OSLER

Federal Court of Appeal's Univar decision provides guidance on how to apply the GAAR

OCTOBER 25, 2017 7 MIN READ

Related Expertise

- Indirect Tax
- International Tax
- Tax
- Tax Advisory Services
- Tax Disputes
- Tax: M&A, Reorganizations and Restructuring Transactions
- Transfer Pricing

In this Update:

- Federal Court of Appeal released its highly anticipated decision in *Univar* on October 13, 2017
- The Court found that the General Anti-Avoidance Rule (GAAR) did not apply to the taxpayer's transactions
- This Update provides a summary of the Court's guidance on how to apply the GAAR

On October 13, 2017, the Federal Court of Appeal released its highly anticipated decision in *Univar*, finding that the General Anti-Avoidance Rule (GAAR) did not apply to the taxpayer's transactions. That decision provides further guidance to taxpayers on how alternative transactions, subsequent amendments, and legislation technical notes should be considered (or not considered) in a GAAR analysis.

Background facts

Section 212.1 of the *Income Tax Act* (ITA) deems dividends to be paid in respect of certain transactions where shares of a Canadian corporation held by a non-resident shareholder are sold to another Canadian corporation that does not deal at arm's length with the non-resident shareholder.

In 2007, CVC Capital Projects (CVC) effected a public takeover of Univar NV, a Netherlands public company. Univar NV controlled Univar Holdco Canada (Univar), and accordingly there was an indirect acquisition of control of Univar. Had CVC used a standard Canadian tax planning structure and established a Canadian corporation to directly acquire the shares of Univar (the Alternative Transaction), section 212.1, which was at issue in this case, would not have applied. The Alternative Transaction was not practical from a commercial perspective, so CVC first purchased the shares of Univar NV and then carried out a series of transactions involving a non-arm's length transfer of the shares of Univar (the Actual Transactions) that replicated the result that could have been achieved by the Alternative Transactions. The Actual Transactions were structured to avoid a deemed dividend under subsection 212.1(1) as a result of the application of a relieving rule in subsection 212.1(4).

Nine years after the Actual Transactions, subsection 212.1(4) was amended such that, if the Actual Transactions had been carried out after that amendment, a deemed dividend under section 212.1 would have arisen. The Budget Supplementary Information accompanying this amendment described it as a clarification of the existing provision. The issue in the *Univar* appeal was whether the GAAR applied on the basis that the Actual Transactions misused or abused section 212.1.

The trial judge ruled against the taxpayer, finding that the series of transactions was an

abuse of the Act.[1] The trial judge found that the fact that the same outcome could have been achieved through a different tax plan was not relevant, since that was not the tax plan that had been implemented by the taxpayer. [2] She also relied on the legislative amendments to subsection 212.1(4) introduced in 2016 (including the supplementary information prepared by the Department of Finance)[3] – after the *Univar* hearing – to support her finding that the transactions were abusive. She cited *Water's Edge* as a precedent in finding the legislative amendment relevant. She noted that in *Water's Edge*, the court had found that parliament moved quickly to close a loophole in response to abusive tax planning. [4]

In overturning the trial decision and concluding that the GAAR did not apply to the transactions at issue, the Federal Court of Appeal confirmed, as the Supreme Court of Canada noted in *Copthorne*[5], that the Minister bears the burden of establishing clear abuse of the ITA. The Federal Court of Appeal reached the following additional noteworthy conclusions:

1. Where an alternative path is available that is consistent with the scheme of the ITA and that achieves the same outcome as the transactions at issue, this will be supportive of the position that the transactions at issue are not caught by the GAAR:

...Whether the surplus of the Canadian corporation is removed by completing the alternative transactions described in paragraph 17 above or by completing the transactions that were done in this case, the same surplus is removed from Canada. Therefore, in my view, these transactions do not frustrate the purpose of section 212.1 of the ITA. [6]

2. Section 212.1 establishes a "clear dividing line" between arm's length and non-arm's length sales of shares. It was not intended to prevent an arm's length purchaser of a Canadian corporation from extracting surplus from Canada that had built up prior to the acquisition. Relying in part on the Alternative Transaction, the Court noted:

...The wording of section 212.1 and the alternative transactions described above illustrate a clear dividing line between an arm's length sale of shares and a non-arm's length sale of shares. If shares of a Canadian corporation with an accumulated surplus are sold by a non-resident vendor to another Canadian corporation with whom that vendor is dealing at arm's length, section 212.1 of the ITA does not apply. A non-resident person could provide funds to the Canadian purchaser to fund the purchase price for the shares and following the closing use the surplus in the Canadian corporation that was acquired to repay that non-resident person the funds that were advanced. Thus, in my view, the purpose of section 212.1 of the ITA was not to prevent the removal from Canada, by an arm's length purchaser of a Canadian corporation, of any surplus that such Canadian corporation had accumulated prior to the acquisition of control. [emphasis added][7]

3. Subsequent amendments to the ITA that prevent other taxpayers from carrying out the tax plan at issue do not necessarily suggest that the transactions at issue are caught by the GAAR. The timing of subsequent amendments is an important factor to consider in this respect.[8] The Federal Court of Appeal noted that in *Water's Edge*, the court reached a conclusion on the policy of the provisions at issue before considering the subsequent amendments.[9] The Federal Court of Appeal cautioned against relying on a subsequent amendment as proof that the transactions under consideration by a court are abusive:

...*[Water's Edge*] does not support the proposition that subsequent amendments to the ITA will necessarily reinforce or confirm that transactions that are caught by the amendments would be considered to be abusive before the amendments are enacted.[10]

The Federal Court of Appeal paid special attention to the timing of the subsequent

amendments at issue in concluding that the amendments could not be used to support the GAAR assessment:

In the case before us the amendments were enacted approximately 9 years after the transactions were completed. In my view, the transactions did not clearly frustrate the object, spirit and purpose of section 212.1 of the ITA as it was written in 2007 and therefore the 2016 amendments cannot be used to make a finding that the avoidance transaction was abusive. [11]

4. Technical notes and budget commentary by the Department of Finance must be carefully considered to ensure they are not taken out of context to support an allegation of abuse:

The Technical Notes and Budget Supplementary Information to which the Tax Court judge referred only address non-arm's length sales of shares. They do not identify any concern arising from a removal of surplus if the shares of the Canadian corporation are sold to an arm's length purchaser.[12]

The 2016 amendments (and the accompanying Budget Supplementary Information) were released approximately 40 years after section 212.1 was introduced, nine years after the transactions at issue, and after the Tax Court heard Univar's appeal. Many members of the tax bar were troubled by the trial judge's apparent reliance in this case on budget commentary drafted by the Department of Finance. This decision sets some important limitations on the relevance of a subsequent legislative amendment (and accompanying Budget Supplementary Information) in a GAAR case.

For further information on this decision, or other tax matters, please contact any member of our National Tax Group.

---

[1] Trial Decision (2016 TCC 159) at para 101.

[2] *Ibid* at paras 104-106.

[3] *Ibid* at para 96.

[4] *Ibid* at para 98.

[5] *Copthorne Holdings Ltd. v. Canada*, 2011 SCC 63, at para 123.

[6] FCA decision (2017 FCA 207) at para 22.

[7] *Ibid* at para 31.

[8] *Ibid* at paras 24-29.

[9] *Ibid* at para 27.

[10] *Ibid* at para 28.

[11] *Ibid* at para 29.

[12] *Ibid* at para 23.