GAAR and sham are no match: Québec Court of Appeal greenlights repo transaction

April 24, 2019

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BLG successfully acted for Kone Inc. (Kone) before the Court of Appeal of Québec who recently dismissed the appeal by the Agence du revenu du Québec (ARQ). The Court of Appeal confirmed the trial decision vacating seven years of tax assessments issued by ARQ to Kone for the 1999-2006 tax years under *Québec's Taxation Act* (QTA). The successful appeal resulted in a dismissal of tax assessments totalling interest income of over $41 million, dismissing ARQ's denial of non-capital losses of over $17 million. Kone will be entitled to a refund of taxes, interest of approximately $2.5 million, and costs.

The assessments targeted a share purchase and repurchase agreement (commonly referred to as a REPO) constructed by Kone to finance two acquisitions by its parent company. Kone used the borrowed funds to acquire preferred shares of a U.S. Corporation from a non-Canadian affiliate.

Kone was able to benefit from the mismatch between the Canadian and U.S. tax regimes. The fact the transactions were treated as a loan for U.S. income tax purposes did not constitute a sham, nor did it change their legal substance (an acquisition and a sale of shares) for Québec tax purposes, thus reconfirming the primacy of legal form over economic substance for Canadian income tax purposes. The Court of Appeal rejected ARQ's argument that the recent decision in *Dean's Knight* from the Supreme Court of Canada changed the interpretation of the object, spirit and purpose of s. 127.6 QTA such that it was broad enough to capture any financing transaction by Canadian companies with non-residents that does not generate interest at a reasonable rate.

The BLG team consisted of Laurie Goldbach (at trial and on appeal), Frédérique Duchesne and Greg Rafter.

By

Thoburn

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