalent transfer of the tax burden towards taxpayers who do not participate in ATP schemes.

In addition, the virtual absence of negative financial consequences for taxpayers is one of the most important endogenous factors in the growth of ATP because it ensures a risk/reward ratio that is very favourable to taxpayers.

Moreover, since taxpayers are primarily responsible for their tax return, a penalty regime cannot be introduced without targeting them.

❑ A penalty contingent on the application of the GAAR

The GAAR cannot apply unless the Minister of Revenue establishes that the avoidance transaction frustrates or defeats the purpose for which the tax benefit was intended to be conferred. Accordingly, the tax administration must be able to describe the object, spirit and purpose of the provisions that were frustrated or defeated, using a unified textual, contextual and purposive interpretation of the provisions of the law. The benefit of the doubt as to whether the avoidance transaction frustrates or defeats the object, spirit or purpose of the provisions in question lies with the taxpayer. In view of the resulting burden on the tax administration, the latter is very cautious in applying the GAAR.

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195 See note 12 above.

196 *Id., par.* 69.

Applying a penalty on the taxpayer once the GAAR is brought into play by the tax administration would be a simple process in itself that would generally require no further analysis in addition to that required for the application of the GAAR.

4.4.3 A penalty on the promoter tied to the penalty on the taxpayer

❑ The relevance of a penalty on the promoter

As mentioned in sub-section 1.2, the propagation of ATP schemes to a growing pool of taxpayers is in part attributable to the emergence of a new business model for tax intermediaries. Under this new business model, tax intermediaries become true promoters of ATP schemes and offer them to many clients as off-the-shelf tax products.

Following the lead of Australia and New Zealand, to discourage the promotion of obviously abusive tax avoidance transactions, a penalty applicable to the promoters of such avoidance transactions could be introduced into Québec's tax legislation.

❑ Definition of promoter

In Québec, the reporting requirements rules concerning tax shelters define the promoter of a tax shelter as a person who, in the course of carrying on a business:

— either issues or sells, or promotes the issuance, sale or acquisition of, the tax shelter;

— acts as a mandatary or advisor in respect of the issuance or sale, or the promotion of the issuance, sale or acquisition, of the tax shelter;

— or accepts consideration in respect of the tax shelter.

The definition used in Australia for the purposes of the penalty for the promotion if a tax exploitation scheme is more restricted. According to this definition, the expression “promoter” means an entity if, at the same time:

— the entity markets the scheme or otherwise encourages the growth of the scheme or interest in it;

— the entity or an associate of the entity receives (directly or indirectly) consideration in respect of that marketing or encouragement;

— it is reasonable to conclude that the entity has had a substantial role in respect of that marketing or encouragement.

This last definition has the advantage of clearly delimiting the scope of the penalty by limiting it to the behaviour pattern that the penalty seeks to deter, namely the real promotion of ATP schemes. Accordingly, a tax advisor who develops a tax planning arrangement at the request of a client or one who gives his opinion on a planning arrangement is not covered by this definition. In this regard, in an information document on this measure, the Australian authorities specified that:

> 3.49 An entity is not a promoter merely because they provide advice about the scheme. As a result, financial planners, tax agents, accountants, legal practitioners and others are not promoters merely because they provide advice about a tax exploitation scheme, even if that advice provides alternative ways to structure a transaction, or sets out the tax risks of the alternatives.
>
> 3.50 The civil penalty regime is not intended to inhibit the provision of independent and objective tax advice, including advice regarding tax planning. Advisors who advise on tax planning arrangements, even those who advise favourably on a scheme later found to be a tax exploitation scheme, are not at risk of civil penalty to the extent that they have merely provided independent, objective advice to clients.[197]

Similarly, not everyone who may participate in the marketing of a tax exploitation scheme is likely to have a penalty imposed on them. Only those who have a substantial role in it are targeted.

Accordingly, like the approach taken in Australia, Québec's penalty would apply to a person or to a partnership (the promoter), who satisfies the following conditions:

- the person markets or promotes an abusive avoidance transaction or otherwise encourages its growth or the interest it arouses;
- he, or an entity with which he is related, receives, directly or indirectly, consideration in respect of that marketing, promotion or encouragement;
- it is reasonable to conclude that he has had a substantial role in respect of that marketing, promotion or encouragement.

To that end, any transaction in respect of which a penalty would be imposed on a taxpayer pursuant to the application of the GAAR to such transaction would be considered an abusive avoidance transaction.

197 AUSTRALIA, Parliament of the Commonwealth of Australia, House of representatives, *Explanatory Memorandum — Tax Laws Amendment (2006 Measures N° 1) Bill 2006*, paragraphs 3.49 and 3.50. The document treats also of what constitutes a substantial role in paragraphs 3.46 to 3.48.

Similarly, to that end, an employee of a promoter (other than a specified employee[198] of the promoter) would not be considered to have a substantial role in the marketing, by such promoter, of an abusive avoidance transaction. However, the conduct of an employee (including a specified employee) of a promoter would be deemed to be that of his employer for the purposes of the provisions concerning the penalty on the promoter.

4.4.4 Determination of the amount of the penalties

To deter the use of ATP schemes, it is necessary to significantly alter the risk/reward ratio that currently is clearly favourable to the taxpayer.

However, it must be kept in mind that the targeted transactions lie within the realm of tax avoidance and not tax evasion or fraud. Accordingly, the penalty for avoidance must be less than the one for tax evasion.

❑ Penalty on the taxpayer

The penalty applicable to a taxpayer, with regard to an avoidance transaction, would be 25% of the additional tax resulting from the application of the GAAR.

The 25% rate is half the rate applicable in cases of tax evasion or fraud. By way of comparison, this rate is also the lowest rate generally applied for tax avoidance in the Australian system.

❑ Penalty on the promoter

The penalty imposed on the promoter would equal 12.5% of the amounts received or receivable by him regarding the avoidance transactions in respect of which a penalty would have been imposed to taxpayers.

The 12.5% rate is half the rate applicable in the event of a false statement made by a promoter in an application for an identification number in respect of a tax shelter.

198 "Specified employee" of a person means an employee of the person who is a specified shareholder of the person or who does not deal at arm's length with the person (sec. 1 Q.T.A.).

4.4.5 A penalty that could be avoided

❑ Penalty on the taxpayer

A taxpayer could avoid the penalty in respect of an avoidance transaction in the following cases:

- where the taxpayer disclosed such transaction (or the series of transactions that includes such transaction) to Revenu Québec, in accordance with the preventive disclosure rules mentioned in sub-section 4.3.2, no later than the statutory filing date of the tax return for the taxation year in which the transaction (or the series of transactions that includes such transaction) occurred;
- where the taxpayer disclosed such transaction to Revenu Québec in the course of mandatory early disclosure as mentioned in sub-section 4.1.1, and the form prescribed for that purpose was filed no later than the statutory filing date of the tax return for the taxation year in which the transaction occurred.

This approach is based on the one used in Ireland, which seeks to strongly encourage early reporting of transactions likely to give rise to the application of the GAAR, so as to enable the tax administration to react more quickly, if need be. A taxpayer would thus have the possibility of avoiding the penalty by disclosing the transaction or series of transactions.

Moreover, unlike the situation in Ireland where the penalty consists of a surcharge, the penalty on the taxpayer would be a strict liability penalty. Accordingly, the taxpayer could object to the penalty by submitting a defence of due diligence.

❑ Penalty on the promoter

Since the penalty on the promoter is tied to the penalty on the taxpayer, the promoter could avoid it in respect of each taxpayer who makes either preventive or early disclosure of the avoidance transaction (or the series of transactions that includes such transaction) or submits a successful defence of due diligence.

For instance, assuming that all the taxpayers who dealt with the promoter made either preventive or early disclosure of the avoidance transaction (or the series of transactions that includes such transaction), no penalty would be imposed on the promoter.

4.4.6 Actions under consideration

The ministère des Finances is considering the implementation of a penalty regime, with the following parameters, where the GAAR applies to an avoidance transaction, regarding a taxpayer:

- the taxpayer would incur a penalty equal to 25% of the additional tax resulting from the application of the GAAR to the avoidance transaction;
- the promoter would incur a penalty equal to 12.5% of the amounts received or receivable by him regarding the avoidance transaction in respect of which a penalty would be imposed on the taxpayer;
- the promoter would be a person, including a partnership, who satisfies the following conditions:
  - he markets or promotes an abusive avoidance transaction or otherwise encourages its growth or the interest it arouses;
  - he, or an entity with which he is related, receives, directly or indirectly, consideration in respect of that marketing, promotion or encouragement;
  - it is reasonable to conclude that he has had a substantial role in respect of that marketing, promotion or encouragement.
- the taxpayer would have the possibility of avoiding the penalty in the following cases:
  - where he had disclosed such transaction (or the series of transactions that includes such transaction) to Revenu Québec, in accordance with the preventive disclosure rules mentioned in sub-section 4.3.2, no later than the statutory filing date of the tax return for the taxation year in which the transaction (or the series of transactions that includes such transaction) occurred;
  - where he had disclosed such transaction to Revenu Québec in the course of mandatory early disclosure as mentioned in sub-section 4.1.1, and the form prescribed for that purpose was filed no later than the statutory filing date of the tax return for the taxation year in which the transaction occurred;
  - where he had submitted a successful defence of due diligence;
- since the penalty on the promoter is tied to the penalty on the taxpayer, the promoter could avoid it where the taxpayer made either preventive or early disclosure or mounted a successful defence of due diligence.

CONCLUSION

The recent growth in ATP is a global phenomenon that threatens the integrity of national tax systems and has a negative effect on public finances. Québec and other jurisdictions in Canada are not immune to this phenomenon and the tax authorities must manage this risk.

Like other tax administrations in Canada and many foreign tax administrations, Québec's tax administration has recently set up a specialized anti-ATP team.

In regard to fiscal policy, it has been established that the main objective should be to deter taxpayers from using ATP schemes by altering the risk/reward ratio for users and discouraging the design and marketing of off-the-shelf tax products by tax intermediaries.

Moreover, certain characteristics inherent in Québec's tax system have an impact on the development of ATP schemes while certain contextual factors regarding Québec's fiscal policy limit the array of legislative tools that can be developed to fight against ATP.

The actions under consideration described in this paper take all these factors into account in presenting proposals for legislative amendments adapted to the tax situation in Québec.

Seen from the standpoint of deterrence, these proposals seek to force disclosure of two types of transactions with features frequently associated with ATP schemes. In addition, they introduce a penalty regime and extend the period of limitation applicable in respect of a transaction covered by the GAAR. However, they also stipulate a preventive disclosure mechanism for taxpayers wishing to avoid the penalty and the extended period of limitation. Moreover, no change to the GAAR is being considered, other than a clarification to the notion of *bona fide* purposes.

From the standpoint of the tax authorities, these are measured proposals for legislative amendments. They maximize the hoped-for deterrence effect while minimizing disturbance to current ways of doing things, both for taxpayers and for the tax administration.

Appendix 1 – Synthesis of the actions under consideration

1. A mandatory early disclosure mechanism

The ministère des Finances is considering the introduction of mandatory early disclosure rules with the following parameters:

- would be subject to a disclosure requirement a confidential transaction, i.e. a transaction providing a tax benefit regarding which a taxpayer retained the services of an advisor, where the contract between the taxpayer and the advisor includes an undertaking of confidentiality by the taxpayer towards other persons or the tax administration in relation to the transaction;
- in addition, a transaction would be subject to a disclosure requirement if it is a transaction regarding which the remuneration of the advisor takes any of the following forms:
  - it is conditional, in whole or in part, on obtaining a tax benefit resulting from the transaction, or it is established, in whole or in part, on the basis of such tax benefit;
  - it is refundable, in whole or in part, to the taxpayer if the expected tax benefit from the transaction does not materialize;
  - it is acquired, in whole or in part, to the advisor only after the expiry of the period of limitation applicable to the taxation year or to the taxation years during which the transaction takes place;
- the expression “advisor”, regarding a transaction, would mean a person, including a partnership, who provides help, assistance or advice regarding the design or implementation of the transaction or who commercializes or promotes it;
- the taxpayer would be the person required to make early disclosure;
- the taxpayer would have to send information, using a prescribed form, that is sufficiently detailed for the tax administration to be able to identify and analyze the transaction relating to the risky behaviour pattern;
- early disclosure would have to be made within a deadline of 30 days after the transaction begins to be carried out;

- a penalty, that would rise to a maximum amount established on the basis of the number of days late in filing the prescribed form for the disclosure, would be imposed. The minimum penalty would be $10 000. It would rise by $1 000 per day late, as of the second day late, to a maximum of $100 000;
- for a taxpayer who omits to file the prescribed form for early disclosure and any person associated with or related to the taxpayer, the period of limitation applicable to the tax consequences arising from the undisclosed transaction would be suspended until the time the prescribed form is filed.

2. Amendments to the GAAR to clarify the notion of *bona fide* purposes

The ministère des Finances does not intend to propose changes to the GAAR other than to the definition of avoidance transaction where it would be specified that the following are not *bona fide* purposes:

- the obtaining of a tax benefit;
- the reduction, avoidance or deferral of tax or other amount payable under a Québec law other than the *Taxation Act*, a law of another province of Canada or a federal law;
- the increase in a refund of tax or of another amount under a Québec law other than the *Taxation Act*, a law of another province of Canada or a federal law;
- any combination of the purposes mentioned above.

3. Extending the period of limitation when the GAAR applies

The ministère des Finances is considering the following actions, concerning the period of limitation, where the GAAR applies:

- the normal periods of limitation for application of the GAAR by the Minister of Revenue would be extended by three years, and the reassessment could relate only to the items covered by the application of the GAAR;
- this additional three-year period would not apply to a transaction or series of transactions where the taxpayer discloses such transaction or series of transactions to Revenu Québec, in accordance with the preventive disclosure rules, no later than the statutory filing date of the tax return for the taxation year in which the transaction or series of transactions occurs;

- neither would the additional three-year period apply to a transaction where the taxpayer discloses such transaction to Revenu Québec in the course of mandatory early disclosure and the form prescribed for that purpose is filed no later than the statutory filing date of the tax return for the taxation year in which the transaction occurs.

4. A penalty regime where the GAAR applies

The ministère des Finances is considering the implementation of a penalty regime, with the following parameters, where the GAAR applies to an avoidance transaction, regarding a taxpayer:

- the taxpayer would incur a penalty equal to 25% of the additional tax resulting from the application of the GAAR to the avoidance transaction;
- the promoter would incur a penalty equal to 12.5% of the amounts received or receivable by him regarding the avoidance transaction in respect of which a penalty would be imposed on the taxpayer;
- the promoter would be a person, including a partnership, who satisfies the following conditions:
  - he markets or promotes an abusive avoidance transaction or otherwise encourages its growth or the interest it arouses;
  - he, or an entity with which he is related, receives, directly or indirectly, consideration in respect of that marketing, promotion or encouragement;
  - it is reasonable to conclude that he has had a substantial role in respect of that marketing, promotion or encouragement.
- the taxpayer would have the possibility of avoiding the penalty in the following cases:
  - where he had disclosed such transaction (or the series of transactions that includes such transaction) to Revenu Québec, in accordance with the preventive disclosure rules mentioned in sub-section 4.3.2, no later than the statutory filing date of the tax return for the taxation year in which the transaction (or the series of transactions that includes such transaction) occurred;

- where he had disclosed such transaction to Revenu Québec in the course of mandatory early disclosure as mentioned in sub-section 4.1.1, and the form prescribed for that purpose was filed no later than the statutory filing date of the tax return for the taxation year in which the transaction occurred;
- where he had submitted a successful defence of due diligence;

— since the penalty on the promoter is tied to the penalty on the taxpayer, the promoter could avoid it where the taxpayer made either preventive or early disclosure or mounted a successful defence of due diligence.

Appendix 2 – Consultation Process

With the publication of the discussion paper on ATP, the ministère des Finances is inviting members of the tax community, professional groups and associations concerned as well as all people with an interest in the subject to provide their comments, opinions or suggestions by filing a brief before March 1, 2009.

The Department may make the briefs it receives public by placing them on its website. To that end, it urges those who will be filing briefs to use the template available on the consultation web page. The Department reserves the right to select the documents it puts online.

Briefs can be sent by email, regular mail or fax to:

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