

Canada releases consultation paper to strengthen the General Anti-Avoidance Rule

August 19, 2022

On August 9, 2022, Canada's Department of Finance released its highly anticipated consultation paper on the General Anti-Avoidance Rule (GAAR). Described as "a targeted and practical diagnostic on the GAAR", it follows through on the government's 2020 Fall Economic Statement commitment to improve tax fairness by consulting with Canadians on how to strengthen the GAAR.

Fiscal impact of the GAAR

The fiscal impact of the GAAR is significant. In fiscal years 2016 to 2021, \$4.1 billion of "tax earned by audit"¹ was assessed using the GAAR. Recognizing that the "[t]he potentially disruptive impact of any change to the GAAR must be taken into consideration in the analysis of the options discussed in this paper", the Department of Finance is accepting written representations on the relative merits of the suggested approaches until September 30, 2022.

The GAAR "acts as a legislative limit on tax certainty by barring abusive tax avoidance transactions".² Where the Minister of National Revenue can establish abusive tax avoidance, the GAAR will apply to deny the tax benefit even though the tax arrangement is consistent with a literal interpretation of the relevant statutory provisions. Abusive tax avoidance is established where:

1. a tax benefit arose from a transaction or a series of transactions;
2. at least one of those transactions was an avoidance transaction, that is a transaction that cannot reasonably be considered to have been undertaken or arranged primarily for *bona fide* purposes other than to obtain the tax benefit; and
3. the transaction is abusive, that is it frustrates the object, spirit and purpose of the provisions.

The consultation paper

A number of significant options are discussed in the consultation paper.

As stated, the government intends to add an explicit economic substance rule to the GAAR. It is looking at various alternative ways to test whether a transaction lacks economic substance, and where a transaction is found to be lacking in economic substance, at various alternative consequences that could reasonably follow.

The government is also considering introducing a penalty based on a percentage of the tax benefit, increasing the interest rate on taxes in dispute under a GAAR assessment, and extending the reassessment period for an additional three years for GAAR assessments.

Concerning the avoidance transaction test, often considered to “serve an important gatekeeper function for the GAAR”³, the possibility of adopting an interpretive rule to specify what is meant by a “*bona fide*” purpose is up for discussion, along with whether it is appropriate to consider certain purposes, such as foreign tax avoidance, to be *bona fide* non-tax purposes. Lowering of the “primarily” threshold under the purpose test to “one of the main purposes”, or even “one of the purposes”, “a material purpose” or a “non-incidental purpose” test, is also being considered.

Concerning the abuse test, the Department of Finance’s most significant proposals include putting greater emphasis on the “abuse of the Act read as a whole” portion of the existing legislation; and adopting interpretive rules for assessing certainty, predictability and fairness, such as rules establishing a broad notion of fairness and rules providing that the GAAR applies to foreseen and well as unforeseen tax planning. The Department of Finance is also considering changing the judicially established onus under the misuse and abuse test such that the taxpayer would, in particular circumstances, have the burden of establishing that its actions do not constitute an abuse or misuse of the statutory provisions.

The application of the GAAR to treaty abuse was not discussed. The government’s stated intent is to announce more on its plans to curb tax treaty abuse at a later date. Foreign taxpayers with Canadian subsidiaries or investments should carefully monitor further developments in this area.

Don’t hesitate to reach out to Natalie Goulard, a tax disputes partner in the Montréal office of BLG, for assistance or advice should you wish to make representations to the Department of Finance.

¹ “Tax earned by audit” (TEBA) excludes provincial taxes, federal interest and penalties, as well as any impact that stems from appeals reversals and uncollectable amounts.

² *Canada v. Alta Energy Luxembourg S.A.R.L.*, 2021 SCC 49, para 2.

³ The Consultation paper states that since *Canada v. Canada Trustco Mortgage Co.*, 2005 SCC 54, in approximately 29 per cent of the cases where the GAAR was found to not apply, it was because the avoidance test had not been met. The government has been successful in the courts in a significant number of GAAR cases.

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