

# TAX FLASH

## Supreme Court Upholds GAAR Decision in Copthorne Transaction

*Maria Severino, CA is a Tax Partner in the Toronto office of Collins Barrow*

On December 16, 2011, the Supreme Court of Canada (SCC) released its unanimous decision in Copthorne Holdings Ltd. v. The Queen. The ruling affirmed that the general anti-avoidance rule (GAAR) applies to the series of transactions undertaken by the taxpayer and related parties, the result of which preserved \$67 million of paid up capital (PUC). Through a series of transactions, including corporate amalgamations, the taxpayer repatriated capital to its non-resident shareholder as a repayment of PUC rather than as a dividend, intending to avoid Canadian withholding tax that would have otherwise been payable. As a result of the SCC decision, the taxpayer is liable for \$9 million of Canadian withholding tax.

GAAR can apply to disallow a tax benefit in tax planning transactions which result in a misuse of a provision of the Income Tax Act (Act) or an abuse of the Act read as a whole. Generally, it applies where:

1. There is a **tax benefit**;
2. The transaction is an **avoidance transaction** undertaken primarily to obtain a tax benefit; and
3. The avoidance transaction giving rise to the tax benefit is **abusive**.

The SCC held that there was a tax benefit in this case since had the amalgamation been a vertical amalgamation (as opposed to horizontal); the PUC of the shares would have been cancelled. The SCC also held that the sale of shares undertaken as part of the series of transactions was not primarily undertaken for a bona fide non-tax purpose.

The SCC held that the avoidance transaction was abusive as the series of transactions resulted in the PUC of the shares of the amalgamated corporation exceeding the amount originally invested in the relevant predecessor corporations which frustrated the purpose of subsection 87(3) of the Act. The sale of the shares circumvented the words of subsection 87(3) and in the context of the series, achieved a result subsection 87(3) was designed to prevent. Judge Rothstein concluded that "The transaction was therefore abusive and the assessment based on the application of GAAR was appropriate."

Judge Rothstein cautioned that GAAR is a provision of last resort and that it should only be applied to transactions that are clearly abusive. He stated that the benefit of the doubt is given to the taxpayer and that the onus is on CRA to prove that the transaction is abusive. The three part analysis that leads to a finding of abusive tax avoidance is as follows:

1. The transaction achieves an outcome the statutory provision was intended to prevent;
2. The transaction defeats the underlying rationale of the provision; or
3. The transaction circumvents the provision in a manner that frustrates or defeats its object, spirit or purpose.

The SCC decision in this case was not unexpected. The decision highlights that where a series of transactions are designed to circumvent a specific policy objective reflected in a particular provision or provisions of the Act, GAAR may apply. §

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[www.collinsbarrow.com](http://www.collinsbarrow.com)  
[info@collinsbarrow.com](mailto:info@collinsbarrow.com)