SCC File No. 39869

IN THE SUPREME COURT OF CANADA
(ON APPEAL FROM THE FEDERAL COURT OF APPEAL)

BETWEEN:

DEANS KNIGHT INCOME CORPORATION

APPELLANT
(Respondent in the
Federal Court of Appeal)

- and -

HER MAJESTY THE QUEEN

RESPONDENT
(Appellant in the
Federal Court of Appeal)

FACTUM OF THE INTERVENER, TAX EXECUTIVES INSTITUTE, INC.

(Pursuant to Rule 42 of the *Rules of the Supreme Court of Canada*, SOR/2020-156)

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PART I - OVERVIEW

1. "Control" is foundational to various forms of relationships tested in the *Income Tax Act*[1] (the "*Tax Act*"). Corporations under common control may share tax attributes, whereas the acquisition of corporate control by a new person, or group of persons, typically results in the deferral, denial, or streaming of pre-existing corporate tax attributes.

2. For purposes of the *Tax Act* and the general anti-avoidance rule ("GAAR"), Parliament made a deliberate decision to determine acquisitions of control of a corporation by reference to voting control at the shareholder level (known as *de jure* control) – a proposition in harmony with Canadian business corporation statutes.

3. The Federal Court of Appeal ignored the unambiguous legislative choice to distinguish shareholder level voting (*de jure*) control from operational level (*de facto*) control. Instead, the Court adopted an 'actual control' notion in determining whether a transaction has abused the loss restriction regime.[2] This notion of 'actual control' is not contemplated in the *Tax Act*, is undefined in the jurisprudence, and is incompatible with the legislative schemes established by Parliament.

4. The Federal Court of Appeal's approach in this case was the antithesis of the approach to the GAAR analysis set out by this Court in *Canada Trustco* and *Copthorne* – that the object, spirit, and purpose of the provisions of the *Tax Act* must be interpreted harmoniously, using a "unified textual, contextual and purposive approach".[3]

5. The Court bypassed context by disregarding the statutory scheme in subsections 256(7) to 256(9) of the *Tax Act* and its clear direction that an *acquisition* of control is always measured with reference to shareholder level voting control. The prescriptive response to loss restriction in section 256 is highly relevant. The code therein is replete with rules that focus on the share ownership (actual or deemed) sufficient for voting control.

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1 *Income Tax Act*, RSC 1985, c 1 (5th Supp), as amended [***Tax Act***].

2 *Canada v Deans Knight Income Corporation*, 2021 FCA 160 at para 72-93 [***FCA Decision***].

3 *Canada Trustco Mortgage Co v Canada*, [2005] 2 SCR 601 at para 47 [***Canada Trustco***]; *Copthorne Holdings Ltd v Canada*, [2011] 3 SCR 721 at para 70 [***Copthorne***].

6. On appeal, the Crown admits that Parliament not only made a deliberate policy choice to use the *de jure* voting control test for acquisitions of control, but also determined that a *de facto* operational control test would be inappropriate and unworkable. The Crown advocates that, despite the unambiguous adoption of voting control, Parliament intended an *ad hoc* approach to control – under the GAAR – when loss restriction is at stake.

7. That assertion is untenable and inconsistent with the judicial function. Parliament has considered the loss restriction issue and has expressly addressed it with the voting control standard adopted in Canada's corporate statutes and the common law. The GAAR is intended to bolster – not jettison – Parliament's express choices.

8. To be sure, the GAAR is not limited to a textual analysis. The GAAR may apply in circumstances where a taxpayer's transactions are designed to manipulate shareholder level voting control in an abusive manner. However, the proper function of the GAAR is to recharacterize abusive *transactions* and not to rewrite the *legislative scheme*.

9. The Federal Court of Appeal's ill-defined notion of actual control is so fundamentally at odds with the legislative scheme that it renders the interpretation and application of, and compliance with, the control provisions of the *Tax Act* unworkable. That Court's approach, if upheld, would result in the acquisition of control limitations being applied to transactions on a discretionary and circumstantial basis and would dramatically impair confidence in tax outcomes and precision in the associated financial reporting for Canadian corporations.

PART II - ISSUE

10. The issue raised in this appeal is whether the Federal Court of Appeal erred in abandoning Parliament's choice of the long stablished *de jure* control standard in favour of an inchoate notion of 'actual control' when an avoidance transaction under the GAAR is identified by the Canada Revenue Agency.

PART III - STATEMENT OF ARGUMENT

A. Shareholder Level Voting Control – Entrenched in History and Statute

11. "Control" is foundational to the definition of various forms of inter-corporate relationships for the purposes of multiple legislative schemes in the *Tax Act,* including determining when corporations are "related", "associated", "affiliated", or "connected".[4]

12. Control of a corporation for purposes of the *Tax Act* is determined by examining voting control at the shareholder level. This test for control, often referred to as "*de jure*" or legal control, mirrors the test found in various corporate statutes.

13. For example, the corporate statute applicable to the corporate taxpayer in this case provides that control is determined by considering the voting rights of the shareholders:

> **2(2)** For the purposes of this Act, a body corporate is controlled by a person if:
>
> (a) securities of the body corporate to which are attached more than 50% of the votes that may be cast to elect directors of the body corporate are held, other than by way of the security only, by or for the benefit of that person, and
>
> (b) the votes attached to those securities are sufficient, if exercised, to elect a majority of the directors of the body corporate.[5]

14. Corporations under common control may share tax attributes, whereas the acquisition of corporate control by a new person or group of persons typically results in the deferral, denial, or streaming of pre-existing corporate tax attributes.[6] As such, control is a key component of many restrictive rules in the *Tax Act*.

15. Prior to the Federal Court of Appeal's decision, it was settled law[7] that control of a corporation is *acquired* only when a person, or group of persons with a common

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4 As defined in ss. 251(2), 256(1), 251.1 and 186(4) of the *Tax Act*, respectively.

5 *Business Corporations Act*, RSA 2000, c B-9, s. 2(2); see also, *Canada Business Corporations Act*, RSC 1985 c C-44, s. 2(3) and *Business Corporations Act*, RSO 1990, c B.16, s. 1(5).

6 See *e.g.*, Canada Revenue Agency, *Income Tax Technical News, No 30* (21-May-2004) at "Corporate Loss Utilization Transactions"; *Tax Act*, ss. 66.7, 111(4)-(5).

7 *Vina-Rug (Canada) Limited v Minister of National Revenue*, [1968] SCR 193; *Silicon Graphics Ltd v Canada*, 2002 FCA 260, [2003] 1 FC 447 at para 21-22.

connection, gain control of shares with sufficient votes to elect a majority of the directors of the corporation. Canadian courts have accepted this as the governing standard for an acquisition of control for decades,[8] resulting in certainty of application both within corporate groups and in commercial transactions between unrelated corporations.

16. It is undisputed that there are only two standards of control contemplated by the *Tax Act*:[9]

(a) the *de jure* control standard: uniformly applicable where a provision simply refers to "control"; and

(b) the *de facto* control standard: uniformly applicable where a provision refers to "control directly or indirectly in any manner whatever".[10]

17. It is also undisputed that each of the two standards takes into account different factors in determining where control lies. While *de jure* control is determined with reference to voting rights at the shareholder level, *de facto* control is determined with reference to a broader set of circumstances relevant to the conduct of the business operations.[11]

B. The Legislative Scheme – A Contextually-Focused Review

18. To this day, *de jure* and *de facto* control are the *only* standards of control contemplated by the *Tax Act*. In addition, an *acquisition* of control in the *Tax Act* is always determined by reference to *de jure* control: the *Tax Act* never refers to an acquisition of *de facto* control.

19. The distinction between *de jure* and *de facto* control was codified in 1988 when Parliament amended the provisions of the *Tax Act* to specify which provisions would be subject to the *de jure* control standard and which would be subject to the *de facto* control standard. These amendments included amending a number of provisions that had previously referred to *de jure* control to refer to *de facto* control and *vice versa*.[12]

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8 *Buckerfield's Ltd v Minister of National Revenue* (1964), [1965] 1 Ex CR 299 at 302-03, affirmed in *Duha Printers (Western) Ltd v Canada*, [1998] 1 SCR 795 at para 35 [*Duha*].

9 Appellant's Factum at para 30; Respondent's Factum at para 3-4.

10 Defined in *Tax Act*, s. 256(5.1).

11 Appellant's Factum at para 49-52; Respondent's Factum at para 55-60.

12 See *MMV Capital Partners Inc v The Queen*, 2020 TCC 82 at para 127 and fn 58-59.

20. This deliberate use of the *de jure* and *de facto* control standards is underscored by the acquisition of control regime in subsections 256(7) to (9), which constrains "loss trading". Colloquially, an acquisition of control creates a "loss restriction" event.[13] In short, loss restriction is governed and regulated by the acquisition of control regime. Subsections 256(7) to (9) ought to be the centerpiece of a GAAR analysis of the loss restriction regime.

21. Parliament has, over time, introduced a number of specific anti-avoidance provisions into the acquisition of control regime. Those provisions limit loss continuity and the use of various tax attributes by determining the circumstances in which there is an acquisition of control by a person or group. These rules strike a delicate balance – they carefully do not blur the clean distinction between legal and factual control that permeates the *Tax Act*.

22. *All* of these rules are based on the premise that control means voting control, determined at the shareholder level. *None* of these rules are predicated upon factual control factors:

    (a) Several rules in subsection 256(7) deem an acquisition of control to have occurred, or to not have occurred, in various commercial contexts. These rules turn on share ownership – whether actual or deemed – sufficient to constitute an acquisition of voting control under the long-established *de jure* test. For example, the rules in paragraphs 256(7)(*b*) and (*c*) deem all of the shares acquired on an amalgamation or share exchange to be aggregated into the hands of a notional shareholder. The ordinary *de jure* control test is then applied to that notional shareholder.

    (b) The rules concerning rights to acquire shares in subsection 256(8) presume that the *de jure* control test is to be applied based on the votes attached to those shares. In the absence of a voting control test, this section would serve no useful purpose.

    (c) Subsection 256(8.1) contains rules that allow the *de jure* control test to be applied to corporations without share capital – it deems the corporation to have a single class of shares and determines who holds those shares.

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[13] Although undefined in the years in dispute, Parliament has now codified that a "loss restriction event" for a corporation for purposes of the *Tax Act*, including section 111, means an acquisition of control of that corporation by a person or group of persons: see s. 251.2(2)(*a*).

C. Federal Court of Appeal Decision is Inconsistent with Parliament's Choice

23. Despite purporting to respect the distinction between the *de jure* and *de facto* control standards, the Federal Court of Appeal introduced a new notion of 'actual control' that not only confuses the distinct rationales for those separate standards, but also collapses the distinction between them:

> [83] It is true that the object, spirit and purpose of subsection 111(5) as articulated [in paragraphs 70-82 of the judgment] does include forms of *de jure* and *de facto* control. However, the actual control test is different than the statutory *de facto* control test in subsection 256(5.1) of the Act. Moreover, it must be remembered that the GAAR is intended to supplement the provisions of the Act in order to deal with abusive tax avoidance. I see nothing inconsistent with the conclusion that the object, spirit and purpose of subsection 111(5) takes into account different forms of control even though the text of the provision is limited to *de jure* control.[14]

24. The Federal Court of Appeal describes 'actual control' as a hybrid between *de jure* and *de facto* control. However, in cobbling together the 'actual control' notion – a concept with no known standards – the Federal Court of Appeal focused on a selection of operational level factors in reaching the conclusion that the GAAR applied.[15] Those are the very factors that render the *de facto* standard unworkable for an acquisition of control. The Federal Court of Appeal's approach is contrary to Parliament's intended legislative scheme.

25. As this Court has repeatedly admonished, the GAAR analysis must be undertaken in harmony with the legislative framework of the *Tax Act* and the established body of common law interpreting that framework.[16] The Federal Court of Appeal failed to meaningfully engage with the operative legislative scheme, namely the acquisition of control regime in subsections 256(7) to (9). Inexplicably, that Court simply ignored that regime. This is precisely the kind of judicial rulemaking, divorced from statute, that this Court cautioned against in *Canada Trustco*.

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14 *FCA Decision*, *supra* note 2 at para 83.

15 *FCA Decision*, *supra* note 2 at para 101-108.

16 *Canada Trustco*, *supra* note 3 at para 47; *Copthorne*, *supra* note 3 at para 70; *Canada v Alta Energy Luxembourg S.A.R.L.*, 2021 SCC 49 at para 47-49, 58 [*Alta Energy*].

26. The GAAR provides that an *abusive transaction* may be recharacterized to determine the appropriate tax consequences in light of the legislative scheme. However, the GAAR is not designed or intended to *rewrite the legislative scheme*.

27. Inventing an untested concept to supplant the regime chosen by Parliament is not the proper role of the GAAR. It is inappropriate to use the GAAR to apply a standard rejected by Parliament. The Federal Court of Appeal has not applied the GAAR to uphold an unexpressed policy of the *Tax Act* – rather, the GAAR has been applied to impose a policy that is contrary to the scheme of the *Tax Act*.

28. Using the GAAR to undermine Parliament's deliberate choice does violence to the unified approach sanctioned in *Canada Trustco* and endorses the untenable position that the unexpressed policy can be entirely inconsistent with the express choices of Parliament reflected in the text and context of the *Tax Act*. The Federal Court of Appeal's analysis ought to have focused on whether the impugned transactions misused or abused the *de jure* standard that underpins the acquisition of control regime.

D. Circumstantial Approach to Control Impedes Business Confidence

29. If upheld, the Federal Court of Appeal's approach to the control standard would result in an acquisition of control being applied to transactions on a discretionary and circumstantial basis, dramatically impairing confidence in tax outcomes and precision in the associated financial reporting for Canadian taxpayers.

30. The Federal Court of Appeal relies on the purpose of the impugned transactions to justify opposing interpretations of the legislative scheme, stating that it is appropriate for one interpretation of control to apply to 'regular' transactions and a contrary interpretation to apply in the context of a GAAR analysis.[17] The Crown also advocates for a circumstantial approach on the basis that taxpayers should not enter into "avoidance transactions", which by their nature involve tax planning.[18]

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[17] *FCA Decision*, *supra* note 2 at para 82-83.

[18] Respondent's Factum at para 36-39.

31. A circumstantial approach fundamentally misconstrues the *raison d'etre* of the object, spirit and purpose analysis and the discipline imposed on taxpayers and the Minister alike by the "misuse and abuse" element of the GAAR test. A proper GAAR analysis in this appeal must consider the purpose of the acquisition of control regime in section 256 and their interplay with the loss restriction rules in section 111.

32. The loss restriction rules in section 111 are by their nature anti-avoidance rules – aimed at preventing corporations from accessing losses when a new shareholder (or group) acquires control. It is incongruous to switch approaches to the underlying legal standard when the standard has been carefully selected by Parliament for an anti-avoidance rule. Moreover, to apply a different standard for avoidance transactions in that context would subvert the *de jure* control standard altogether where the loss restriction rules are engaged.

33. The proposition that control can be applied in a circumstantial manner is untenable. Canadian companies and their officers, directors, and shareholders must be secure in the knowledge that such a fundamental aspect of Canadian law is not at risk. The GAAR ought to be reserved for transactions that involve a clear manipulation and circumvention of the *de jure* control standard. And, in any event, the GAAR must not be used to invent a new hybrid standard that fits neither of the approaches to control contemplated in the *Tax Act*.

34. TEI is concerned that this introduction of a novel concept will penetrate beyond the loss restriction regime and jeopardize other regimes in the *Tax Act* that rely on control, or common control within a corporate group. These regimes not only include restrictions on various attributes such as scientific research expenses and investment tax credits, but also such matters as:

(a) whether there has been a deemed tax year-end within a corporate group, triggering substantial tax compliance and reporting obligations;

(b) whether a foreign subsidiary is subject to the tax reporting obligations for a "controlled foreign affiliate";

(c) whether companies are related and may share tax attributes with each other; and

(d) whether dividends may be paid tax free between Canadian corporations.

E. GAAR Must Respect Parliament's Choice

35. TEI is very concerned that the Crown's approach to control does not have a single, unified meaning for purposes of the *Tax Act*, but rather the meaning changes depending on the context of the transaction.

36. Parliament has chosen a clear standard for the loss restriction regime: *de jure* control. This is uncontroverted:

(a) The Crown admits that Parliament made a deliberate policy choice to use the *de jure* voting control test for acquisitions of control.[19]

(b) The Crown admits that a *de facto* operational control test was carefully considered and determined to be inappropriate and unworkable.[20]

37. The acquisition of control regime is, at its heart, a loss restriction regime and is fundamentally focused on preventing tax avoidance. The approach advocated by the Crown – where the courts apply a situational approach to control based on tax motivation – is simply not workable. It is incoherent to ask the Court to rewrite an anti-avoidance standard on *ad hoc* basis whenever an avoidance transaction is examined under the GAAR.

38. The inchoate 'actual control' notion would result in similar transactions having different tax consequences depending on the Minister's view as to the relative importance of tax planning to those transactions. Not only is it uncertain when the actual control notion should apply, but also the notion has unknown parameters, leaving the risk that the Minister simply cherry-picks operational level *de facto* control factors to suit the situation. Moreover, it is inconsistent with the judicial function and the proper role of the GAAR to bypass a clear legislative choice on a case-by-case basis.

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[19] Respondent's Factum at para 36-39. This was for precisely the reasons set out in *Duha*, *supra* note 8 – *de jure* control is a workable standard that is a proxy for when a corporation should be treated as a "new" taxpayer.

[20] Respondent's Factum at para 42-49

39. The proper administration of the *Tax Act* undeniably includes curtailing abusive tax avoidance. Taxpayers should not be permitted to abuse the *de jure* control standard to undermine the loss restriction regime. However, that abuse must be measured against the legislated standard, as interpreted over decades by the courts. The GAAR is intended to support the express legislative choices in the *Tax Act*, not to overwrite them.

40. A coherent GAAR analysis in the context of the loss restriction rules must analyze whether the impugned transaction is a manipulation or circumvention of shareholder level voting control by reference to the factors that are relevant to the *de jure* control test. The approach adopted by the Federal Court of Appeal at the urging of the Crown is simply unworkable.

41. More broadly, if the Federal Court of Appeal's approach is affirmed, Canadian businesses will face tremendous uncertainty in assessing whether the GAAR would reverse the ordinary tax consequences. This Court has repeatedly admonished lower courts that the misuse and abuse analysis brings rigour to the application of the GAAR and requires a dispassionate examination of the object, spirit, and purpose of the relevant provisions of the *Tax Act*, that avoids moral judgment or a results-oriented approach.[21] In this case, the Federal Court of Appeal has done the opposite by finding an object, spirit, and purpose of the provisions that is in contradiction to the admittedly deliberate choice of Parliament. From TEI's perspective, an untethered approach of this nature will result in a lack of confidence in the tax system and it is essential that this Court reaffirm that the analysis under the GAAR remains rigorous and grounded in the legislative scheme.

PART IV - SUBMISSIONS ON COSTS

42. TEI does not seek costs and asks that no costs be ordered against it.

PART V - ORDER SOUGHT

43. TEI takes no position with respect to the disposition of the appeal and makes no submissions on the ultimate order to be made.

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[21] *Copthorne*, *supra* note 3 at para 70; *Alta Energy*, *supra* note 16 at para 92.

DATED at the City of Toronto, Province of Ontario this 6th day of September 2022.

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PART VI - TABLE OF AUTHORITIES