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Only tax appeals of national significance are heard by the Supreme Court of Canada.

# Two tax cases have their day in high court



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*The Tax Expert*

If you disagree with the way the Canada Revenue Agency has assessed your tax return, you are entitled to your proverbial "day in court."

Your first avenue of appeal is the Tax Court of Canada. And if you are unsuccessful there, you can then take your case to the Federal Court of Appeal.

If you lose at this level, however, you are not automatically entitled to have your case reviewed by the Supreme Court of Canada. The SCC only hears cases of "national importance" and, thus, very few tax cases actually make it to the land's highest court.

And so it was an auspicious day in March, 2005, when the SCC agreed to hear not one but two tax cases. After much anticipation, the decisions in these twin appeals were released late last month and are already the talk of the town among Canada's tax community due to the impact they will undoubtedly have on tax planning going forward.

Given that the SCC has only heard

half about a half-dozen tax cases in the last three years, you may be wondering what tax issue intrigued the esteemed judicial panel enough to warrant a rare hearing?

Answer: the GAAR, or General Anti-Avoidance Rule.

Never heard of the GAAR? Don't worry, you're not alone. The GAAR is one of the more ominous, elusive and mysterious pieces of tax legislation in the entire Income Tax Act. Many brilliant tax-filing schemes have been dreamed up by tax experts in the past two decades, but always with the warning that "the GAAR may apply."

The GAAR basically states that if a tax transaction is classified as an "avoidance transaction," the Act can deny any tax benefit resulting from that transaction.

An "avoidance transaction" is a transaction that results in a "tax benefit," unless the transaction is carried out primarily for bona fide, non-tax purposes. A "tax benefit" may include a reduction, avoidance or deferral of tax.

The Act also goes on to state that the GAAR will not apply to a transaction as long as the transaction does not result in the "misuse" of a provision of the Act or an "abuse having regard to the provisions of the Act read as a whole."

The first case, involving Douglas Mathew and several other taxpayers, concerned a series of transactions in which accrued losses on a mortgage portfolio were transferred from a corporation, through a partnership formed specifically for that purpose, to several taxpayers who then claimed those losses personally. The CRA disallowed the de-

duction of the losses, concluding that the transactions were avoidance transactions, and were "an abuse of the Income Tax Act as a whole."

This was confirmed by both the Tax Court of Canada and the Federal Court of Appeal. Two weeks ago, the SCC agreed with the lower courts' decisions, concluding, "the series of transactions frustrated Parliament's purpose of confining the transfer of losses such as these to a non-arm's length partnership." The SCC found that the scheme resulted in "abusive tax avoidance."

The second case results released last week involved Canada Trustco Mortgage Company, a subsidiary of Toronto-Dominion Bank, and whether Canada Trustco was entitled to claim tax depreciation on \$120-million worth of trailers that it purchased, and then leased back to the vendor in a complex sale-leaseback arrangement.

The SCC ruled that the tax depreciation claimed by Canada Trustco should be allowed and was not abusive since it did not violate the "the object, spirit or purpose of the relevant [tax depreciation] provisions."

So what's this got to do with you? Well, the SCC made several general comments on the future application of the GAAR, stating that the onus is on the CRA and not the taxpayer to establish whether a transaction is abusive. If the abusive nature of a tax transaction is "unclear, the benefit of the doubt goes to the taxpayer."

The SCC's decision was a victory not only for taxpayers, but for tax litigation guru Al Meghji of Osler, Hoskin and Harcourt LLP, who argued the case on behalf of Canada Trustco. Not surprisingly, he said he was "thrilled" with the decision.

The SCC's comments should provide more certainty when courts have to decide future GAAR cases. As Meghji adds: "GAAR is not a smell-test which allows CRA to say we don't like this one, we like that one. It's a legal test."

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