The Joint Committee on Taxation of
The Canadian Bar Association and
The Canadian Institute of Chartered Accountants

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July 29, 2004

The Honourable Ralph Goodale, P.C., M.P.
Minister of Finance
L'Esplanade Laurier, 140 O'Connor Street,
Ottawa, ON
K1A 0G5

Dear Minister:

**Re: Retroactive Amendment to GAAR in the Federal Budget of March 23, 2004**

In the federal budget of March 23, 2004, the government announced its intention to legislate retroactively in an unprecedented manner. Under the guise of "clarifying" the law, the government proposed to change the law materially by broadening the scope of the general anti-avoidance rule ("GAAR") in section 245 of the *Income Tax Act* (Canada) (the "Act"), retroactive 16 years to its enactment in 1988. While any change to impose taxation retroactively is highly objectionable, this is particularly so when it is GAAR that is to be retroactively amended. GAAR is a unique provision that by its nature pertains to a wide range of circumstances and can have an equally wide range of consequences where it applies.

The Joint Committee on Taxation of the Canadian Bar Association and the Canadian Institute of Chartered Accountants (the "Joint Committee") urges you in the strongest possible terms not to proceed with the amendment on a retroactive basis. The proposed retroactivity violates the central principles underlying the imposition of tax in Canada and may have adverse effects on our tax system.

The Joint Committee wishes to make it clear that this submission addresses only the retroactive nature of the proposed amendment to GAAR, and not the merits of the proposed amendment on a prospective basis. We may be making a separate submission at a future time on the substantive aspects of the amendment.

***Proposed GAAR Amendment***

The proposal to amend GAAR (the "Proposal") is contained in the Notice of Ways and Means Motion to Amend the Income Tax Act, Resolution 18:

> That, for greater certainty, subsection 245(4) of the Act has operated from its inception to exclude a transaction from the operation of subsection 245(2) of the Act only where it may reasonably be considered that the transaction would not result directly or indirectly in a misuse of the provisions of the *Income Tax Act*, the *Income Tax Regulations*, the *Income Tax Application Rules*, any enactments amending the *Income Tax Act*, the *Income Tax Regulations*, the *Income Tax Application Rules* or a tax treaty, or in an abuse having regard to those provisions, read as a whole.

Further information on the Proposal in contained in Tax Measures: Supplementary Information:

> A statutory general anti-avoidance rule was introduced in the Income Tax Act in 1988. This rule is intended to prevent abusive or artificial tax avoidance schemes, without interfering with legitimate commercial and family transactions. In seeking to distinguish between legitimate tax planning and abusive tax avoidance, the general anti-avoidance rule aims to establish a reasonable balance between the protection of the tax base and the need for certainty for taxpayers in planning their affairs.
>
> Budget 2004 proposes to clarify that the Act's general anti-avoidance rule applies to a misuse or abuse of the provisions of the Income Tax Regulations, the Income Tax Application Rules (ITARs), and any enactments amending the Act, Regulations or ITARs, as well as to a misuse or abuse of a tax treaty.

Hence, the Proposal would amend section 245 of the Act to expand the range of transactions to which GAAR may apply: whereas under the current wording GAAR can only apply to a transaction that results in a misuse of the provisions of the Act or an abuse having regard to the provisions of the Act read as a whole, under the revised wording GAAR would apply if there is a misuse or abuse of the Act, the Income Tax Regulations, the Income Tax Application Rules or any bilateral tax treaty. This very significant expansion of GAAR is to apply from the inception of GAAR in 1988. The Proposal would replace the text of the law as originally enacted with something different, effective as of the time of the original enactment.

***Summary of Objections***

The Joint Committee has expressed its concerns with retroactive legislation on several previous occasions, most recently in June of 2003. The Proposal is an extreme case of retroactive legislation, due to both the extent of the retroactivity involved and the fact that GAAR is a provision of such unique, tremendous importance. This retroactivity is totally inappropriate, for many reasons. These are summarized below, and discussed more fully in the appendix attached to this letter.

- *Proposal alters the law.* Court decisions make it clear that the Proposal is not a "clarification" of the law, contrary to the statements in the Budget materials. Rather, the Proposal materially expands the scope of one of the most important and far-reaching provisions of the Act.

- *Undermining the judicial system.* Our system of government rests on a basic division of powers: the legislative and executive branches make the laws, and the courts interpret them. If the government doesn't agree with the way a court interprets the law, it has the same rights of appeal to higher courts that taxpayers have. By retroactively changing the law, the government undermines the role of the judicial system, a role that is fundamental to our society.

- *An expropriation of taxpayers' appeal rights.* Taxpayers look to their right of appeal to the courts as a critical check on government's ability to take their property from them except in accordance with the law. The retroactivity of the Proposal strips taxpayers who have relied on GAAR as written of that right. The government is unilaterally decreeing how GAAR is to be applied by the courts in respect of past transactions, thereby effectively depriving affected taxpayers (both those currently in the appeals system and those facing new reassessments as a result of this change in law) of their day in court.

- *An abandonment of fairness.* Government writes the tax laws, and taxpayers arrange their affairs accordingly, based on the words used in the legislation. Possessed of the power to write the rules, government has an obligation to exercise that power in a way that is fair to taxpayers. Reaching back 16 years to retroactively tax people represents a fundamental violation of government's duty to act fairly. The perception that government acts fairly is critically important to taxpayer compliance in a self-assessment system. Fairness is also important more generally for maintenance of the rule of law, which underpins our society.

- *Proposal not within Finance's own guidelines.* In the past, the Department of Finance ("Finance") has indicated circumstances in which it considers retroactive amendments to impose taxation to be appropriate. While the Joint Committee considers those guidelines to be too broad to be an acceptable framework, it is important to note that the Proposal does not satisfy even Finance's own guidelines for legislating retroactively.

- *Retroactive amendments to GAAR particularly inappropriate.* GAAR is an extreme sanction that recharacterizes transactions that come within the letter of the law. It can apply in a limitless range of circumstances to cause an equally broad range of changes to the application of the Act, and its application is based on the highly subjective principle of a "misuse" or an "abuse". Retroactively amending such a powerful provision of such breadth and subjectivity is particularly disconcerting. If there is any provision of the Act that should *not* be amended retroactively, it is GAAR.

- *Failure to act promptly.* To the extent that retroactive legislation to impose tax is ever acceptable, the government must act expeditiously as soon as it becomes aware of the issue it wishes to address. The issue addressed by the Proposal is in no way hidden or unexpected, and has been widely discussed in public essentially since the introduction of GAAR. It is manifestly unfair to leave taxpayers to rely on the original language for many years, even though Finance was aware of the issue, and then to introduce a retroactive amendment.

- *Proposal has international ramifications.* The Proposal will directly affect both the Act's treatment of foreign enterprises and Canada's international obligations under its bilateral tax treaties. To do this on a retroactive basis will severely undermine international faith in the integrity of Canada's fiscal laws.[1] Weakening the integrity of Canada's legal system can only harm our ability to

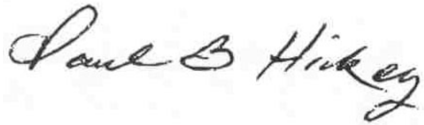
[1] See for example the March 1, 1997 edition of *The Economist*, writing about a previous instance of retroactive GST legislation (at p. 74): "Nobody disputes that governments have the power to tax. But imposing taxes on activities long since done with would seem an invitation to chaos. Except, perhaps, in Canada, where a court is considering the justice of a government minister reaching back six years to impose a big tax liability."

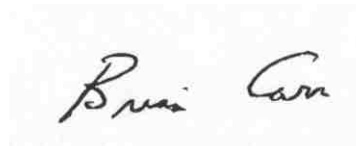
participate in the international business community. This was demonstrated in 1983, when Canada was forced to abandon its attempt to make elements of the *Income Tax Conventions Interpretation Act* retroactive in the face of pressure from foreign governments.

### *Conclusion*

The Joint Committee hopes that you will seriously reconsider the retroactivity of the Proposal. Circumventing our judicial system and effectively revoking the right of taxpayers to appeal tax disputes is not in Canada's interest. Abandoning the most basic principles of fairness in taxation law is not in Canada's interest. Inviting the reproach of the international community is not in Canada's interest. The Joint Committee urges you to eliminate the retroactivity of the Proposal.

Yours very truly,





Paul Hickey
Chair, Taxation Committee
Canadian Institute of Chartered Accountants

Brian Carr
Chair, Taxation Section
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**APPENDIX**

This Appendix sets out the Joint Committee's reasons why it is wrong to amend GAAR on a retroactive basis as proposed in the 2004 budget.

As a preliminary matter, the Joint Committee wishes to reiterate the limited scope of its submission:

- The submission relates solely to the intended retroactivity of the proposal to amend GAAR (the "Proposal").[2]
- The Joint Committee is not commenting at this time on the advisability of changing the wording of section 245 in the manner described in the Proposal *on a prospective basis.*
- The Joint Committee is not commenting at this time on the issue of whether GAAR should prevail over the terms of Canada's tax treaties, something that the Department of Finance ("Finance") clearly intends.
- The Joint Committee is not commenting at this time on whether Canada can or should seek to unilaterally amend its rights and responsibilities under the terms of its various tax treaties with other countries.

All of these are important issues on which the Joint Committee may express views at another time. However, they are separate issues from the issue that is the focus of this submission: namely, the retroactive nature of the Proposal. Put simply, the Joint Committee strenuously objects to the retroactivity of the Proposal in purporting to change the law for the period 1988 to 2004. Changing the law on a prospective basis is one thing. Rewriting a crucial chapter of legislative history many years after the fact to make the words read the way Finance wishes it had written them back in 1988 is quite another, and is completely inappropriate.

The headings below correspond to the points in the letter.

***Proposal alters the law***

The Notice of Ways and Means Motion states that the amendment is being made "for greater certainty". The Supplementary Information states that the Proposal clarifies the application of subsection 245(4). These statements suggest that the Proposal is not intended to alter the law, but simply to state in clearer terms what it already provides. If Finance believes that the Proposal will not alter the law, this belief is contrary to existing case law and to the views of tax practioners as to how the courts will interpret the language currently in subsection 245(4).

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[2] The Budget materials also include a Notice of Ways and Means Motion to amend the *Income Tax Conventions Interpretation Act*. Despite the absence of any reference to retroactivity in the words of this proposal, we understand that Finance also intends this amendment to be retroactive. If this is correct, the comments made in this submission apply equally to this proposal.

In the cases of *Fredette v. The Queen*[3] and *Rousseau-Houle v. The Queen*,[4] the Tax Court of Canada held quite clearly that a misuse or abuse of the Income Tax Regulations (the "Regulations") is not a misuse or abuse of the Act within the meaning of subsection 245(4).[5] These decisions cannot be ignored in ascertaining the current state of the law. While the matter of the non-application of GAAR to tax treaties has not been considered in the same way as its non-application to the Regulations, the clear preponderance of views is that GAAR as currently worded cannot as a general matter apply to "treaty abuse".[6]

The scope of subsection 245(4) as presently worded can only be known with certainty once it has been considered by higher-level courts. Thus, it is not possible for Finance to prove that the Proposal is merely a clarification that will not alter the law. Finance has no way of knowing how the higher-level courts would interpret the present language of subsection 245(4). In maintaining that the Proposal is a clarification, Finance is merely expressing a view as to what it thinks the outcome would be if the subsection were to be interpreted by higher-level courts. As just noted, Finance's view is contrary to the general expectation of practitioners that subsection 245(4) as presently worded would not be interpreted to contemplate the misuse or abuse of the Regulations or tax treaties, an expectation that is supported by the Tax Court decisions referred to above.

The basic premise of the Proposal as being a clarification of the existing law is therefore fundamentally flawed. In the Joint Committee's view, the Proposal is a significant change in the law, which reverses existing judicial authority and expands GAAR's application.

***Undermining the judicial system***

Our system of government provides distinct roles to distinct branches. The legislative branch (Parliament) enacts laws that govern the rights and responsibilities of the state and of its citizens. The executive branch (through the Governor in Council) also enacts such laws pursuant to powers delegated to it by the legislative branch. The judicial branch interprets those laws and resolves interpretational disputes in an orderly and even-handed fashion, acting as a check on the

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[3] 2001 DTC 621 (TCC).

[4] 2001 DTC 250 (TCC).

[5] In *Fredette* at paragraph 72 (p. 636-37): "The main provision to which the respondent referred in contending that there had been a misuse of, or an abuse having regard to, the provisions of the Act read as a whole is subsection 1100(11) of the Regulations. It is clear in administrative law that an act and regulations, although both enactments, are very different in nature. An act is passed by Parliament or a provincial legislative assembly, whereas regulations are most often adopted by a government (the executive) under the authority of an act. In my view, since subsection 245(4) of the Act does not say 'the Act and Regulations read as a whole', one must not take into account the rules adopted by the government in the Regulations. If Parliament had wanted them to be considered, it would have clearly so stated in subsection 245(4) of the Act, as it has done in a number of other provisions of the Act."

[6] Attached to this appendix is a brief summary of representative commentary in this regard. The Joint Committee notes certain comments made (in *obiter*) by the Tax Court in *RMM Canadian Enterprises Inc. and Equilease Corporation v. The Queen*, 97 DTC 302 at 315-16, concerning tax treaties and tax avoidance, although these comments were specifically limited to the *Canada-U.S. Income Tax Convention* and it is not clear that the Court was suggesting that GAAR necessarily prevails over tax treaties.

powers of the executive branch. When faced with a court decision with which it does not agree, the executive branch has the option of appealing to a higher court. The role of the courts as "the final interpreters of the law"[7] is fundamental to our society.

Retroactively legislating to reverse the effect of court decisions that the government (legislative or executive branch) doesn't care for undermines the role of the judicial branch. When Finance decides, as with the Proposal, that the words of the Act should be retroactively changed because it disagrees with the way in which the courts have interpreted the existing words, such action constitutes an attack on the role of the judicial branch as the interpreter of the law. With the ability to choose which case to take to court on this issue, the executive branch made its case in *Rousseau-Houle*, and lost. It made its case again in *Fredette*, and lost again. It could have appealed either or both of those cases to the Federal Court of Appeal, and (presumably well aware of the weakness of its legal position) chose not to. Making the Proposal retroactive is nothing more than an end-run around the judicial system that has already told the government, "the words you wrote do not achieve the result you want." It is (to say the least) inappropriate that, in support of a provision designed to thwart attempts to misuse or abuse the tax system, the government would itself take actions that could easily be construed as a misuse of Parliament's power to legislate.

***An expropriation of taxpayers' appeal rights***

Taxpayers arrange their affairs based on their interpretation of the words used in tax legislation. If the government disagrees with an interpretation, a taxpayer expects to have resort to an impartial procedure for resolving the dispute. For taxpayers who have relied on a particular interpretation of subsection 245(4), the Proposal negates this reasonable expectation. The government is imposing its desired interpretation rather than allowing the matter to be resolved by the courts. This amounts to an expropriation of the appeal rights of taxpayers whose positions have been, or may in the future be, challenged by the Canada Revenue Agency ("CRA"). Some of these taxpayers have already incurred time and expense in availing themselves of their rights under the Act to seek judicial interpretation of subsection 245(4). This expropriation of appeal rights can only have an adverse effect on taxpayers' view of the tax system and their willingness to themselves comply with the rules of that system.

***An abandonment of fairness***

The government has extensive powers with respect to the tax laws. It both writes the laws (Finance/Parliament) and enforces them (Canada Revenue Agency), i.e., it is both rule-maker and rule-enforcer. Accompanying that uniquely powerful role is an obligation on the part of government to act fairly. Taxing people today on the basis of laws that will be written tomorrow is incompatible with that obligation, as Finance has itself acknowledged:

> Tax policy considerations, however, dictate that retroactive tax changes remain exceptional. Tax certainty, which requires that taxpayers be able to determine precisely their tax liability, is a fundamental principle of taxation. It is especially important that this principle be respected in the case of a tax, such as the income

[7] See Session paper 8512-351-79, September 1995, Comprehensive Response of the Government of Canada to the Seventh Report of the Standing Committee on Public Accounts (the "Finance Response"), page 15.

> tax, the collection of which is based on a system of self-assessment. Taxpayers should be able to expect stability and continuity in the tax rules; they should be able to expect certain tax results when they plan their investments on the basis of the rules as they know and understand them.[8]

Various considerations of fairness manifest themselves in tax laws: who gets taxed, on what, how much, etc. However, the central element of fairness in taxation is the most basic: the right to know the law in effect on any given day, and not to be subject to the changing of the rules to retroactively expand the tax net after people have arranged their affairs based on the law as written. As stated in *Sullivan and Driedger on the Construction of Statutes,* one of Canada's leading legal texts:

> It is obvious that reaching into the past and declaring the law to be different from what it was is a serious violation of rule of law…[T]he fundamental principle on which rule of law is built is advance knowledge of the law...And when retroactive legislation results in a loss or disadvantage for those who relied on the previous law, it is unfair as well as arbitrary. Even for persons who are not directly affected, the stability and security of law are diminished by the frequent or unwarranted enactment of retroactive legislation.[9]

Fairness in tax laws matters for various reasons. It matters because the rule of law that underlies our system of government is premised on government using its extraordinary powers fairly. It matters because taxpayers' perception of the equity of the tax system directly affects their willingness to fully comply with that system (no small consideration in a self-assessment system). It matters because other countries (whose participation in our economy is purely voluntary) expect it as a pre-condition to doing business with us. A 16-year retroactive substantive change in law is completely incompatible with the government's obligation of fairness.

***Proposal not within Finance's own guidelines***

The Finance Response lays out Finance's views on when retroactive legislation may be appropriate. The Joint Committee considers these guidelines to be much too liberal in terms of when retroactive legislation is permissible. However, without debating the appropriateness of the guidelines, it is sufficient to point out that the Proposal does not meet even Finance's own criteria for legislating retroactively.

These guidelines indicate that retroactive legislation might be considered when an interpretation arises that is contrary to the CRA's "long-standing well-known interpretation" of the law and the position adopted by a majority of taxpayers.[10] This is clearly not the situation here. Not only is it unclear to the Joint Committee exactly where the CRA has "publicly and unequivocally" taken the position "over a long period of time" that GAAR applies to abuses of the Regulations, the

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[8] Finance Response, *supra* note 6, at p. 15.

[9] *Sullivan and Driedger on the Construction of Statutes* (4th ed.), pp. 553-554.

[10] Finance Response, *supra* note 6, p. 16: "Where the Department of National Revenue publicly and unequivocally advocates a given interpretation over a long period of time, and where such interpretation has been followed by most taxpayers in the filing of their income tax returns, it does not unduly disrupt the reliance of taxpayers to amend the law so as to confirm this interpretation following an adverse decision which, while constituting a legal interpretation of the existing legislation, has an effect equivalent to a change in law."

ITARs and treaties,[11] the interpretation of subsection 245(4) made by the courts in *Fredette* and *Rousseau-Houle* was the obvious one based on its words. Nor is there any evidence that "most" (if any) taxpayers share Finance's view. Indeed, tax practitioners have been telling Finance since at least 1988 that GAAR does not apply to an abuse or misuse of a tax treaty. For example, in 1989 the following comment was made in a paper presented at the Canadian Tax Foundation Annual Conference:

> Although treaty benefits do indeed reduce tax payable under the Act by virtue of paragraph 110(1)(f) of the Act and the legislation implementing the relevant treaty, and would therefore seem to give rise to "tax benefits" as defined in subsection 245(1) of the Act, the legislative history accompanying GAAR does not specifically indicate an intent to override tax treaties. The legislation itself also contains no such specific indication of intent. Thus, the only treaty override possible must be effected by means of the definitional provisions of the Income Tax Conventions Interpretation Act.[12]

The same point was made in an earlier Tax Foundation paper by another senior practitioner:

> One point that may cause some difficulty for Revenue Canada with respect to the interaction of section 245 and Canada's tax treaties is that, although recharacterization under section 245 by the Minister of a series of transactions may be effective for purposes of the Income Tax Act, it may or may not be effective for purposes of Canada's tax treaties. [13]

This is reinforced by recent comments from Professor Brian Arnold:

> The relationship between the GAAR and tax treaties has been hotly debated in the Canadian tax community. The risk that tax treaties might override the GAAR has been known by the Department of Finance for 15 years.[14]

The retroactivity of the Proposal fails to meet the threshold Finance has set for retroactive legislation.

***Retroactive amendments to GAAR particularly inappropriate***

Given the unique function of GAAR in the Act, and the unusual nature of this provision, it is particularly inappropriate for any amendment to GAAR to be made on a retroactive basis.

The courts have told us that GAAR is not like other provisions of the Act. It constitutes the "heavy artillery,"[15] acting as it does to allow the CRA to recharacterize the consequences of a

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[11] Note for example that no mention of this position is made in the Information Circular on GAAR (IC 88-2 and Supplement), which would be the logical place for the CRA to publicly adopt such a position.

[12] Richard G. Tremblay, "Permanent Establishments in Canada", in *Report of the Proceedings of the Forty-First Tax Conference,* 1989 Conference Report (Toronto: Canadian Tax Foundation, 1990) at 38:6. Attached to this Appendix is a brief summary of representative papers on this topic.

[13] Robert F. Lindsay, "The General Anti-Avoidance Rule: Points to Consider", in *Report of the Proceedings of the Fortieth Tax Conference,* 1988 Conference Report (Toronto: Canadian Tax Foundation, 1989) at 5:32.

[14] Tax Notes International, April 5, 2004, p. 10.

[15] *RMM Canadian Enterprises Inc. and Equilease Corporation v. The Queen*, 97 DTC 302 at 307 (TCC).

transaction that otherwise comes within the letter of the law. It is an "extreme sanction", an "anti-avoidance provision of last resort."[16] Unlike other provisions, GAAR can apply in any circumstances, since it back-stops the Act generally rather than a particular section or part of the Act. The retroactive amendment of a provision capable of applying so broadly, to a range of circumstances that cannot be foreseen, and which (when applicable) produces such extraordinary consequences is particularly offensive to the rule of law and general principles of fairness.

Equally important in the Joint Committee's view is the high degree of subjectivity inherent in GAAR. The application of subsection 245(4) depends on what constitutes an "abuse" or "misuse" of the provisions of the Act, these being very subjective concepts. Reasonable people can and do differ as to what constitutes an "abuse" or "misuse", as demonstrated by the fact that a special committee exists to oversee the CRA's application of this extraordinary sanction. Taxpayers already face a substantial burden in trying to plan their affairs in the face of a provision of such scope, such subjectivity and such impact. Adding the further uncertainty that the words of the provision may be amended *after the fact* because Finance doesn't like the way the courts are interpreting them is simply inappropriate. If there is any provision of the Act that should *not* be amended retroactively, it is GAAR.

***Failure to act promptly***

Past instances of retroactive amendments adverse to taxpayers' interests (as rare as they are) have typically involved changes announced as quickly as possible after Finance has perceived that there is a problem. The Proposal is entirely different in this regard.

The possibility that the term "Act" in subsection 245(4) would be interpreted to refer just to the Act itself and not the Regulations, ITARs or tax treaties is something that has been apparent since 1988. While people can fairly disagree over the correct interpretation of the term "Act", any reasonable person would concede that there is at least a very reasonable and obvious argument (which in fact has prevailed twice in the courts, as noted above) that the term "Act" is limited to the statute itself. Indeed, as described above, tax practitioners have been publicly noting this limitation for some time.

Thus, this is an issue that should have been apparent to Finance for many years, not something that came to its attention shortly before the budget. Even if Finance was unaware of the issue initially, which is hard to believe, it should have been alerted to the issue at the latest when the CRA issued reassessments that resulted in the government's losses in *Fredette* and *Rousseau-Houle* in March of 2001. Yet the government waited *many more years* before acting in March 2004.

Once Finance became aware that the language in subsection 245(4) did not implement the intended policy, it was incumbent upon Finance to act promptly to correct the deficiency. It is manifestly unfair to leave taxpayers to rely on the original language for many years, and then to amend the language retroactively. In those very rare circumstances where retroactivity is warranted for a change that is adverse to taxpayers' interests, government must move with all

[16] See respectively *Jabs Construction Limited v. The Queen*, 99 DTC 729 at 738, para. 48 (TCC), and *The Queen v. Imperial Oil Limited*, 2004 DTC 6044 at 6049, para. 31 (FCA).

due dispatch when it becomes aware of a perceived inadequacy in legislation. The Proposal does not meet even this minimal standard.

***Proposal has international ramifications***

The Proposal will have a direct effect on persons resident in other jurisdictions, and, thus, the tax systems of those jurisdictions as well. Indeed, given the nature of the Proposal, it is intended to affect such persons.

As noted at the outset, the Joint Committee is not commenting on the merits of the Proposal, and in particular on its interaction with Canada's international tax treaty obligations. Putting this aside, it is clear that a stable legal and fiscal regime is of paramount importance in international affairs. A belief in international circles that Canada's laws are not dependable or trustworthy would be of great concern, and so Finance should take care to avoid fostering this belief. Retroactively rewriting one of the principal anti-avoidance provisions in the Act in part to impose greater taxation on non-residents in respect of completed transactions will be likely to undermine faith in the Canadian tax system. The negative image of the tax system created by this action would be reinforced by the publicity arising when reassessments are made based on the retroactive amendment. Canada's failed attempt in 1983 to make elements of the *Income Tax Conventions Interpretation Act* retroactive, which it was forced to abandon in the face of pressure from foreign governments, is a clear reminder that the international aspect of the Proposal adds an additional layer of concern regarding its retroactivity.[17]

[17] For example, assume that Canada invokes GAAR to deny treaty benefits to a non-resident in respect of a taxation year that is statute-barred in its home country, such that the non-resident cannot claim foreign tax credits or other home-country relief for the extra Canadian tax payable. The non-resident's home country is unlikely to consider the resulting double taxation to be acceptable. If Canada were compelled under competent authority to forego reassessing in such circumstances, would this not unfairly distinguish between non-residents whose relevant taxation years are statute-barred in their home country and those whose relevant taxation years are not? The international ramifications of the retroactivity of the Proposal are very serious.

**SCHEDULE**

**PUBLISHED COMMENTARY RELATING TO GAAR AND TAX TREATIES**

- R. F. Lindsay, "The General Anti-Avoidance Rule: Points to Consider," in *Report of Proceedings of the Fortieth Tax Conference*, 1988 Conference Report (Toronto: Canadian Tax Foundation 1989) 5:1-33.

  Lindsay suggests that GAAR may be effective in respect of a treaty for the purpose of defining an amount in a way that is relevant for the particular treaty, but that it may not be effective in "non-definitional" situations. In the former case, Lindsay cites the potential application of GAAR in applying the definition of "dividend" in Article X(3) of the Canada-U.S. treaty, as the definition includes "income subjected to the same taxation treatment as income from shares by the taxation laws of the State of which the company making the distribution is a resident." In the latter case, he cites disposition of real property by a Canadian corporation in connection with ensuring that its shareholders come within the protection of Article XIII of the Canada-U.S. treaty on a subsequent disposition of shares.

- B. Arnold and J. R. Wilson, "The General Anti-Avoidance Rule—Part 3" (1988) 36:6 *Canadian Tax Journal* 1369-1410.

  The authors doubt that treaty relief could ever be a misuse of the provisions of the Act but state without analysis that it might involve an abuse of the Act subject to GAAR. Wilson has since taken a more restrictive view of the interaction of GAAR and treaties, and Arnold has recently acknowledged that this view is far from accepted (see below for each author).

- R. G. Tremblay, "Permanent Establishments in Canada" in *Report of Proceedings of the Forty-First Tax Conference*, 1989 Conference Report (Toronto: Canadian Tax Foundation, 1990) 38:1-69.

  Tremblay concludes that since the legislative history of GAAR and the legislation itself shows no intention that it should override tax treaties, it does not provide a treaty override.

- J-M. Déry & D. A. Ward, "Canada," in International Fiscal Association, *Cahiers de droit fiscal international*, vol. 78a, *Interpretation of Double Taxation Conventions* (Deventer, the Netherlands: Kluwer, 1993) 259-93.

  The authors note that the question of the application of GAAR to treaties has not been determined.

- C. F. Steiss, "Issues Relating to Tax Treaties," in *Report of the Proceedings of the Forty-Fifth Tax Conference*, 1993 Conference Report (Toronto: Canadian Tax Foundation, 1994) 45:1-33.

Steiss suggests that GAAR could have application in the context of a tax treaty where the treaty would permit recharacterization of a particular amount, receipt or distribution, using an example similar to that used by Lindsay, above. He notes that the application of GAAR as a treaty override in other situations is not clear and will require judicial determination.

- R. G. Tremblay, "GAAR and Treaty Shopping," in *Report of Proceedings of the Forty-Seventh Tax Conference*, 1995 Tax Conference (Toronto: Canadian Tax Foundation, 1996) 38:1-42.

  Tremblay concludes that, in the absence of an explicit agreement between treaty partners to allow GAAR to apply, GAAR cannot be applied to limit entitlement to the benefits of a tax treaty. However, he suggests, citing Lindsay's 1988 article, that GAAR may be used to determine the meaning of certain terms of a tax treaty in a restrictive fashion.

- J. G. Russell, "The New Limitation-on-Benefits Article," International Tax Planning feature (1995) 43:4 *Canadian Tax Journal* 964-82.

  Russell expresses uncertainty as to whether GAAR could be applied to a tax treaty without amending the Income Tax Conventions Interpretation Act, and (less) continuing uncertainty even if such amendments are made.

- J. N. Gregory. "Disposing of Canadian Business by Non-Residents: A Canadian Perspective" in *Income Tax and GST Planning for the Purchase, Sale and Canada-U.S. Expansion of a Business*, 1996 Corporate Management Tax Conference (Toronto: Canadian Tax Foundation, 1996) 22:1-17.

  Gregory concludes that while GAAR may play a restricted role in definitional matters relating to tax treaties as suggested by others referred to above, it is doubtful that GAAR has general application to tax treaties beyond this narrow connection.

- J. Li & D. Sandler, "The Relationship Between Domestic Anti-Avoidance Legislation and Tax Treaties" (1997) 45:5 *Canadian Tax Journal* 891-958.

  The authors conclude that GAAR cannot apply to a transaction whose sole purpose is to take advantage of a treaty provision, since this would not constitute an abuse of the Act. They suggest that if a treaty term is not fully defined, the definition under Canadian domestic law, including an extended meaning as a consequence of a reassessment under GAAR, will generally apply for treaty purposes. They also suggest that the Tax Act should be amended to incorporate specific treaty override language into GAAR.

- D. A. Ward, "Have Tax Treaty Rules Been Eroded" in *Report of Proceedings of the Fifty-First Tax Conference*, 1999 Tax Conference (Toronto: Canadian Tax Foundation, 2000) 41:1-21.

  Ward suggests that there "may be a very powerful argument" that GAAR should not be applied to an abuse of a tax treaty.

- A. A. Khan, "Does GAAR Apply to Treaty Shopping?" (1999) 4 *Tax Forum* 1-17.

  Khan opines that GAAR applies to treaty shopping on the basis that it is fair to assume that application in this context does not amount to a treaty override, since the contracting parties understood at formation that only parties entitled to treaty application qualify for treaty benefits, and that tax avoidance is not within the spirit of the treaty document.

- P. Hickey. "Trends and Developments in International Tax Policy" in *Report of Proceedings of the Fiftieth Tax Conference*, 1998 Tax Conference (Toronto: Canadian Tax Foundation, 1999) 47:1-28.

  Hickey cites Tremblay's article, above, to the effect that in order for GAAR to apply to override tax treaties an intent to allow GAAR to do so would need to be included in the Tax Act.

- N. Goyette, Countering Tax Treaty Abuses: A Canadian Perspective on an International Issue (Toronto: Canadian Tax Foundation, 1999).

  Goyette suggests that if the intention of Parliament is that it should be possible to invoke GAAR in respect of cases of abuse of tax treaties, it has no option but to amend the provision. She also notes, however, that even if GAAR was so amended, it would only apply where the section was not inconsistent with the relevant tax treaty.

- J. R. Wilson and J. M. Welch, "The GAAR and Canada's Tax Treaties: Which is Trump?" in B. Arnold and J. Sasseville, eds., *Special Seminar on Canadian Tax Treaties: Policy and Practice* (Kingston, ON: International Fiscal Association, Canadian Branch, 2001) 6:1-72.

  The authors offer the "tentative conclusion" that where GAAR and a tax treaty provision are determined to be in conflict the treaty provision should override GAAR. The author's acknowledge that Article XXIX A of the U.S.-Canada tax treaty provides an exception. They also acknowledge that GAAR may be relevant in the circumstances described in section 3 of the Income Tax Conventions Interpretation Act (Canada) where Canadian domestic law is applied to provide the meaning of a term used in a tax treaty.

- D. Toaze, "Tax Sparing: Good Intentions, Unintended Results" (2001) 49:4 *Canadian Tax Journal* 879-924.

  Toaze suggests that, in order for GAAR to apply to a treaty, the treaty partners would have to explicitly agree to the override of the treaty by domestic anti-avoidance legislation.

- N. Goyette, "Tax Treaty Abuse: A Second Look" (2003) 51:2 *Canadian Tax Journal* 764-805.

  Goyette reiterates her previous position in *Countering Tax Treaty Abuses,* above, that subsection 245(4) limits GAAR to abuses of the Tax Act. She suggests that while a broad and liberal interpretation of the Tax Act could lead a court to extend the application of GAAR to tax treaty abuses, the current trend of strict interpretation would not.

- J. Bernstein, "European Holding Companies: A Canadian Perspective," 33 *Tax Notes International* 911 (March 8, 2004).

  Bernstein observes that most senior tax practitioners would argue that GAAR may not be successfully applied to prevent treaty shopping, as it does not apply to treaties.

- B. Arnold, "News Analysis: Canada's 2004 Budget Tax Measures Spare Income Trusts," 34 *Tax Notes International* 10 (April 5, 2004).

  Arnold admits that the relationship between GAAR and tax treaties has been hotly debated in the Canadian tax community, and that the risk that tax treaties might override GAAR has been known by the Department of Finance for 15 years. He notes, with respect to the proposed changes, that taxpayers will be "annoyed by the attempt in the budget proposals to deprive them of arguments based on the provisions of a tax treaty that, according to the provisions of the implementing legislation, prevail over any other inconsistent laws, including the GAAR."