Dockets: 2012-739(IT)G
2012-4194(IT)G

BETWEEN:

GERBRO HOLDINGS COMPANY,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeals heard on November 3, 4, and 5, 2014
and June 22, 23 and 24 at Toronto, Ontario
and November 16, 2015, at Montreal, Quebec.

Before: The Honourable Lucie Lamarre, Associate Chief Justice

Appearances:

Counsel for the Appellant:	Stéphane Eljarrat Joel Scheuerman
Counsel for the Respondent:	Naomi Goldstein Rita Araujo

JUDGMENT

The appeal from the reassessments made under the *Income Tax Act* (**ITA**), for the taxation years ended on December 31, 2005 and December 31, 2006, are allowed and the reassessments are referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that Gerbro did not have to report for the taxation years ended on December 31, 2005 and December 31, 2006, income in the amounts of $841,803 and $754,210 respectively imputed to it under section 94.1 of the ITA.

If either of the parties requests to make submissions on costs, both parties shall file written submissions with the Registry on or before August 31, 2016. If no submissions are received, the Appellant will be awarded one set of costs for the two appeals (2012-739(IT)G and 2012-4194(IT)G).

Signed at Ottawa, Canada, this 22nd day of July 2016.

"Lucie Lamarre"

Lamarre A.C.J.

Citation: 2016 TCC 173
Date: 20160722
Dockets: 2012-739(IT)G
2012-4194(IT)G

BETWEEN:

GERBRO HOLDINGS COMPANY,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Lamarre A.C.J.

1 INTRODUCTION

[1] The appellant, Gerbro Holdings Company (**Gerbro**), is appealing from two assessments made by the Minister of National Revenue (**Minister**) with respect to its taxation years ending on December 31, 2005 and December 31, 2006 (**Relevant Period**). The two appeals were heard on common evidence. The Minister's assessments imputed to Gerbro income of $841,803 for 2005 and $754,210 for 2006 under section 94.1 of the *Income Tax Act* (**ITA**) in respect of Gerbro's investments in the following five offshore investment (hedge) funds (collectively, the **Funds**):

1. The Raptor Global Fund Ltd. (**Raptor**);

2. Arden Endowment Advisors Ltd. (**Arden**);

3. M. Kingdon Offshore Ltd. (**Kingdon**);

4. Haussmann Holdings N.V. (**Haussmann**); and

5. Caxton Global Investments Ltd. (**Caxton**).

[2] Section 94.1 is an anti-avoidance provision which applies where (1) a taxpayer's interest in a non-resident entity derives its value, directly or indirectly, primarily from portfolio investments in listed assets, and (2) it may reasonably be concluded, having regard to all the circumstances, that one of the main reasons for the taxpayer acquiring, holding or having the interest in the non-resident entity was to pay significantly less Part I taxes than would have been payable if the taxpayer had held the portfolio investments directly. I will refer to the rules set out in section 94.1 as the offshore investment fund property rules (**OIFP Rules**).

[3] The essence of the Respondent's position is that all the Funds derived their value primarily from portfolio investments and that Gerbro, being a sophisticated investor, invested with an intention to reduce or defer Canadian taxes, as contemplated by the concluding part of the subsection. This position is premised on the low or non-existent taxation in the jurisdiction in which the investment vehicles of the Funds were located, on the fact that the hedge funds selected made no distributions to their shareholders, as well as on the existence of other tax-motivated transactions that Gerbro entered into over time.

[4] The Appellant, on the other hand, argues that section 94.1 does not apply since neither of the two above-stated requirements is met. It submits that (1) the Funds did not derive their value primarily from portfolio investments in listed assets, and (2) that none of Gerbro's main reasons for investing in the Funds was to reduce or defer Canadian taxes. In its Amended Notice of Appeal, the Appellant stated that it invested in the Funds to complement its investments in traditional long equities, in order to meet its primary objective of capital preservation which is set out in its investment guidelines.[1]

[5] The evidence adduced at trial does not support the Appellant's position that the Funds did not primarily derive their value, directly or indirectly, from portfolio investments in listed assets. However, the appeal must succeed on the basis that, having regard to all the circumstances, it may reasonably be concluded that none of Gerbro's *main* reasons for investing in the Funds was to defer or avoid Canadian taxes as contemplated by the OIFP Rules.

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[1] Amended Notice of Appeal at paragraphs 7, 10, 17 and 20.

2 FACTS

[6] The parties have agreed on some of the relevant facts and these are set out in a Statement of Agreed Facts (Partial) which is attached as Appendix A to these reasons for judgment. I will summarize the key facts.

2.1 Appellant's Interpretation of the Facts

[7] In 1986, the late Gerald Bronfman left a substantial inheritance for Marjorie Bronfman in a spousal trust (**MB Trust**) and Gerbro was established as a holding company tasked with investing the MB Trust's capital and income during Ms. Bronfman's lifetime. Gerald Bronfman's last will and testament further provided that the remaining capital and income would go to Marjorie's four children following her death.[2] In the Relevant Period, Ms. Bronfman had already reached the age of 88 years, which was why Gerbro's investments had to be liquid.

[8] Ms. Nadine Gut held the position of president of Gerbro. Before being appointed president, she had been a part-time (from the company's inception) and then full-time (as of June 1990) employee of Gerbro.[3]

[9] Gerbro was a Canadian-controlled private corporation incorporated under the *Canada Business Corporations Act*[4] with a fiscal year-end of December 31, and its sole shareholder was the MB Trust.[5] Gerbro chose to use independent money managers to manage its investments since it did not have the resources in-house to actively manage its own portfolio. Nonetheless, Gerbro expended significant resources to make allocation decisions with respect to the MB Trust's capital in accordance with the applicable investment guidelines.

2.1.1 Investment Policies and Guidelines

[10] Gerbro's board of directors adopted its first written investment guidelines in 1992,[6] in which they codified the capital preservation investment philosophy

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2 Exhibit A-1, Tab 1.

3 Transcript, vol. 1, page 12 line 27 to page 13 line 2.

4 R.S.C. 1985, c. C-44.

5 On January 27, 2014, Gerbro was continued as a Nova Scotia unlimited liability company. Thereafter, on March 1, 2014, Gerbro merged with Marbro Holdings Company, which resulted in the creation of Gerbro Holdings Company. (Statement of Agreed Facts (Partial), Exhibit A-3, paragraphs 7-10.)

6 Exhibit A-4.

Gerbro already adhered to. Subsequent amendments to the 1992 investment guidelines did not change Gerbro's investment philosophy of capital preservation. In essence, the amendments to the investment guidelines refined Gerbro's policies for selecting managers as well as its portfolio allocation guidelines. They also updated historical figures influencing the minimum expected return requirement for achieving capital preservation, such as the rate of inflation and Gerbro's operating costs. A set of investment guidelines adopted in April 2002 (**2002 Guidelines**)[7] was still in force at the beginning of the Relevant Period, but was updated by a new set of guidelines in April 2005 (**2005 Guidelines**).[8] The 2002 Guidelines included an appendix that was a checklist for selecting and replacing investment managers.

[11] Although Gerbro's main objective was capital preservation, like most investors, it had as a secondary objective earning a return consistent with prevailing market expectations. This meant that if the markets were achieving good returns, Gerbro also wanted to benefit from the higher than normal returns, subject to the level of volatility being acceptable.

[12] Moreover, the money Gerbro invested had to be allocated to investments that (i) were liquid, (ii) provided Gerbro with sufficient cash to pay its yearly operating costs as well as its yearly tax liabilities, and (iii) provided Marjorie Bronfman with enough cash to sustain her lifestyle and to fully carry out her philanthropic endeavours.[9]

[13] Gerbro referred to the applicable investment guidelines to make its investment allocation decisions. To achieve the objective of capital preservation, the 2005 Guidelines fixed a minimum return of 6.5%. The prevailing rate of inflation, the operating expenses of Gerbro and the annual expenses of Marjorie Bronfman were considered in order to arrive at this target rate of return. To this expected return criterion, the 2005 Guidelines attached a target volatility of 10%, which served as a gauge of risk.[10]

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7 Exhibit A-8.

8 Exhibit A-1, Tab 2.

9 Transcript, vol. 1, page 37 lines 3 to 26 and page 15, lines 21 to 27.

10 *Ibid.*, page 21, lines 5 to 13.

[14] In addition, the 2005 Guidelines set upper and lower allocation percentages for five distinct asset classes as follows:[11]

	Minimum Allocation	Maximum Allocation
Cash	0%	5%
Bonds [Fixed Income]	10%	30%
Equities ***	30%	60%
Directional [Hedge] Funds *	0%	30%
Non-directional [Hedge] Funds	0%	30%

* The maximum allocation for equities and directional funds combined is 60%.

** International equities as a sub group of equities could have an allocation of 0% to 30% of the combined portfolio.

[15] Nadine Gut's testimony established that Gerbro rigorously followed its well-defined objectives set out in its investment guidelines. In the Relevant Period, the percentages Gerbro *actually* allocated to each of the five asset classes were consistent with the above-referenced allocation percentages.[12]

2.1.2 Evolution of Portfolio Allocation

[16] At its inception, Gerbro retained SEI Investments, an investment management firm, to build a suitable portfolio.[13] Subsequently, Gerbro did much of the due diligence work preceding allocation decisions internally, and its allocation decisions were presented to and approved by its investment committee (**Investment Committee**).

[17] From 1993 to 2001, Gerbro retained Sandra Manzke from Tremont (a consulting firm located in the state of New York) to act as a consultant in searching for hedge fund managers. Ms. Manzke helped Gerbro identify potential hedge fund managers which had at least three years of proven positive returns and at least

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11 Exhibit A-1, Tab 2.

12 See Tab 1 of Exhibits A-9 to A-16.

13 Transcript, vol. 1, page 15, lines 13 to 20.

$100 million of assets under management. Most managers Tremont suggested to Gerbro were based in the United States.[14]

[18] Gerbro argued forcefully that it did not restrict its search for managers to United States managers and supported this assertion with examples of some Canadian managers it had historically invested with. From 2003 to 2006 it invested in Maple Key Limited Partnership, but divested itself of that investment due to disappointing returns. Gerbro redeemed an investment it had made around the year 2000 with another Canadian manager, Boulder Capital Management, later renamed Silvercreek Limited Partnership, due to accounting fraud related to the Enron scandal.[15]

[19] In the early 1990s, Gerbro invested amounts of $1 to $2 million with celebrity world hedge fund managers such as George Soros.[16] In those years Gerbro benefited from the exceptional returns those hedge fund managers produced on currency plays.

[20] It appears from the minutes of Gerbro's board of directors' meeting held on January 28, 1993 that Gerbro considered adding hedge funds to its portfolio as a means of protecting itself from a potential meltdown of financial markets.[17] This suggestion originated from one director, Mr. Schechter, who spoke about the benefits of increasing Gerbro's percentage allocation to hedge funds.

2.1.3 Similarities Among the Funds

[21] The investments in the Funds ensued progressively. In 2005, Gerbro acquired and held shares in Raptor, Arden, Kingdon and Haussmann. In 2006, Gerbro acquired and held shares in Caxton, Raptor and Haussmann.

[22] All the Funds were subject to annual management fees, ranging from 1% to 3%. Moreover, all the Funds, aside from Haussmann, had to pay an incentive performance fee ranging from 10% to 30% above a high-water mark.

[23] Another similarity is that all the Funds were located in low-tax jurisdictions and therefore paid only a nominal amount of tax, if any at all. Raptor and Arden

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14 *Ibid.*, page 95, lines 12 to 28; Exhibit A-21, presentation by Tremont to Gerbro in 1994.
15 Transcript, vol. 1, page 88, lines 13 to 27.
16 Transcript, vol. 1, page 96, line 24 to page 97 line 5, and lines 12 to 14.
17 Exhibit A-17.

were registered as exempted companies under the *Companies Law* of the Cayman Islands.[18] Kingdon and Haussmann were incorporated in the Netherlands Antilles.[19] Lastly, Caxton was registered as an exempted company under the laws of the British Virgin Islands.[20]

[24] Gerbro submitted that it could not replicate the investment strategies of the Funds for lack of exact knowledge about the investments each Fund carried and for want of the financial resources required to replicate sophisticated investment strategies. The lack of exact knowledge also meant that it could not calculate the amount of Part I tax that it would have paid if it had hypothetically held the Funds' investments directly. The competitive advantage of each Fund consisting in the research leading up to investment decisions and in the alternative trading strategies their respective managers used, the Funds did not disclose their basket of assets to investors. In some cases, notably Raptor, the managers provided information on select trades after the fact.[21]

[25] Gerbro contends that it was never invited to invest in the onshore vehicles of the Funds. It should be noted that all investments in the Funds had equivalent onshore investment vehicles in the United States, except for Haussmann.[22] When an investor was admitted to invest in the Funds, the manager would direct the investor to the appropriate investment vehicle. Given that the hedge funds were unregulated investments, the managers had full discretion to accept an investor, and if the investor was accepted, to decide in which investment vehicle that investor could subscribe for shares.

[26] According to Ms. Gut's testimony, the jurisdiction that the fund was located in was not relevant in deciding whether to invest in any of the Funds.[23] The information about the low-tax jurisdiction was in the offering memorandum of each Fund. The memoranda were only provided to Gerbro as a formality prior to it making an investment. At that point, the Investment Committee had already made the decision to subscribe for shares.

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18 Statement of Agreed Facts (Partial), at paragraphs 21 and 73.

19 *Ibid.*, at paragraphs 105 and 135.

20 *Ibid.*, at paragraph 172.

21 Transcript, vol. 1, page 123, lines 10 to 14.

22 Transcript, vol. 1, page 85, lines 23 to 25.

23 Ms. Gut made this assertion for each Fund; see transcript, vol. 1, page 116, lines 15 to 21 (Haussmann), page 124, lines 18 to 26 (Raptor), page 132, lines 1 to 2 (Kingdon), page 141, lines 22 to 24 (Arden), page 150, lines 8 to 11(Caxton).

[27] Although the managers of the Funds had a discretionary power to declare dividends, they did not declare any dividends for Raptor, Caxton, Arden and Kingdon in the Relevant Period. Gerbro received relatively small dividends from Haussmann as compared to the size of its investment in that Fund, which exceeded $5 million at all times during the Relevant Period. The dividends it received from Haussmann were in the amounts of $8,915.82 in 2005 and $26,311.44 in 2006.[24]

2.1.4 Particularities of each of the Funds

[28] While they had many similarities, the Funds were distinct in the strategies that they employed and should be described separately in some detail.

2.1.4.1 Haussmann

[29] Haussmann is a hedge fund of funds, which means that Haussmann achieved capital appreciation by building a portfolio composed of other hedge funds. The fund was managed by a group of advisors, including Mirabaud, a bank with which Gerbro transacted business. Coincidentally, Haussmann also invested in Raptor and Kingdon.[25] Haussmann was able to invest in a multitude of funds since it pooled money from many investors.

[30] That investment fell within Gerbro's directional hedge fund asset class, and the hedge funds Haussmann invested with were allowed to buy and sell securities, options, commodity futures and foreign currencies.[26] The hedge funds were also allowed to engage in leveraging and in sophisticated trading strategies using derivatives.

[31] Gerbro's stated reasons for investing in Haussmann were twofold. Firstly, it wanted to gain access to many hedge funds to which it could not have access on its own. Haussmann was able to get access to them because of the large amounts of money it invested. At the time, the fund had $4 billion worth of assets under management.[27] Gerbro asserts that, due to this economic disparity alone, it could not have replicated Haussmann's strategy.[28] Secondly, by investing with

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24 Statement of Agreed Facts (Partial), at paragraphs 167 and 168.
25 *Ibid.*, at paragraph 153.
26 Statement of Agreed Facts (Partial), at paragraph 155.
27 Transcript, vol. 1, page 105, line 11, to page 106, line 2.
28 *Ibid.*, page 113.

Haussmann, Gerbro benefited from a wealth of knowledge about financial markets which Haussmann had acquired from speaking to many managers it had either invested with or considered investing with.

[32] In addition, Haussmann is the only one of the Funds that is publicly traded. Its stock traded on the Irish Stock Exchange.[29] The fact that it is publicly traded was relevant to the extent that Haussmann would have qualified as an exempt interest under the proposed foreign investment entity rules (**FIE Rules**),[30] which rules will be addressed later on in my reasons.

2.1.4.2 Raptor

[33] Raptor was managed by James Pallotta and had approximately $9 billion worth of assets under management when Gerbro invested in 2005. The iconic Paul Tudor Jones brought James Pallotta into the Tudor Group, and Mr. Pallotta formed the Raptor fund under the umbrella of the Tudor Group. Gerbro was never extended the opportunity to invest directly with Paul Tudor Jones, but Mirabaud brokered a sale of Raptor shares to Gerbro.[31]

[34] This investment fell within Gerbro's directional hedge fund asset class and was primarily in equities, both long and short, and in related derivatives. These types of investments included common stocks, preferred stocks, warrants, options, bonds, repurchase agreements, reverse repurchase agreements and contracts for differences.[32]

[35] Gerbro's only stated reasons for investing were James Pallotta's past performance, his reputation in the industry and Raptor's low historical volatility.[33] These reasons appear in an internal memorandum dated February 28, 2005 from Daniel Conti, a Gerbro employee, to Ms. Gut.[34]

[36] The fund is set up as a master-feeder structure, where Raptor is an offshore feeder fund for Raptor Global Portfolio Ltd (**Global**), the master fund.[35] Global was the legal entity that traded in all of the assets, however, its objectives were

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29 Statement of Agreed Facts (Partial), at paragraph 137.
30 Transcript, vol. 1, page 151, lines 10 to 14.
31 *Ibid.*, pages 118 and 119.
32 Statement of Agreed Facts (Partial), at paragraph 48.
33 Transcript, vol. 1, pages 118-119.
34 Exhibit A-25.
35 Statement of Agreed Facts (Partial), at paragraph 22.

aligned with those of Raptor. James Pallotta offered investment advice to Global through the Tudor Investment Corporation, a Delaware company.[36] The Raptor Global Fund Limited Partnership (**Raptor LP**) was the onshore feeder fund for Global.[37]

[37] Subject to limited exceptions, anyone with ties to the United States, whether an individual or a corporation, was excluded from holding shares in the Raptor feeder fund.[38] Instead, such persons could have been invited to invest in the onshore Raptor LP.

2.1.4.3 Arden

[38] Arden was managed by Averell H. Mortimer and was a fund of funds. Mr. Mortimer provided advice through Arden Asset Management Inc., a company incorporated under the laws of New York of which he was the president.

[39] This investment fell within Gerbro's non-directional hedge fund asset class, that is, its focus was on finding investments with low correlation to equity financial markets. To achieve this low correlation, Arden invested in other hedge funds that traded in, among other things, securities, fixed-income instruments, derivatives on the fixed-income instruments, commodity futures, options on futures, securities of companies undergoing extraordinary corporate transactions and securities of companies in difficulty.[39]

[40] Gerbro's only stated reason for investing in Arden was Averell H. Mortimer's ability to achieve market-neutral returns which introduced diversification into, and reduced volatility in, Gerbro's portfolio. According to Ms. Gut, adding Arden to its portfolio would significantly reduce the portfolio's volatility.[40] This statement was supported with statistical analyses that Gerbro conducted in 2005.[41] The investment was thus expected to contribute to achieving Gerbro's target volatility of 10%.

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36 *Ibid.*, at paragraph 24.

37 Raptor's Offering Memorandum, Exhibit A-1, Tabs 3, 5 and 6.

38 Statement of Agreed Facts (Partial), at paragraph 57.

39 *Ibid.*, at paragraphs 87 and 88 and Arden Private Placement Memorandum, Exhibit A-1, Tabs 7 and 8.

40 Transcript, vol. 1, pages 134 to 140.

41 Exhibit A-12, Tab 5; see also presentation by Arden to Gerbro, May 4, 2005, Exhibit A-29.

[41] On December 1, 2005, in response to the proposed FIE Rules, Gerbro entered into a year-end transaction whereby it sold all of its Arden shares to its wholly-owned subsidiary Woodrock Canada Inc. (**Woodrock**) by way of a reduction of capital.[42] The purpose of this transaction was to efficiently comply with the proposed FIE Rules. Selling the Arden shares to Woodrock allowed Gerbro to remain exposed to Arden while optimizing its Canadian tax structure in light of the FIE Rules.[43] This year-end transaction triggered a capital gain of $523,689 in Gerbro's 2005 fiscal year.[44]

2.1.4.4 Kingdon

[42] Gerbro made its first investment in Kingdon in 1994, and did so because of the reputation and performance of its manager, Mark Kingdon. Gerbro's management team was impressed with Mark Kingdon's credibility and integrity.

[43] The investment in Kingdon fell within Gerbro's directional hedge fund asset class.

[44] In 2005, Kingdon was structured as a stand-alone fund and received investment advice from Kingdon Capital Management LLC, a Delaware company.[45] Kingdon used an internally developed asset allocation model to allocate its assets primarily among investments in common stock and bonds.[46]

[45] On December 1, 2005, Gerbro entered into a year-end transaction whereby it sold all of its shares of Kingdon to Woodrock by way of a reduction of capital in response to the proposed FIE Rules.[47] This year-end transaction triggered a capital gain of $1,769,977 in Gerbro's 2005 fiscal year.[48]

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42 Statement of Agreed Facts (Partial), paragraph 104.

43 In retrospect, and considering that the FIE Rules were never adopted, this year-end transaction may have resulted in inefficient tax planning. Unlike what it had done with respect to Caxton and Raptor, amending its tax return to remove amounts included in net income under the proposed FIE Rules, Gerbro could not retroactively undo the year-end transaction.

44 Gerbro's T2 Corporation Income Tax Return, Summary of Dispositions of Capital Properties, December 31, 2005, Exhibit A-28.

45 Statement of Agreed Facts (Partial), at paragraphs 106 and 107.

46 *Ibid.*, paragraphs 117-118.

47 *Ibid.*, paragraph 134; transcript, vol. 1, pages 132-133.

48 Gerbro's T2 Corporation Income Tax Return, Summary of Dispositions of Capital Properties, December 31, 2005, Exhibit A-28.

2.1.4.5 Caxton

[46] In 2006, when given the opportunity to subscribe for shares in Caxton, Gerbro invested because of Caxton's performance and the fund's low correlation with other investments in Gerbro's portfolio. The low correlation was due to the fact that Caxton traded primarily in commodities and that commodities had low correlation with equity markets. Gerbro attributed Caxton's success to its manager Bruce Kovner. [49]

[47] The fund was set up as part of a master-feeder structure in which Caxton was an offshore feeder fund for Caxton International Limited (**Caxton Limited**), the master fund.[50] Caxton Limited was a subsidiary of Caxton, and was the legal entity that purchased, held and sold all of the assets. Its objectives were aligned with those of Caxton. Bruce Kovner offered investment advice to Caxton Limited through Caxton Associates LLC, a Delaware company. Caxton Global Investments (USA) LLC was the onshore feeder fund for Caxton Limited.[51]

2.1.5 Calculation of Part I Tax Otherwise Payable in the Auditor's Report

[48] Gerbro submits that, in the auditor's report, Mr. Joseph Armanious incorrectly calculated tax that would otherwise have been payable if Gerbro had held the Funds' investments directly. The auditor did not have an exhaustive list of the trades with the adjusted cost base and proceeds of disposition for each asset, nor did he have any information about the timing of the dispositions during the year. To make up for the lack of information, the auditor calculated the taxes otherwise payable using information available in the Funds' financial statements. He looked at the total amount of realized gains in the year for each of the Funds, which were expressed in United States dollars, regardless of when the gains were realized during the year. He pursued his calculation by converting the realized gains appearing on the financial statements into Canadian dollar gains using the Bank of Canada average exchange rate for each fiscal year. Finally, the auditor multiplied the converted Canadian dollar gain by Gerbro's tax rate for the Relevant Period to obtain the amount of taxes otherwise payable with respect to each Fund.[52] The auditor compared these amounts with the negligible amount of tax each Fund paid offshore and arrived at the conclusion that the Funds paid significantly less

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49 Transcript, vol. 1, pages 144-145.

50 Statement of Agreed Facts (Partial), at paragraph 174.

51 *Ibid.*, at paragraph 176, and Caxton's offering memorandum, Exhibit A-1, Tab 13.

52 Gerbro's tax rate was calculated to be 35.79%.

tax than would have been payable if Gerbro had held the Funds' investments directly. Joseph Armanious, the auditor for the CRA, testified at trial that this was the process he followed.

[49] The Appellant vigorously defends the position that the calculation of Canadian income taxes otherwise payable contained in the auditor's report is flawed. In that regard, the Appellant emphasizes that the auditor's calculation was legally inaccurate since it is at odds with the recognized method set out in *Gaynor (H.R.) v. M.N.R.*[53]

[50] Gerbro further argues that the practical impossibility, due to the nature of investments in hedge funds, of calculating the amount of tax otherwise payable points up the fact that this factor should not be given a great deal of weight in inferring an intention to avoid or defer taxes. As previously explained, hedge funds, in order to maintain their competitive advantage, do not disclose the nature and timing of specific trades.

2.2 Facts Added by the Respondent

[51] The Respondent added the fact that Gerbro's directors were knowledgeable about tax matters, given their professional backgrounds, and therefore could not have been unaware of the significant tax benefits associated with investing in the Funds when they approved them. Ms. Gut and David G. Broadhurst held a chartered accountant's professional designation, while Samuel Minzberg and Hillel W. Rosen were lawyers with a leading law firm. Of these lawyers, the former had a practice in taxation and the latter in mergers and acquisitions.[54]

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53 [1991] 1 C.T.C. 470 (FCA). That case settled the issue of the proper calculation, pursuant to paragraph 40(1)(*a*) of the ITA, of a capital gain on foreign securities purchased in foreign currency. It was determined that the cost of the securities had to be expressed in Canadian currency at the exchange rate prevailing at the time of their acquisition while the valuation of the proceeds of disposition of the same securities had to be made in Canadian currency at the rate of exchange prevailing at the time of the disposition. Subsection 261(2) of the ITA has since been adopted; it imposes a statutory obligation upon taxpayers to compute their Canadian tax results in Canadian currency. Specifically, the foreign currency amount must be converted to Canadian currency using a stipulated rate of exchange on the date that the foreign currency amount first arose. (See *The Queen v. Agnico-Eagle Mines Limited*, 2016 FCA 130, at paragraphs 71-73.)

54 Curricula vitae of the members of Gerbro's board of directors (Exhibit R-1).

[52] Moreover, the Respondent lists numerous documents that allegedly prove that Gerbro always considered the reduction or avoidance of tax when investing in hedge funds, which involved discussions about the efficient reallocation of assets from one manager to another in segregated accounts, tax-motivated transactions to respond to the FIE Rules or judgments on the tax efficiency of existing or potential investments.[55]

[53] She adds that the "one of the main reasons" test is applied not only to the reasons for investing at the moment at which the investment is made, but also to the reasons for continuing to hold the investment in the non-resident entity.

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[55] See memorandum from Nadine Gut to Gerbro's Investment Committee dated April 15, 2003 (Exhibit R-8), from which can be seen that Gerbro considered the tax consequences of redeeming its investment in the Peregrine portfolio, a segregated investment account held with John Dale; memorandum from Rodrigue Babin, a Gerbro employee, to the Investment Committee, dated February 14, 2002 (Exhibit R-9), explaining that investing in a fund of funds was less burdensome under the proposed FIE Rules; memorandum from Rodrigue Babin to the Investment Committee, dated October 22, 2003 (Exhibit R-12), expressing reservations about investing with Walter Scott, an independent investment manager, in a British Virgin Islands (**BVI**) pooled fund due to the new FIE Rules; memorandum from Nadine Gut to the Investment Committee, dated February 20, 2003 (Exhibit R-13), in which it is stated that the board favoured the reallocation of assets with the caveat that the reallocation be done in a tax-efficient manner; memorandum from Ms. Gut to the Investment Committee, dated June 19, 2003 (Exhibit R-16), laying out the three options for optimizing Gerbro's after-tax return under the proposed FIE Rules; memorandum from Rodrigue Babin to the Investment Committee, dated October 22, 2003 (Exhibit R-17), in which a preference is stated for the year-end transaction option to mitigate the effect of the proposed FIE Rules, as opposed to the synthetic exposure option; memorandum from Ms. Gut to board members, dated October 20, 2003 (Exhibit R-18), providing a description of transactions to be undertaken in response to the proposed FIE Rules and indicating that the transactions needed to be reviewed by Gerbro's tax advisors; memorandum from Ms. Gut to the Investment Committee, dated December 8, 2004 (Exhibit R-19), in which year-end transactions relating to Gerbro's investment in Kingdon and Arden are summarily discussed; memorandum from Ms. Gut to the Investment Committee, dated November 6, 2006 (Exhibit R-20), in which reference is made to a year-end transaction that was supposed to take place in 2006, but was never implemented as the proposed FIE Rules were not going to come into force; memorandum from Daniel Conti, a Gerbro employee, to Ms. Gut, dated October 19, 2004 (Exhibit R-25), containing a statement that Maple Key Plus, in which Gerbro was contemplating an investment, was a "tax efficient fund".

[54] In addition, the Respondent points to the Funds' policy of reinvesting income rather than making distributions to its shareholders as an indicator that the managers of the Funds considered the Canadian tax aspect.[56]

[55] The Respondent also criticizes Gerbro for having called only Ms. Gut to testify regarding Gerbro's main reasons for investing in the Funds, rather than calling other employees to corroborate Ms. Gut's version. She asks the Court to draw a negative inference from this.

[56] On the topic of equivalent Canadian investments, the Respondent rejects Gerbro's assertion that they did not limit their search for hedge funds to United States hedge funds, as well as the broader assertion that there were no comparable Canadian hedge funds with equivalent characteristics to those of the Funds.

[57] While the Appellant called Mr. Luis Seco to testify as to the accuracy of that opinion, the Respondent urges the Court to discard his expert report. The reason put forward is that the report is non-compliant with the Code of Conduct for Expert Witnesses, Schedule III to the *Tax Court of Canada Rules* (*General Procedure*).

[58] As regards the qualification of the Funds' investments as portfolio investments in listed assets, the Respondent summarized, to the extent of her understanding, the type of investments each Fund primarily derived its value from. On the assumption that the term “portfolio investments” is more encompassing than the type of passive investments that would trigger the foreign accrual property income (**FAPI)** rules, the respondent asks that the Court conclude that the Funds derived their value primarily from portfolio investments in listed assets.

[59] Finally, the Respondent brought it to the Court's attention that, when Gerbro communicated in writing with the CRA in response to certain requests for information during the audit stage, Gerbro referred to the nature of the investment in each of the Funds as being “[a]sset appreciation through portfolio investments”.[57] In cross-examination Ms. Gut stated that Gerbro's characterization likely mirrored words used in the Funds' offering memoranda and that she understood “portfolio investment” to mean a group of investments.[58]

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56 Respondent's Written Submissions, at paragraph 25.

57 Exhibit R-27.

58 Transcript, vol. 2, page 112, line 25 to page 114, line 13.

3 APPLICABLE LAW

[60] Section 94.1 of the ITA is the applicable provision in the case at bar, and it reads as follows:

> **94.1(1)** If in a taxation year a taxpayer holds or has an interest in property (referred to in this section as an "offshore investment fund property")
>
> (*a*) that is a share of the capital stock of, an interest in, or a debt of, a non-resident entity (other than a controlled foreign affiliate of the taxpayer or a prescribed non-resident entity) or an interest in or a right or option to acquire such a share, interest or debt, and
>
> (*b*) that may reasonably be considered to derive its value, directly or indirectly, primarily from portfolio investments of that or any other non-resident entity in
>
> (i) shares of the capital stock of one or more corporations,
>
> (ii) indebtedness or annuities,
>
> (iii) interests in one or more corporations, trusts, partnerships, organizations, funds or entities,
>
> (iv) commodities,
>
> (v) real estate,
>
> (vi) Canadian or foreign resource properties,
>
> (vii) currency of a country other than Canada,
>
> (viii) rights or options to acquire or dispose of any of the foregoing, or
>
> (ix) any combination of the foregoing,
>
> and it may reasonably be concluded, having regard to all the circumstances, including
>
> (*c*) the nature, organization and operation of any non-resident entity and the form of, and the terms and conditions governing, the taxpayer's interest in, or connection with, any non-resident entity,
>
> (*d*) the extent to which any income, profits and gains that may reasonably be considered to be earned or accrued, whether directly or indirectly, for the benefit of any non-resident entity are subject to an income or profits tax that is

> significantly less than the income tax that would be applicable to such income, profits and gains if they were earned directly by the taxpayer, and
>
> (*e*) the extent to which the income, profits and gains of any non-resident entity for any fiscal period are distributed in that or the immediately following fiscal period,
>
> that one of the main reasons for the taxpayer acquiring, holding or having the interest in such property was to derive a benefit from portfolio investments in assets described in any of subparagraphs 94.1(1)(*b*)(i) to 94.1(1)(*b*)(ix) in such a manner that the taxes, if any, on the income, profits and gains from such assets for any particular year are significantly less than the tax that would have been applicable under this Part if the income, profits and gains had been earned directly by the taxpayer, there shall be included in computing the taxpayer's income for the year the amount, if any, by which
>
> (*f*) the total of all amounts each of which is the product obtained when
>
> (i) the designated cost to the taxpayer of the offshore investment fund property at the end of a month in the year
>
> is multiplied by
>
> (ii) 1/12 of the total of
>
> (A) the prescribed rate of interest for the period that includes that month, and
>
> (B) two per cent
>
> exceeds
>
> (*g*) the taxpayer's income for the year (other than a capital gain) from the offshore investment fund property determined without reference to this subsection.

4 ISSUES

[61] The first issue in this appeal is whether the Funds derived their value, either directly or indirectly, primarily from "portfolio investments" in listed assets (**Value Test**). To answer this question the Court will define the term portfolio investment and then determine if the Funds primarily derived their value from such investments. If they did, the Court will ascertain whether the portfolio investments are investments in assets listed in subparagraphs 94.1(1)(*b*)(i) to (ix).

[62] The second issue is whether it may reasonably be concluded, having regard to all the circumstances, including those mentioned in paragraphs 94.1(1)(*c*) to (*e*), that one of Gerbro's main reasons for investing in the Funds was to pay less tax than would have been payable under Part I of the ITA if the portfolio investment had been held directly (**Motive Test**).

[63] In its Amended Notice of Appeal, the Appellant disagreed as to the calculation of the imputed income in the event that the Court should conclude that both the Value Test and the Motive Test have been met. However, this question was not argued before me in either the written submissions or in open court. I therefore conclude that this last point is no longer at issue.

[64] Before dissecting each issue, I will first address the question of the burden of proof with respect to the respondent's assumptions of mixed fact and law. I will then give an overview of the foreign affiliate regime, section 94.1 and the proposed FIE Rules, which were never adopted.

5 ANALYSIS

5.1 Preliminary Remarks: Respondent's Assumptions of Mixed Fact and Law

[65] It is trite law that in tax appeals a taxpayer has the onus of proving on a balance of probabilities that the Minister's assumptions of fact are not true, and that, absent such evidence, the assumptions will stand.[59]

[66] The assumptions of fact must be "precise and accurate so that the taxpayer knows exactly the case it has to meet": *Anchor Pointe Energy Ltd. v. Canada*, 2003 FCA 294, [2003] F.C.J. No. 1045 (QL), at paragraph 23.

[67] Assumptions of law or mixed fact and law are not binding on this Court, regardless of the fact that they could have or should have been stricken from the pleadings. To hold otherwise would be to divest this Court of its power to rule on questions of law. In *Kopstein et al. v. The Queen*, 2010 TCC 448, 2010 DTC 1307, Justice Jorré, ruling on a motion to strike, enunciated this proposition in the following way:

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[59] *Johnston v. Minister of National Revenue*, [1948] S.C.R. 486; *Canada v. Loewen*, 2004 FCA 146, [2004] 4 F.C.R. 3, at paragraphs 7-8; *Vine v. Canada*, 2015 FCA 125, [2015] 4 F.C.R. 698, at paragraph 25.

> [67] In assessing whether it is appropriate to strike a paragraph of a pleading one must bear in mind the practical effect of the paragraph.
>
> [68] In this context one must bear in mind that an invalid or irrelevant assumption does not cast an onus upon an appellant just because it was pleaded. For example, if on discovery it turns out that an assumption was never made then there is no onus on the appellant to disprove it; if the respondent wishes to rely on that particular fact, the respondent will have to prove it. Similarly, if what is pleaded as an assumption of fact is simply a conclusion of law and no underlying facts for that conclusion of law have been assumed elsewhere then there is no obligation on an appellant to disprove that.

[68] Furthermore, this Court should not be required to extract the factual components from assumptions of mixed fact and law when these assumptions are incorrectly pleaded. See *Anchor Pointe*, *supra*, at paragraph 27. Properly pleading assumptions of fact is incumbent on the Respondent when drafting her reply.

[69] By order dated May 27, 2014 in the present appeals, (*Gerbro Inc. v. R.*, 2014 TCC 179, [2014] 6 C.T.C. 2010), Woods J. denied the Appellant's motion to strike the assumptions in paragraphs 19 (ff), (zz), (ttt) and (pppp) of the Reply in respect of the 2005 taxation year, and paragraphs 14.35, 14.73 and 14.94 in the Reply in respect of the 2006 taxation year.[60] It is clear from her reasons for order that she denied the motion because of the "fresh step" rule, in section 8 of the *Tax Court of Canada Rules* (*General Procedure*). In disallowing Gerbro's motion to strike, Justice Woods enforced the policy behind the "fresh step" rule, which is to ensure that the appeal process moves forward, and not backwards as that would risk unduly prolonging the appeal process. Allowing the motion to strike would have resulted in the Crown being granted leave to amend its reply to extract the factual assumptions underlying its assumption of mixed fact and law, and that in turn would have necessitated further discovery.

[70] Justice Woods did not make any legal findings as to the effect of the inappropriate assumptions at trial. She noted that the strategy of Gerbro's counsel of waiting to bring the motion to strike might have worked against Gerbro, since it was now barred from having the assumptions struck. This does not address the matter of the effect of those assumptions at trial, which, according to *Kopstein*,

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[60] Those paragraphs state that one of the Appellant's main reasons for acquiring and holding an interest in the Funds was to derive a benefit from portfolio investments, directly or indirectly, in such a manner as to reduce or defer Canadian taxes that would otherwise have been applicable had the Appellant earned directly the income generated from the underlying assets of the Funds.

should not have the effect of placing the onus on Gerbro. As a matter of fact, Justice Woods stated, at paragraph 31 of her order, that "[i]f it were not for the potential application of the fresh step rule, the purpose test assumptions should be struck out with leave to amend to extricate the factual elements."

[71] The Supreme Court in *Canada (Director of Investigation and Research) v. Southam Inc.*, [1997] 1 S.C.R. 748 distinguished questions of mixed law and fact from purely factual or legal questions with the following example:

> 35. . . . Briefly stated, questions of law are questions about what the correct legal test is; questions of fact are questions about what actually took place between the parties; and questions of mixed law and fact are questions about whether the facts satisfy the legal tests. A simple example will illustrate these concepts. In the law of tort, the question what "negligence" means is a question of law. The question whether the defendant did this or that is a question of fact. And, once it has been decided that the applicable standard is one of negligence, the question whether the defendant satisfied the appropriate standard of care is a question of mixed law and fact. I recognize, however, that the distinction between law on the one hand and mixed law and fact on the other is difficult. On occasion, what appears to be mixed law and fact turns out to be law or *vice versa*.
>
> [Emphasis added.]

[72] Thus, it can be concluded that the assumptions in paragraphs 19 (ff), (zz), (ttt), and (pppp) of the 2005 reply are assumptions of mixed fact and law. The same is true for the assumptions in paragraphs 14.35, 14.73 and 14.94 of the 2006 reply. Justice Woods pointed out the existence of at least two legal questions in the Minister's assumptions, namely: "What is a portfolio investment?" and "When do tax considerations satisfy the purpose test?" (*Gerbro*, *supra*, at paragraph 30.) I agree.

[73] The Respondent must now cope with assumptions of mixed fact and law in her reply that are for all intents and purposes ineffective in placing on the Appellant the burden of proving that its investments in the Funds were portfolio investments or that the Motive Test was met. Given the analysis below, the ineffective assumptions are of no consequence.

5.2 The Mischief the OIFP Rules Sought to Resolve

5.2.1 Historical and Statutory Overview of the Foreign Affiliate Regime

[74] The foreign affiliate rules in Division B, subdivision i of Part I of the ITA existed for over a decade before the OIFP Rules were enacted in 1984.[61] Since their inception in 1972, the foreign affiliate rules have been modified substantially over the years, both before and after the OIFP Rules were enacted.

[75] In brief, the foreign affiliate regime is made up of two components. Those components are the current inclusion of foreign accrual property income of a controlled foreign affiliate (**CFA**) of a taxpayer resident in Canada (subsections 91(1) and 95(1)), and the foreign affiliate dividend regime (**FA dividend regime**), which deals with the taxation of dividends when they are received by Canadian residents from foreign corporations (sections 90 and 113).[62]

[76] The two components produce various tax outcomes on two main axes. Simply put, the taxation outcomes will depend on whether the foreign corporation in which the interest is held is a foreign affiliate or a CFA,[63] and whether the income earned is active or passive. The FAPI rules apply when a controlled foreign affiliate earns FAPI (passive investment income, such as interest, rent, royalties or dividends.) The FA dividend rules apply as long as the foreign corporation is a foreign affiliate, not necessarily controlled by Canadian residents.[64] A CFA, on the other hand, will have to determine, with regard to passive income, if it has FAPI, which will be taxed on an imputation basis. Subsequently, if the CFA pays a dividend it will still be subject to the FA dividend regime.

[77] A first observation is that a Canadian taxpayer stands to benefit through income deferral from an investment in a non-controlled foreign affiliate earning passive income, as long as the taxpayer does not receive dividends, the caveat

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61 *An Act to amend the statute law relating to income tax*, S.C. 1974-75-76, c. 26; section 94.1 was enacted by *An Act to amend the Income Tax Act and related statutes*, S.C. 1984, c. 45, s. 30.

62 Jinyan Li, Arthur Cockfield & J. Scott Wilkie, *International Taxation in Canada*, 3rd ed. (Markham, LexisNexis, 2014), at pages 304-305.

63 A foreign affiliate is defined in subsection 95(1) as a non-resident corporation in which the taxpayer has an interest of not less than 10%, taking into account detailed aggregation rules. A CFA generally is a foreign affiliate of a Canadian resident taxpayer who is able to exercise de jure control over the affiliate. The non-resident entity in which an interest is held can be (i) a CFA, which means that it is also a foreign affiliate, (ii) simply a foreign affiliate or (iii) neither a CFA nor a foreign affiliate. According to paragraph 1(a) of section 94.1, that provision can only apply to the two latter categories.

64 Li et al., *supra*, note 62, at pages 305-307.

being that the OIFP Rules do not apply. The Canadian taxpayer will instead be taxed annually on non-distributed FAPI of a CFA. In substance, the ITA will ignore the foreign legal construct in arriving at the net income of the Canadian taxpayer, thereby effectively bringing the income earned by the non-resident corporation into the Canadian tax base.[65]

[78] The Federal Court of Appeal in *Lehigh Cement Ltd. v. Canada*, 2014 FCA 103, [2015] 3 F.C.R. 117, [2014] 4 C.T.C. 107 at paragraph 19, aff'g 2013 TCC 176, [2013] 5 C.T.C. 2010, highlighted the fact that Canadian taxpayers can easily manipulate the tax status of a non-resident corporation they invest in so as to obtain the desired tax savings. In anticipation of this mischief, the foreign affiliate regime includes at paragraph 95(6)(*b*) an anti-avoidance provision which denies the benefit of acquiring or disposing of shares in a non-resident entity when the principal purpose of those actions is to reduce or defer the payment of tax. It should be noted that prior to the facts that arose in the *Lehigh* decision and prior to a technical amendment in 2001, the applicable test was a "one of the main reasons" test rather than a "principal purpose" one.[66] The following passage summarizes the findings of the Court on the manipulation of the tax status of non-resident corporations:

> **19** The "foreign affiliate" status of a non-resident corporation, which is dependent on the non-resident corporation's ownership status, can give rise to tax savings for a Canadian taxpayer because of the ability to claim a deduction offsetting the amount of the dividends included into income. And often the Canadian taxpayer can easily manipulate that status to get those tax savings. For example, it can transform a non-resident corporation into a "foreign affiliate" by acquiring more shares in it. Or it can dispose of shares to avoid the non-resident corporation from becoming a "controlled foreign affiliate." In this context, "taxpayers jockey to get on the right side of the distinctions to take advantage of the rules": Vern Krishna, *The Fundamentals of Canadian Income Tax* (9th ed., 2006) at page 1327.

[79] In *Trans World Oil & Gas Ltd v. Canada*, [1995] 1 C.T.C. 2087 (TCC), aff'd, [1998] 3 C.T.C. 37 (FCA),[67] Judge Bowman, as he then was, held that Trans World U.S. could not deduct the active business losses incurred by it when it was a

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65 *Ibid.*, at pages 310-311.

66 *Income Tax Amendments Act*, 2000, S.C. 2001, c. 17, subs. 73(11)-(13) and (14); S.C. 1995, c. 21, subs. 46(7).

67 The FCA did not provide reasons for its unanimous decision. It affirmed the decision of Judge Bowman without hearing any argument from the Respondent as the Federal Court of Appeal Justices were not convinced that there was a reviewable error.

CFA of the Appellant's majority shareholder, Mr. Phillips, against the FAPI it generated in subsequent years when it was a CFA of the Appellant corporation, Trans World Oil & Gas Ltd. In passing Judge Bowman summarized the objective of the FAPI regime as follows:

> **. . .** The object behind the FAPI rules was to discourage Canadians from parking investments in offshore companies (usually tax havens), or, if they did, at least to require them to pay taxes currently on the income so generated. . . .

[80] The decision of the Federal Court of Canada – Trial Division in *Canada Trustco Mortgage Co. v. Minister of National Revenue*, [1999] 2 C.T.C. 308, aff'g [1991] 2 C.T.C. 2728 (TCC) reiterated the purpose of FAPI and the elementary fact that the FAPI regime does not capture income from an active business. In 1995, amendments were adopted to carve out investment business income from active business income, which amendments were not applicable when the facts of that case occurred.[68] That decision is important as it was the first time that the courts were called upon to explore the meaning of "active business" in respect of FAPI.[69] The following passages are relevant:

> **18** Under the Act provision is made, in relation to the computation of income, in Division B, concerning Computation of Income, Subdivision i, concerning Shareholders of corporations not resident in Canada, for certain income to be included as income of a Canadian shareholder. Within that subdivision, ss. 90 and 91 provide that income of a Canadian taxpayer is to include certain amounts in respect of dividends received or other payments on behalf of shares held in a corporation not resident in Canada. Other sections deal with aspects of the earnings from foreign corporations, and s. 95 deals with "foreign accrual property income", here called "FAPI". The statutory provisions are complex, but it is agreed, and it is clear, that FAPI as provided for in that section, for the years in question, did not include income from an active business. . . .
>
> . . .
>
> **25** At the relevant time there was no definition of "active business" as that term is used in paragraph 95(1)(*b*). It has since been defined for purposes of FAPI by amendment of the Act in 1995, following the decision of the Tax Court in this case. That amendment expressly excluded from "active business" of a controlled foreign affiliate an "investment business carried on by the affiliate...". Thus the amendment would appear to exclude the income in issue here from income gained

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68 *An Act to Amend the Income Tax Act, the Income Tax Application Rules and Related Acts*, S.C. 1995, c. 21, subs. 46(3).

69 The meaning of active business was also at issue in *Alexander Cole Ltd. v. M.N.R.*, [1990] 2 C.T.C. 2437 (TCC).

> from an active business. From the amendment it seems the income here in question would now be FAPI. That amendment has no application in this case.
>
> [Emphasis added.]

[81] Parliament enacted section 94.1 in 1984 to fill the void caused by the fact that only a direct interest in a CFA could give rise to an imputation of FAPI. As indicated in paragraph (1)(*a*) of section 94.1, the OIFP Rules apply only to an interest in a non-resident entity other than a CFA or a prescribed non-resident entity.

5.2.2 Historical Overview of OIFP and FIE Rules

[82] The enactment of section 94.1 of the ITA in 1984 was Parliament's reaction to the marketing to the Canadian population at large of interest roll-up funds, which avoided FAPI.[70] However, it is contentious whether the OIFP Rules capture only the types of income that would be considered FAPI if the non-resident entity in which the interest was held was a CFA[71] or whether they can apply to other types of income (including active income).[72]

[83] Reportedly as early as the beginning of the 1980s, brokers started selling to Canadian taxpayers investments in interest roll-up funds the sole purpose of which was to help Canadian taxpayers minimize their tax liability on returns from risk-free investments in government bonds.[73] The schemes were variations of the

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70 Private offshore "interest roll-up" funds had been created to permit Canadian investors to earn passive income so that the FAPI Rules would not attribute the income to them and the ultimate realization of the investment would give rise to a capital gain: J.D. Bradley, "Taxation of Offshore Investment Funds" in *Report of Proceedings of the Fortieth Tax Conference*, 1988 Conference Report (Toronto: Canadian Tax Foundation, 1989), 46:1-22 at 46:1-2; Robert G Witterick, "Securities Lending, Offshore Funds, and Defeasances", *Report of Proceedings of the Thirty-Sixth Tax Conference*, 1984 Conference Report (Toronto: Canadian Tax Foundation, 1984), 618-60 at 652; Heather Kerr, Ken McKenzie & Jack Mintz eds., *Tax Policy in Canada* (Toronto: Canadian Tax Foundation, 2012), at page 12:15.

71 Written Representations of the Appellant, at paragraphs 17a. and 111; John G. Lorito and Dean Allan Kraus, "The Proposed Foreign Investment Entity Rules", *Report of the Proceedings of the Fifty-Second Tax Conference*, 2000 Conference Report (Toronto: Canadian Tax Foundation, 2001), 32:1-87.

72 Respondent's Written Submissions, at paragraphs 38 and 158.

73 Robert B. Goodwin, "Canadian Real Estate Funds and Offshore Mutual Funds", *Report of Proceedings of the Thirty-Fifth Tax Conference*, 1983 Conference Report (Toronto: Canadian Tax Foundation, 1984), 231-253.

following scheme: promoters would set up in known tax havens a mutual fund which invested exclusively in government of Canada bonds or similar assets. The reason for investing in government bonds was that interest routinely paid to the offshore mutual fund was exempted from Canadian withholding tax.[74] In addition, the brokers marketed the mutual funds in such a way that Canadian investors would not be subject to FAPI. Successfully avoiding the FAPI regime meant that the yearly interest income could accrue tax-free within the offshore mutual fund. Canadian taxpayers therefore obtained a tax deferral benefit and would only be taxed upon the disposition of their mutual fund interest many years later. More often than not, the disposition of the mutual fund interest gave rise to capital gains.

[84] After the coming into force of section 94.1 in 1984, there was general consensus that the OIFP Rules ended the spread of interest roll-up funds.

[85] To remedy the continued use of offshore investment funds to defer Canadian taxes, Parliament proposed the first iteration of the FIE Rules in 1999 following the publication of the *Report of the Technical Committee on Business Taxation*.[75] The critics of the existing section 94.1 pointed to the lack of information about taxpayers' offshore arrangements, difficulty in establishing the requisite intent, and an arbitrary mechanism for imputing income.[76]

[86] After a long process of revisions and public consultations, the proposed FIE rules were ultimately never adopted.[77] As a result of the abandonment of the

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74 Such interest was not subject to withholding tax because of clause 212(1)(*b*)(ii)(B), as it then read.

75 *Report of the Technical Committee on Business Taxation* (Ottawa: Department of Finance, December 1997), chapter 6.

76 Lorito and Krauss, supra, note 71 at 32:6-7; the imputation mechanism can even be penalizing when the gains imputed at the prescribed rate overestimate the actual rate of return of the investment, since any capital loss resulting from the sale of the shares at a later date would only partially offset the over-imputation.

77 The proposed amendments were issued in six iterations, followed by two bills which never saw the light of day. Bill C-33 was tabled in the House of Commons on November 22, 2006, and died on the Order Paper upon prorogation of Parliament. It was later reintroduced in Parliament as Bill C-10 on October 29, 2007. Although the House of Commons adopted it, the Senate never did. The latter referred the bill to the Standing Senate Committee on Banking, Trade and Commerce instead, and eventually it was abandoned; see Written Representations of the Appellant, paragraphs 147 to 161, which refer to Canada, Department of Finance, *Legislative Proposals and Explanatory Notes on Taxation of Non-Resident Trusts and Foreign Investment Entities* (Ottawa: Department of Finance, June 2000); Canada, Department of Finance, *Notice of Ways and Means Motion*

FIE Rules, the ITA reverted to the long-forgotten OIFP Rules. It is worth noting that the OIFP Rules were enhanced through various measures shortly after the abandonment of the FIE Rules.[78]

[87] Section 94.1 has been examined but once, in *Walton v. The Queen*, 98 DTC 1780 (TCC).

5.3 Defining Portfolio Investments

[88] The breadth of the OIFP Rules and their relationship to the foreign affiliate regime will be determined largely by the meaning that is attributed to the expression "portfolio investment". Absent a definition in the ITA, the meaning to be assigned to this expression must be determined pursuant to a textual, contextual and purposive analysis: *Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54, [2005] 2 S.C.R. 601, at paragraph 10.

5.3.1 The Plain Commercial Meaning of Portfolio Investment in an International Investment Context

[89] The use of the word portfolio to qualify the term investment implies that the meaning of portfolio investment must be distinct from that of the term investment without that qualifier, that much is clear. On this premise, investments in assets listed in subparagraphs 94.1(1)(*b*)(i) to (ix), which include shares and bonds, do not automatically constitute portfolio investments. The Value Test, which involves determining if the non-resident entity derives its value primarily from portfolio investments in listed assets, is a two-step test. Firstly, it must be determined whether the non-resident entity derives its value, either directly or indirectly, primarily from portfolio investments. Upon a finding that it does not, the OIFP

To Introduce an Act to amend the Income Tax Act, including amendments in relation to foreign investment entities and non-resident trusts, and to provide for the bijural expression of the provisions of that Act, November 2006; Canada, Bill C-33, *An Act to amend the Income Tax Act, including amendments in relation to foreign investment entities and non-resident trusts, and to provide for the bijural expression of the provisions of that Act*, 1st Sess., 39th Parl., 2006; Canada, Bill C-10, An Act to amend the Income Tax Act, including amendments in relation to foreign investment entities and non-resident trusts, and to provide for the bijural expression of the provisions of that Act, 2nd Sess., 39th Parl., 2007 (as passed by the House of Commons 29 October 2007).

78 Those measures included a 2% increase over and above the prescribed rate for the calculation of imputed income each year, an extended reassessment period of three additional years (see subparagraph 152(4)(*b*)(vii)) and yearly reporting obligations (Form T1135).

Rules cannot apply. In the contrary case, it must be determined whether the portfolio investments were made in listed assets.

[90] It is worth noting that the meaning of the more commonly used expression "investment portfolio" should not be identified with that of "portfolio investment" in section 94.1.[79]

[91] The Respondent refers me to the *Black's Law Dictionary* definitions of the words "portfolio" and "investment", which are substantially the same as the definitions appearing in the *Concise Oxford English Dictionary* (12th ed.) and *Canadian Oxford Dictionary*. Those individual terms are defined in *Black's Law Dictionary* as follows:

> **portfolio. . . . 1.** The various securities or other investments held by an investor at any given time. An investor will often hold several different types of investments in a portfolio for the purpose of diversifying risk.
>
> **investment. . . .** 1. An expenditure to acquire property or assets to produce revenue; a capital outlay.
>
> . . .
>
> 2. The asset acquired or the sum invested. [80]

[92] Both parties refer me to the definition of "placement de portefeuille", the equivalent expression to portfolio investment in the French version of the ITA, in the *Dictionnaire de la comptabilité et de la gestion financière*.[81] However, the parties disagree as to the interpretation thereof. The definition reads as follows:

> **PORTFOLIO INVESTMENT**
>
> PLACEMENT DE PORTEFEUILLE
>
> *Syn. et var.* VALEUR DE PORTEFEUILLE; TITRE EN PORTEFEUILLE; TITRE IMMOBILISÉ DE L'ACTIVITÉ DE PORTEFEUILLE (*FR*); *TIAP (FR)*

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79 Bradley, *supra*, note 70 at 46:8-9.

80 *Black's Law Dictionary*, 9th ed., sub verbis, "portfolio" and "investment".

81 Respondent's Written Submissions at paragraph 143; Written Representations of the Appellant, at paragraph 125.

> *Finance*. Placement à long terme ne visant pas à créer des liens d'association avec l'entité émettrice des titres en cause.[82]

[93] The definition in the "*Dictionnaire de la comptabilité et de la gestion financière*" is most similar to the since deleted definition found in the CICA Handbook when section 94.1 was enacted. I accept the Respondent's point that the definition in the CICA Handbook serves a different purpose and should not be blindly imported in the section 94.1 context.[83] The purpose of the CICA Handbook is to create an accounting standard for the reporting of long-term investments in financial statements, whereas the purpose of the ITA is to levy tax. The CICA Handbook is a useful reference tool for accountants, but should only be regarded as an interpretative aid in relation to tax legislation: *Canderel Ltd. v. Canada*, [1998] 1 S.C.R. 147 at paragraphs 32-42.

[94] The Respondent further quotes the Moneyterms online definition, which defines "portfolio investments" as an "investment made by investors who are not particularly interested in involvement in the management of a company".[84] (Respondent's Book of Authorities, Tab 43.)

[95] I have come across two other definitions of the term "portfolio investment" as used in the international investment context. The first is the definition of the International Monetary Fund in its 1977 *Balance of Payments Manual* (**Manual**),[85] and the second is from the International Bureau of Fiscal Documentation, *IBFD International Tax Glossary* (**IBFD**).

[96] The Manual defines portfolio investment in a negative sense as an investment other than a foreign direct investment:

> 423. The category for portfolio investment adopted for this Manual covers long-term bonds and corporate equities other than those included in the categories for

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82 Louis Ménard, *Dictionnaire de la comptabilité et de la gestion financière*, 3e ed., (Toronto: Institut Canadien des Comptables Agréés, 2011), *sub verbo* « portfolio investment » (Respondent 's Book of Authorities, Tab 51); the Appellant refers to the 2ed (2004) (Appellant's Book of Authorities, Tab 9).

83 Respondent's Written Submissions, at paragraph 149 and Witterick, *supra*, note 70, at 649.

84 *Moneyterms: investment & finance explained*, online: <moneyterms.co.uk/portfolio-investment/>.

85 International Monetary Fund, *Balance of Payments Manual*, 4th ed. (Washington, DC: International Monetary Fund, 1977), at page 142.

> direct investment and reserves. The definitions of those instruments, which are adapted from the definitions in the United Nations' *A System of National Accounts (SNA)* are as follows . . .

[97] Because portfolio investment is defined in a negative sense, understanding the concept of foreign direct investment is necessary. The Manual defines foreign direct investments as foreign investments that are made with the intention to exercise "significant influence over the operations of the enterprises". This is contrasted with portfolio investments, which are primarily acquired because of the "likelihood of an appreciation in … value".[86] Recognizing the difficulty in classifying property in one or the other category, the Manual provides the following guidance:

> **412.** When foreign ownership is concentrated in the hands of one investor or group of associates, the percentage chosen as providing evidence of direct investment is typically quite low – frequently ranging from 25 per cent down to 10 per cent. Since the previous edition of the Manual was prepared, the apparent tendency has been toward adopting percentages at the lower end of that range. That tendency seems to have developed in growing recognition of the fact that – especially for large corporations of the type that are likely to engage in multinational operations – a small, organized group of stockholders may well have an influence in management that is much more than proportionate to its share in the equity capital.[87]

[98] The IBFD definition also includes thresholds of ownership in classifying an investment as a portfolio investment. The definition reads as follows:

> *Portfolio Investment* (1) Term in fairly common use, typically for a relatively small shareholding in a company, e.g. below 10%, held without regard to the underlying business of the company and its relationship with that of the shareholder. Often used in the context of tax treaties where such shareholdings, in contrast with direct investment, are generally subject to a higher rate of withhold tax. . . .[88]

[99] A last definition, provided by counsel for the Respondent during oral argument, is that of the eminent tax scholar Vern Krishna and reads as follows:

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86 *Ibid.*, at page 137.

87 *Ibid.*, at pages 137-138.

88 *IBFD International Tax Glossary*, 7th ed., *sub verbo* "portfolio investment".

> Portfolio Investments
>
> Debt or equity investments in a corporation that do not provide the investor with substantial ownership or influence in the management of the corporation. Typically, equity ownership of less than 10% of a corporation is considered to be a portfolio investment.[89]

[100] The common thread between the various definitions is that they consider portfolio investments to be investments over which the investor does not exercise significant control, but merely wishes to passively benefit from an appreciation in value.

[101] I therefore find that the ordinary commercial meaning of portfolio investment in the international investment context is an investment in which the investor (non-resident entity) is not able to exercise significant control or influence over the property invested in.

[102] Since the OIFP Rules do not specify thresholds for determining whether or not a non-resident entity is taking a controlling interest, this determination will have to be made on the facts. Taken as a whole, the definitions suggest thresholds ranging from 10% to 25% ownership. However, one should be cognizant of the fact that a small group of well-organized investors could have a controlling interest while having less than 10% ownership, especially in the case of sizeable investments.

[103] A helpful indicator of a controlling interest is that the investments are usually long-term investments acquired at a premium to gain access to some level of control. This suggests that portfolio investments are passive investments that do not entail active management of, or control over, the operations of the underlying investment in any manner whatsoever. Investments that are bought and sold within a short time are more compatible with portfolio investment classification.

[104] The only difficulty with these definitions of portfolio investment is that they are awkward to apply to investments in some of the assets listed in paragraph 94.1(1)(*b*), notably investments in foreign currency. For instance, what is a substantial or controlling interest in foreign currency? The drafting of the OIFP

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89 Vern Krishna, *The Fundamentals of Income Tax Law* (Toronto: Carswell, 2009), in the Respondent's Supplementary Book of Authorities, Tab 6, and transcript, November 16, 2015, at pages 86-87.

Rules is sloppy in this respect, but insufficient on its own for there to be any derogation from the commercial meaning of portfolio investment. This is not particularly problematic, since investments in foreign currency are unlikely to be a primary income-generating source for a bona fide business other than an investment business. The application of the controlling interest test to real estate is even less problematic since a portfolio of wholly owned buildings would not be caught by the definition of portfolio investment.

[105] According to the definition I have accepted, the same investment could be classified differently with respect to different persons. For example, a minority shareholder with a small block of shares may be deriving value from a portfolio investment, whereas another shareholder, who has a controlling interest, will not be.

5.3.2 Contextual Analysis of OIFP Rules Is Inconclusive

[106] The contextual interpretation of "portfolio investment" is inconclusive since it adds nothing more than the fact that there is a link between the OIFP Rules and the foreign affiliate regime.

[107] This being said, the OIFP and FAPI regimes are intertwined. The OIFP Rules only apply when the FAPI regime does not since they suppose that the non-resident entity in which the interest is held is not a CFA.

[108] The regimes are further intertwined since the computation of FAPI as defined in subsection 95(1) requires the inclusion of the amount determined under variable C of the definition, and this involves the application of a look-through rule in certain circumstances in which a CFA is interposed between the Canadian investor and a non-resident entity to which the OIFP Rules would apply.[90]

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[90] Canada Revenue Agency, Interpretation-internal, 2009-034286I7, "Meaning of Portfolio Investment in 94.1(1)(b)", January 10, 2011.

5.3.3. The Policy Behind the OIFP Rules

[109] The purpose of the OIFP Rules is compatible with the ordinary commercial meaning of portfolio investment, as it achieves the objective of capital export neutrality.[91]

[110] While the obvious policy objective in 1984 was to put an end to certain financial arrangements, notably interest roll-up funds, one can also say that section 94.1 was adopted to achieve better capital export neutrality with respect to non-controlling interests in foreign entities. For the purposes of the latter objective, it is appropriate that the OIFP Rules be more extensive than the FAPI rules. This is so because the Canadian resident is not presumed to have acquired its interest in the non-resident entity in order to exercise significant influence over important management decisions. Such an intention would be more compatible with an interest in a foreign entity which falls within the definition of a CFA.

[111] The underlying policy of the OIFP rules is to make Canadian residents subject to income tax on all inherently passive and tax-motivated offshore investments made through non-controlled foreign intermediaries.[92] The objective is to ensure that capital export neutrality is achieved.[93] In theory, capital export neutrality means that the decision of a taxpayer to make investments offshore should be a neutral decision which is not tax-driven. The arguments in favour of capital export neutrality for portfolio investments as a matter of fairness are particularly compelling, and all the more so as the concern about the need for Canadian businesses to maintain competitiveness abroad is less convincing for portfolio investments over which the non-resident entity does not exercise any significant level of influence or control. The oft-cited counter-argument to capital export neutrality is most persuasive for investments in controlled foreign entities that are operating in a free-market environment with other competitors.[94]

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91 Capital export neutrality is achieved when foreign-source income is subject to the same effective rate as Canadian domestic income. (See *Report of the Technical Committee on Business Taxation*, *supra*, note 75, at 6.4.)

92 *Li et al.*, *supra*, note 62, at 359.

93 *Ibid*.

94 Sandra Slaats & Penny Woolford, "The Evolution of the International Tax Rules", (2010), 58 (Supp), Can. Tax. J. 225 at 227; Canada, *Report of the Royal Commission on Taxation*, vol. 4 (Ottawa: Queen's Printer and Controller of Stationery, 1966) at 481; *Kerr et al.*, *supra*, note 69, at 6:5.

[112] Moreover, one cannot overlook the fact that the section 94.1 regime is called the offshore *investment fund property* regime. This is no coincidence, as I find that it confirms the intention of Parliament to achieve better capital export neutrality for non-controlling investments in investment funds.

5.3.4 The OIFP Rules Are Not Merely a Backstop to the FAPI Rules

[113] The Appellant points to statements of the then Minister of Finance, the Honourable Marc Lalonde, to convince the Court that the OIFP Rules were not meant to apply to non-resident entities engaging in a bona fide active business.[95] The Supreme Court of Canada stated in *Doré v. Verdun (City)*, [1997] 2 S.C.R. 862, at paragraph 14, that a Minister's comments could be used to support an interpretation, but cautioned that such comments "are not binding on the courts, and their weight can vary, *inter alia* in light of other factors that may assist in interpreting . . ." Minister Lalonde's statement, while true in most factual circumstances, will prove to be false where the underlying investments of a foreign investment business are nonetheless portfolio investments.

[114] To interpret the OIFP as being a mere backstop to the FAPI rules, as argued for by the Appellant, is problematic. It is problematic from the standpoint of the principles of statutory interpretation since there is an insufficient link between the relevant provisions for the clear commercial meaning of "portfolio investment" to be overridden. I observe with regard to the FAPI and OIFP provisions (i) that they are found in the same subdivision of the ITA and (ii) that one applies when the interest in the non-resident entity does not qualify as a CFA. A major difference, however, is that the FAPI definition refers to, among other things, income from an active business and includes various deeming rules, whereas the OIFP Rules refer to an altogether different term: portfolio investments.

[115] The Appellant's arguments for limiting the application of section 94.1 such that it serves as a backstop to the FAPI rules appear to be contradictory. The Appellant submits that "portfolio investment" should only include investments that could otherwise give rise to FAPI, and then proceeds to state that, due to the imputation mechanism that is based on a prescribed rate, portfolio investments

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95 Budget Papers, "Supplementary Information and Notices of Ways and Means Motions on the Budget" (1984), Department of Finance, tabled in the House of Commons by the Honourable Marc Lalonde, Minister of Finance, February 15, 1984, at page 24; Written Representations of the Appellant at paragraph 106.

should be limited to risk-free investments.[96] The contradiction lies in the fact that the FAPI definition is not limited to risk-free investments; it is circumscribed in a very detailed manner on the basis of active versus passive income. I presume that the Appellant's argument is based on an undue narrowing of the OIFP policy objective of ending the propagation of interest roll-up funds. I am not persuaded by this argument.

[116] Moreover, the architecture of the ITA leads me to conclude that the term portfolio investment can include inventory of an active investment business since actively trading in such inventory does not turn a non-controlling interest into a controlling one.[97] The fact that the investment business uses sophisticated investment instruments or strategies does not alter this conclusion. Neither does the interposing of other corporations or entities to hold these types of investments, since the value of the fund would continue to *indirectly* derive its value from portfolio investments. If Parliament had wanted to exclude inventory of investment businesses it would have used analogous language to that of the foreign affiliate rules prior to the amendments carving out investment businesses. As a matter of fact, there was a recommendation made in 1986 by the Joint Committee on Taxation of the Canadian Bar Association and the Canadian Institute of Chartered Accountants that the Department of Finance clarify the meaning of the phrase "portfolio investments" such that it would "not include property held as inventory, for resale."[98] This recommendation was never adopted. In fact, the concept of "portfolio investments" relates to the different types of property listed in section 94.1, which may very well include property held as inventory of an active investment business. I am of the view that Parliament's choice of words in the OIFP Rules works against the Appellant.

[117] For all these reasons, I find that the FAPI rules and the OIFP Rules have different criteria for their application and that they cannot apply simultaneously. However, the fact that certain types of investments would not generate FAPI does not automatically mean that the OIFP Rules do not apply. To ascertain that neither

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96 Written Representations of the Appellant, at paragraphs 111 and 112.

97 Whether or not the underlying investments of a non-resident entity are held as inventory or capital property will be relevant only to the extent that it enters into the determination of the tax treatment in the foreign jurisdiction.

98 Joint Committee on Taxation of the Canadian Bar Association and the Canadian Institute of Chartered Accountants, "Recommendations on the Income Tax Act, 1986" at A-5, pages VIII-4 to VIII-5 (Appellant's Book of Authorities, Tab 8). See also Written Representations of the Appellant, paragraph 121.

regime applies, one must conduct two distinct analyses, taking into account the characteristics of each regime.

5.4 The Funds Derived Their Value Primarily From Portfolio Investments in Listed Assets

[118] After reviewing the facts of the case, I find on balance that the Funds derived their value primarily from portfolio investments and that, absent evidence to the contrary, those investments were made primarily in listed assets.

[119] The Funds need only *primarily* derive their value from portfolio investments. This means that holding a minimal amount of controlling interests that are not portfolio investments or that are portfolio investments in non-listed assets is insufficient to result in the Value Test not being met.

[120] The case law has interpreted "primarily" to mean "most important" in the context of the ITA: *Will-Kare Paving & Contracting Ltd. v. R.*, [2000] 3 C.T.C. 200 (FCA), at paragraph 8, aff'd [2000] 1 S.C.R. 915. This meaning should be imported into the OIFP Rules, which would mean that the Funds must derive more than 50% of their value from portfolio investments. The reason for importing the meaning of "primarily" from *Will-Kare*, *supra* (which dealt with the definition of "qualified property" in subsection 127(9) of the ITA for the purpose of the investment tax credit in subsection 127(5)), is that the same words are presumed to have the same meaning throughout a statute: *R. v. Zeolkowski*, [1989] 1 S.C.R. 1378, at 1387; Ruth Sullivan, *Sullivan on the Construction of Statutes*, 6th ed. (Markham Ont.: LexisNexis, 2014), at pages 217 to 218.

[121] Even though the Respondent cannot rely on her assumptions, as drafted, that the Funds derived their value primarily from portfolio investments in listed assets, the evidence before me has convinced me on balance that such was the case. While most of the evidence adduced at trial pertained to the Motive Test, the Statement of Agreed Facts (Partial) and the offering memoranda for the Funds (Exhibit A-1, Tabs 3 and 5 to 13) assist me in this finding.

[122] According to that evidence, the Funds did not take controlling interests with a view to exercising significant influence or control over the operations of the companies or entities they invested in, the investments being, to a large extent, in publicly traded securities or commodities. The investments the Funds acquired, either directly or indirectly, were made strictly with a view to capital appreciation, which is more compatible with a portfolio investment classification.

[123] A brief overview of each Fund's strategy demonstrates this. Raptor and Kingdon invested predominantly in equities and related derivatives. Caxton on the other hand, invested heavily in commodities and currencies. Finally, Arden and Haussmann invested in non-controlling interests in other hedge funds to obtain diversification benefits. The Funds were investment businesses and their investments fall squarely into the portfolio investment classification.

[124] I come to the same conclusion on the second aspect of the Value Test, which consists in determining whether the portfolio investments were made in assets listed in subparagraphs 94.1(1)(*b*)(i) to (ix). Shares, debt, options and currencies are explicitly mentioned therein. Futures or warrants fall under the catch-all subparagraph 94.1(1)(*b*)(viii) that lists "rights or options to acquire or dispose of any of the foregoing". The only investments that might not fit snugly into these categories are cash-settled derivatives, such as swaps or contracts for differences, if they are not directly or indirectly linked to the other listed assets.

[125] According to the tax literature, hedge funds make use of swaps and other derivatives for various purposes. Even though hedge funds seem to make extensive use of such derivatives, there is evidence before me to establish that such instruments were not primary income-generating sources for the Funds.[99] The offering memoranda state that the amount actually invested in such assets was minimal. On the evidence provided, I conclude that the Funds derived their value primarily from sophisticated trading strategies involving stocks and bonds, futures, currency, options and related investments.

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99 **Raptor**: Exhibit A-1, Annex A, Tab 3, at page 12 states: "The principal investment objective of the Portfolio is appreciation of its assets primarily through investing both long and short in publicly traded equity securities with an emphasis on U.S. markets and instruments." See also Exhibit A-1, Tab 5, at page 8, and Tab 6, at page 7; **Kingdon**: Exhibit A-1, Tab 9, at page 1, succinctly states: "The Fund invests primarily in common stocks and bonds"; **Arden**: Exhibit A-1, Tab 8, at page 4, states: "The Fund's investment strategy is to provide investors with capital appreciation through the allocation of its assets among various hedge fund managers utilizing a variety of absolute return investment strategies"; **Haussmann**: Exhibit A-1, Tab 10, at page 2, states: "The primary objective of the Fund is to achieve capital appreciation. . . . To achieve its objectives, the Fund invests its assets either in other funds of recognized standing, or in discretionary securities investment accounts . . .". See also Exhibit A-1, Tab 11, at page 1 and Tab 12, at page 1; **Caxton**: Exhibit A-1, Tab 13, at page 1, states: "The Company's objective is capital appreciation. Its principal activity is trading in the international currency, financial, commodities and securities markets".

[126] Moreover, Gerbro's argument that the Funds did not derive their value from portfolio investments is a legal one and hinges on a narrow reading of the meaning of portfolio investment, which I have rejected.

[127] I now turn to the thorny Motive Test.

5.5 One of the Main Reasons

5.5.1 Preliminary Remarks About Hedge Funds

[128] This appeal raises the novel issue of applying the Motive Test in section 94.1 to hedge funds located in low-tax jurisdictions. Subject to the foregoing comments, hedge funds or funds of funds will meet the Value Test. The application of the OIFP Rules therefore hinges on the Motive Test. In applying the Motive Test, one should not lose sight of the particular characteristics that distinguish hedge funds from traditional long equity or fixed-income investments.

[129] The following basic information on hedge funds may be drawn from the evidence, including the testimony of Ms. Gut and of Mr. Luis Seco, the expert called by the Appellant.[100] The term hedge fund refers to a wide range of unregulated investments that offer alternative patterns of returns to those of traditional fixed-income instruments, such as corporate bonds or government bonds, and stocks. Hedge funds are diametrically opposed to exchange-traded funds (ETFs), a type of investment merely *replicating* market indices or other patterns of returns. Hedge funds, on the other hand, seek to actively produce returns that are not correlated with the market as measured by stock indices such as the S&P 500, the Dow Jones Industrial Average or the NASDAQ Composite. These uncorrelated returns are referred to in investment jargon as absolute returns. The ability of a hedge fund to consistently produce absolute returns is tied to the pedigree of the manager.

[130] Hedge funds are not regulated. There is no prescribed legal form to be adhered to in order for a pooled investment vehicle to qualify as a hedge fund. Thus the investment vehicle of the hedge fund might be structured as a corporation

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100 I come to the conclusion later on that, because of technical non-compliance with Subsection 145(3) of the *Tax Court of Canada Rules (General Procedure)*, I cannot give any weight to Mr. Seco's conclusion regarding the returns of the Funds as compared with those of other, Canadian hedge funds and regarding the state of infancy of the Canadian hedge fund market. However, his testimony is still relevant for the general information it provides pertaining to hedge funds.

having legal personality, such as the Funds, or be a fiscally transparent partnership, such as Maple Key, Maple Key Plus and Silvercreek.

[131] Achieving absolute returns goes beyond using sophisticated investment strategies such as short-selling or convertible debt arbitrage, or using derivative products. It requires the outlay of millions of dollars in market research. These large fixed costs and the expertise required make it prohibitive for most investors to replicate the returns, and this makes hedge funds that have historically been successful in producing large risk-adjusted returns very attractive investments.

[132] Furthermore, the fee structure creates an incentive for investment managers to operate under the hedge fund model, as it rewards them for producing high returns. The fee structure is made up of a fixed percentage of the assets under management, generally between 1% and 3%, and a substantial performance fee, generally in the range of 10% to 30%, for returns above the high-watermark. A manager's level of compensation is directly correlated with his success in consistently producing high returns. Over time, a manager's ability to produce high risk-adjusted returns will increase his ability to raise capital, which will sustain an upward trend in the manager’s compensation.

[133] A direct implication of the incentive for managers to operate under a hedge fund model is that access to such managers is often only possible under such a model, rather than under a more traditional segregated investment account model.

5.5.2 What is the Requisite Tax Avoidance Intention for the Motive Test?

[134] Broadly speaking, the Motive Test is concerned with whether one of the Canadian investor's main reasons for investing in the non-resident entity was to derive a benefit therefrom. The type of benefit that is contemplated is a *significant* reduction in, or deferral of, Part I Canadian taxes on the income, profits or gains derived from the portfolio investment.

[135] The wording of the test is unequivocal in requiring that a comparison be made. This comparison involves looking at the amount of foreign taxes paid by the non-resident entity in a given year on the income, profits and gains realized from portfolio investments. The amount of foreign taxes paid, if any, must be compared to the Part I Canadian taxes that would be payable in that same year if the investor earned the income, profits or gains from the portfolio investments directly. The test uses a fiction to make the comparison and is purely hypothetical. The investor

being able to hold the underlying investments is thus of no consequence for the purpose of the comparison.

[136] Using the same reference year for determining if there is a benefit for the purpose of the Motive Test is crucial, because of the time-related value of money. A fundamental idea in finance is that money available at the present time is worth more than the same amount in the future due to its potential earning capacity. Therefore, a dollar today is worth more than a dollar in the future. Deferring income tax is a benefit (a dollar of tax paid today is more valuable to the public purse than a dollar of tax paid many years down the road. This is the very essence of an income tax deferral benefit.) I mention this because it was argued more than once that Gerbro did not obtain a *significant* tax benefit since it would pay more Canadian tax when it redeemed its shares in the Funds at a later date.[101] This may very well be true, but is simply not relevant for determining the requisite benefit for purpose of the Motive Test. In fact, Gerbro's position would severely undermine the OIFP Rules in their application to any tax deferral benefit that they seek to capture. Its position is untenable.

[137] The correct comparison is the amount of foreign tax paid in either 2005 or 2006 on the profit, income and gains realized from the portfolio investments versus the amount of Canadian Part I tax that Gerbro would have paid in 2005 and 2006 if it had held the portfolio investments directly. A *significant* difference, in any given year, between these amounts is the type of benefit contemplated. The Motive Test does not require an exact calculation of the benefit as it is a test of intention. In light of the words "it may reasonably be concluded" preceding the description of the Motive Test in section 94.1, what is to be considered is whether it is objectively reasonable to conclude that such a benefit was contemplated. (See *The Queen v. Wu,* 98 DTC 6004 at page 6006.)

[138] Contrary to Gerbro's submission,[102] the amount of foreign tax paid is a relevant consideration under the OIFP Rules because this amount, or the absence of such amount, will dictate whether or not there is a deferral benefit to begin with. If the foreign taxes paid are similar to the taxes that would be payable on the

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101 The statement that Gerbro derived no tax benefit from the investment in the Funds disregards the tax deferral benefit. Gerbro said that it was not concerned with converting what would otherwise be income into capital gains, but it still obtained a tax deferral from investing in the Funds; see oral argument, transcript, November 16, 2015, at page 24, line 22 to page 25, line 8; page 26, line 25 to page 27, line 10; page 52, line 10 to line 22; page 65, lines 24 to 26.

102 Oral argument, transcript, November 16, 2015, page 145, at lines 7 to 16.

income in Canada, there is no deferral benefit and it would be superfluous to look at intention. This is not the case in the present appeal since the Funds were all located in low-tax jurisdictions. In the present appeal, the Motive Test plays an important role.

[139] The factual question is then quite simply whether it can reasonably be concluded that one of Gerbro's *main* reasons for investing or holding its interests in the Funds was to obtain the benefit in question. Whether it may reasonably be considered that Gerbro in fact obtained the contemplated benefit is a factor to be taken into account under paragraph 94.1(1)(*d*), but is not the only factor. One must still scrutinize the circumstances to determine if obtaining the benefit was a main reason or an ancillary one.

5.5.3 Giving No Weight to the Conclusion in Mr. Seco's Expert Report

[140] The Court has the discretion to exclude the portion of Mr. Luis Seco's expert report comparing the returns of the Funds with those of other, Canadian hedge funds as it is technically non-compliant with the new *Code of Conduct for Expert Witnesses* in Schedule III to the *Tax Court of Canada Rules (General Procedure)* (**Code of Conduct**). Subsection 145(3) of the Rules gives the Court this power and uses the word "may" in introducing the possibility of excluding an expert report. The new subsection 145(3) reads as follows:

> (3) If an expert fails to comply with the Code of Conduct for Expert Witnesses, the Court may exclude some or all of their expert report.

[141] In addition, the new Code of Conduct is explicit as to the contents of any expert report. Such reports should include "the facts and assumptions on which the opinions in the report are based", as well as "any literature or other materials specifically relied on in support of the opinions". According to paragraph 145(2)(*a*) of the Rules, the expert report shall "set out in full the evidence of the expert". (Emphasis added.) The amended section 145 and the new Code of Conduct have been in effect since February 7, 2014.[103] The current version now mirrors the *Federal Courts Rules*, sections 52.1 to 52.6 and 279 to 280.

[142] In *Bekesinski v. Canada*, 2014 TCC 35, [2014] T.C.J. No. 33 (QL), at paragraphs 27 and 28, it was ruled that the plain and obvious meaning of "full

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[103] Amendments to the Rules become effective on the date they are published in the *Canada Gazette*: see subsection 20(2) of the *Tax Court of Canada Act*.

statement" of the evidence in the former version of section 145 required that "the underlying data collected, quantitative analysis employed and the ratios calculated to support [the expert's] opinion" be specifically included in the expert report. This was thus a requirement even before the recent amendments to section 145 of the Rules, and remains one today in light of the amendments.

[143] In *Bekesinski*, at paragraph 13, Justice Campbell also cites Judge Dussault's decision in *Mathew et al. v. The Queen*, 2001 DTC 742 (TCC) in asserting that the underlying purpose of section 145 of the Rules is procedural fairness.

[144] On the facts, the gravity of the non-compliance in the present case can be distinguished from that in *Bekesinski*. In that case, the forensic document chemist tasked with identifying the true date on which a director signed a notice of resignation only stated her conclusions in her report, without disclosing the process she followed or the underlying data. The underlying data were in a working document of the expert, which the litigant decided to withhold. In contrast, Mr. Seco, in his report, only omits to list the data used to calculate the returns of the Funds; there was therefore only a *partial* omission of data.

[145] Mr. Seco's omission became apparent during his cross-examination. The raw data that Mr. Seco used to calculate the average return of the Funds, the associated standard deviation and the correlation of the Funds to equity markets from 2003 to 2006 were not attached to his expert report. Not only were these quantitative data not provided to the Respondent, but Mr. Luis Seco failed to indicate, in Section II, "Materials Relied On", the use of such data in his report. During cross-examination, Mr. Seco stated that he obtained the missing data electronically directly from the Funds' managers. He sought to diminish the importance of this omission by stating that the information was readily obtainable from the managers themselves. The following passage confirms the absence of the data in the report:

> [Rita Araujo:] If you analyzed until September 2003, you only had the Haussmann Memorandum for January 2003. Where was the data coming from for January to September?
>
> [Luis Seco:] That came from Haussmann directly.
>
> [Rita Araujo:] That is not listed in your report.
>
> [Luis Seco:] It is not listed no.

[Rita Araujo:] Your data for Haussmann from January 2003 to September 2006 came directly from Haussmann.

[Luis Seco:] It came from our database.

[Rita Araujo:] You include that in your report?

[Luis Seco:] No.[104]

. . .

[Rita Araujo:] The data that you obtained for Arden after October 2003 to September 2006, where did that data come from?

[Luis Seco:] That did not come from the company. We just entered the data as it was.

[Rita Araujo:] You spoke to Arden or you looked at a database?

[Luis Seco:] Yes. We had it, and then we used it.

[Rita Araujo:] That information is not provided in your report, the data that you used?

[Luis Seco:] No.

[Rita Araujo:] Similarly, if we look again at page 5 and we look at Kingdon, we see that the Confidential Explanatory Memorandum is dated January 1, 2005. Where did you get the data from January 2005 to December 2006?

[Luis Seco:] The same as before. This data was all there, and we obtained it.

[Rita Araujo:] You obtained it from Kingdon directly or from a database?

[Luis Seco:] I don't remember. I do not remember.

[Rita Araujo:] You don't know where the data came from?

[Luis Seco:] I do not remember where the data came from.

[Rita Araujo:] The data is not contained in your report?

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104 Transcript, vol. 5, at page 72.

[Luis Seco:] No.

[Rita Araujo:] So we can't verify the calculations in the report.

[Luis Seco:] You could if you get the data.[105]

. . .

[Rita Araujo:] Do they give you information by phone or do they actually send you the data?

[Luis Seco:] They send you the data.

[Rita Araujo:] They send you data electronically, and you didn't include it in your report.

[Luis Seco:] No, I did not include it in the report.[106]

[146] The Respondent was provided with a CD containing the complete data of the Canadian Hedge Watch Database on March 20, 2015, that is, more than 90 days before the trial was resumed on June 22, 2015.[107] The implication of this is that the Respondent could have replicated the calculations of all the average returns, the standard deviation of returns (annualized volatility) and the correlations (comparison of investments) for the Canadian funds that were used for the purpose of the comparison of annualized returns in Exhibit D of the expert report.[108] The same is not true for the figures for the Funds, which Mr. Seco compared with the Canadian funds.[109]

[147] The fairness of the trial may be affected if the incomplete expert report is allowed. This fairness argument is somewhat weakened, however, because the Respondent could have obtained the missing information by contacting the managers of the Funds. Still, one should be mindful of the fact that the Respondent had no way of knowing where the information actually came from until its source was divulged in cross-examination. It might be added that it was not incumbent on the Crown to verify the compliance of Gerbro's expert report.

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105 *Ibid*., at pages 72 to 73.

106 *Ibid*., at page 79.

107 Letter dated March 20, 2015 from Stéphane Eljarrat to Naomi Goldstein; paragraph 145(7)(*b*) of the Rules.

108 Transcript, vol. 5, pages 32-33, 42-45, 53-55.

109 *Ibid*., pages 71 to 75.

[148] The concerns about the missing data relate to the question of whether there were any Canadian funds comparable to the Funds in the Relevant Period. I give no weight to Mr. Seco's conclusion on this point because of the missing data and some inconsistencies in the application of the criteria he used in his comparison.

[149] The other question submitted to Mr. Seco concerned the state of the Canadian hedge fund market in the Relevant Period. He emphatically stated that the Canadian hedge fund market was in a state of infancy.[110]

[150] Mr. Seco's assertion is problematic because of the lack of depth in his analysis leading up to his conclusion. He relied heavily on the size of the Canadian market relative to the worldwide hedge fund market at the time. His position further appears to be based on a report, commissioned in 2005 by the Investment Dealers Association of Canada, by the Task Force to Modernize Securities Legislation in Canada.[111] This study also expressed the opinion that the Canadian hedge fund market was in its infancy in 2005 and 2006 due to its small size relative to the worldwide hedge fund market.

[151] As the Crown pointed out, Mr. Seco's analysis did not benchmark the size of the Canadian market to that of the markets in other jurisdictions such as the United States. It was also unclear whether the location of the management company or the location of the investment vehicle was used in attributing a hedge fund to a given jurisdiction. As explained in the facts section of these reasons, funds with feeder structures have both onshore and offshore feeders. The management company for each of the Funds, however, was located in the United States. One wonders how these Funds are classified in Mr. Seco's analysis and whether the offshore feeder is still classified as a United States fund since this is the nationality of the manager providing the investment advice. To take it one step further, what is troubling with the methodology is that it is unclear whether the investment vehicle of Canadian funds was located offshore or onshore.

[152] All in all, I do not find it proper, in the circumstances, to give any weight to Mr. Seco's conclusions.

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110 Expert report, Exhibit A-33, at page 10.

111 *Ibid*., page 10, note 4.

5.5.4 Main Reasons Standard

[153] While the Motive Test is not a purely subjective test, a finding as to intention and the importance of an intention is a factual determination intrinsically linked to the evidence provided at trial: *Minister of National Revenue v. Furnasman Ltd.*, [1973] F.C. 1327, [1973] C.T.C. 830 (FCTD) at pages 1336-37 F.C., 836-37 C.T.C. The stated reasons must be objectively reasonable, taking into account the surrounding circumstances of the investments in the fund, notably the factors listed in paragraphs 94.1(1)(*c*) to (*e*).

[154] A person's reasons for doing something are intrinsically personal, and each reason, should there be more than one, can be given different weight when the person makes a decision. Therefore, a main reason is subsumed in the larger subset of the reasons category.

[155] The Act is replete with specific anti-avoidance provisions, and the criteria for their application can be more or less difficult to satisfy depending on the wording used. Clearly a "one of the reasons" test is less difficult to meet than a "one of the *main* reasons" or a "one of the *main* purposes" test.

[156] Although there is an abundance of anti-avoidance provisions in the ITA that use the "one of the main reasons" test, the case law has predominantly applied the test with regard to subsection 256(2.1), formerly subparagraph 138(3)(*b*)(ii)A, which is a specific anti-avoidance provision in the associated corporations rules limiting the multiplication of claims for the small business rate.

[157] The case law applying the "one of the main reasons" test and the "one of the main purposes" test is instructive as to the legal principles applicable in making an appropriate factual determination. Those principles, as adapted for the purpose of the OIFP Rules, can be summarized as follows:

(1) A taxpayer's reasons for investing can be disclosed or undisclosed, and the fact that a tax-avoidance reason is undisclosed, as is often the case, does not prevent a court from inferring that such a reason existed; *Symes v. Canada*, [1993] 4 S.C.R. 695 at 736;

(2) There can be more than one main reason for investing in a non-resident entity: *Groupe Honco Inc v. The Queen*, 2013 FCA 128, 2014 DTC 5006, at paragraph 24, aff'g 2012 TCC 305, 2013 DTC 1032;

(3) The Motive Test is not a *sine qua non* test under which the Court must conclude that tax avoidance was not a main reason for investing if it is convinced that the taxpayer would have invested notwithstanding the absence of any tax benefit: *Continental Stores Ltd. v. The Queen*, 79 DTC 5213 (FCTD) at 5217; *Honeywood Ltd. et al. v. The Queen*, [1981] C.T.C. 38 (FCTD); *contra*: *Jordans Rugs Ltd. et al. v. M.N.R.*, [1969] C.T.C. 445 (Ex. Ct.).

(4) It is improper to conclude that resulting tax savings automatically lead to the inference that obtaining those tax savings must have been a main reason for investing: *Les Installations de l'Est Inc. v. Canada*, [1990] 2 C.T.C. 503 (FCTD), at 509-10; *Saratoga Building Corp. v. M.N.R.*, [1993] 2 C.T.C. 2074 (TCC), at 2086; and

(5) Choosing to invest in a non-resident entity when there was the possibility of investing in another vehicle triggering a larger tax liability is not necessarily determinative of a tax benefit main reason; *Alpine Furniture Co. Ltd. et al. v. M.N.R.*, 68 DTC 5338 (Ex. Ct.), at 5345.

[158] With these principles in mind, and on the basis of the evidence, I conclude that, while tax deferral was an ancillary reason prompting Gerbro to invest in the Funds, none of its *main* reasons was tax deferral as contemplated in subsection 94.1(1). I agree with the Respondent that Gerbro is understating the tax deferral benefit of investing in the Funds. Tax deferral, although not explicitly stated, must reasonably be inferred to have been one of the reasons, conscious or subconscious, for investing in the Funds.

[159] It is possible that Gerbro held the sincere belief that it was investing *solely* to achieve its capital preservation objective, but this is not objectively a reasonable conclusion having regard to all the circumstances. The more reasonable view is that compelling business reasons and the managers' reputations were Gerbro's dominant reasons for investing.

[160] The nature, organization and operation of the Funds and the characteristics of Gerbro's interests therein do not clearly point to tax deferral being a main reason for investing.

5.5.4.1 Clarifying the Difference between "Main" Reasons and Ancillary Reasons

[161] The line between a main reason and a secondary reason is difficult to draw, especially if the reason is undeclared, since it must then be inferred from the relevant circumstances that a particular reason could perhaps be elevated to "main reason" status. Once it has been determined what the requisite benefit is for the purpose of the Motive Test, the determination of whether tax deferral was one of Gerbro's main reasons is entirely factual.

[162] A starting point for discerning the meaning of "main" is the *New Oxford Dictionary of English* definition thereof, according to which a "main" reason would be a reason that is more important than the others.

[163] The definition in the *New Oxford Dictionary of English* reads as follows:

> **Main** adjective [attrib.] chief in size or importance: *a main road ¦the main problem is one of resources. . . .*[112]

[164] This method of proceeding is compatible with the approach followed by Décary, J. in *Lenco Fibre Canada Corp. v. The Queen*, 79 DTC 5292 (FCTD), at 5293:

> . . . the word "main" must be given its significance. In the French language version of the statute, the corresponding word is "principaux". Not every reason will meet this standard. Thus, even where the reduction of taxes payable is a reason, a judgment must still be made as to whether it was a main or principal reason.
>
> [Emphasis added.]

[165] One can argue that the more important a reason for investing is, the harder it will be to elevate another reason, such as obtaining a tax deferral benefit, to the same level. This is of particular importance in the present case, in which I recognize the extreme importance that investing in the Funds had within Gerbro's overall investment strategy.

[166] In contrast, an investment offshore that could otherwise be held directly or that was not particularly attractive commercially would clearly not pose such

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112 *New Oxford Dictionary of English*, 1998, *sub verbo* "main".

difficulties. The only reason for investing in that case, one might suggest, would be to benefit from tax deferral and the conversion of income to capital gains. This reason would not have to be weighed against others.

[167] The reasons that Gerbro invested in the Funds were manifold, and can be summarized as follows:

1) To obtain good returns;

2) To reduce the overall volatility of its portfolio;

3) To invest with trustworthy individuals; and

4) To hold liquid investments[113]

These reasons all feed into the overarching bona fide commercial reason for investing, which, according to the evidence, was extremely important for Gerbro. Moreover, the volatility component of the investments was unaffected by the fact that they were made in a low-tax jurisdiction, and this factor was key. Indeed, Gerbro was facing a situation in which it might have to redeem its shares in the Funds at any time (in the event of the death of Ms. Bronfman). In this context, low volatility was an important factor to be considered in the investment decision as it contributed to lowering the risk associated with the investment.[114] That being so, it is not unreasonable to assert that the tax reason that was inferred took a back seat in Gerbro's investment decision and in its continuing decision to hold the investments in the Relevant Period. Obtaining the tax benefit may have been a reason, but was not a main reason as it was less important than Gerbro's commercial reason for investing.

5.5.4.2 Nature, Organization and Operation of the Funds and the Characteristics of Gerbro's Interest Therein

[168] It was admitted that the Funds, because of their tax-exempt status offshore, were subject to very low tax or no tax at all. However, the nature of the Funds and the strategies they employed, as thoroughly described in the facts section of these reasons, made them, from an objective point of view, very attractive investments

113 Gerbro preferred value managers over growth managers.

114 Appellant's reply submissions, transcript, November 16, 2015, at pages 162 to 164.

for non-tax reasons. The Appellant went to great pains to describe the attractiveness of the returns.

[169] Gerbro did not hold large interests in the Funds, which suggests that the Funds' structure was not being artificially manipulated to obtain a tax deferral. The nature of hedge funds as a turnkey investment is compatible with this view. Gerbro played no role in structuring the Funds. In contrast, the taxpayer in *Walton*, following tax advice, carefully structured the share-capital of the non-resident entity.[115]

[170] Gerbro was very concerned with the reputation of the managers it invested with because of the very nature of the Funds. In fact, the managers of the Funds had full control over the funds invested; Gerbro did not hold a large percentage of the outstanding shares of the Funds; nor did Gerbro have any control over the Funds.

[171] Even if one were to give no weight to the expert opinion of Mr. Luis Seco, it appears obvious that the reputation of a manager of an unregulated offshore investment vehicle, which because of its very nature has custody of the funds invested, was extremely important. A major concern with pooling funds in an investment vehicle, as opposed to using segregated funds, is the greater risk of fraud. A dishonest manager of a pooled fund can more easily orchestrate a ponzi scheme, which would compromise investors' chances of recouping any portion of their initial investments. This counterparty risk is different than the inherent risk that is associated with investing in speculative vehicles. The facts in *Den Haag Capital, LLC v. Correia*, 2010 ONSC 5339, [2010] O.J. No 4316 (QL), exemplify an unfortunate occurrence involving fraud. The hedge fund manager in that case went so far as to forge bank documents.

[172] The choice of investing in the Funds must be understood within Gerbro's overall investment strategy. The Respondent failed to take this aspect into account when weighing the reasonableness of Gerbro's argument that the tax deferral was merely ancillary to its other – dominant and main – reasons. Gerbro believed, as laid out in its investment guidelines, that its investments in the Funds were necessary in order to achieve the desired overall risk/return combination. The importance of this is reinforced by the fact that access to the managers of the Funds was only possible for Gerbro through offshore hedge funds, and these types of alternative investments only made up a part of Gerbro's investment portfolio.

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115 *Supra* (paragraph 87 of the present reasons), at paragraph 15.

[173] It should be added that Gerbro's control over the timing for cashing in its investments was important. The liquidity of the investments was in line with Gerbro's objective of being able to dispose of the investments at a moment's notice were Ms. Bronfman to pass away. Indeed, these liquidity considerations must have been important to Gerbro, since one may think that unregulated investments are harder to sell and consequently less liquid. In the present case, with regard to all of the Funds, Gerbro had full discretion to redeem its shares, with prior written notice of 30 to 60 days, at the end of each quarter, subject only to a two-year lock-up period for Raptor and Kingdon.[116]

5.5.4.3 Amount of Taxes Paid Offshore Was Significantly Less

[174] It may reasonably be considered that Gerbro would have paid significantly more taxes if it hypothetically held the Funds' investments directly. The Funds realized gains in the year, which were not taxed in the jurisdiction in which the Funds were resident. When one considers the amount of gains which it would have realized if it had made the same investments in Canada, it stands to reason that Gerbro would have paid significantly more taxes. This is true even if the exact amount of tax savings cannot properly be quantified because the managers did not disclose the timing of their transactions.

[175] I recognize that the auditor's method of calculating the taxes otherwise payable by Gerbro is at odds with the calculation prescribed in *Gaynor, supra,* [117] and since that decision, in subsection 261(2) of the ITA, but this does not alter the fact that it may reasonably be considered that Gerbro benefited from a significant deferral benefit. The theoretical possibility that any tax savings could be eliminated by equivalent foreign exchange losses is conjectural, and would have been even more so at the time the investments were made.

[176] The fact remains that the non-resident Funds operated in a frictionless tax environment. It is true that income received by the Funds could have been subject to withholding tax in other jurisdictions, but there is no evidence that this was a major concern.

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116 Exhibit A-1, Tab 6, at pages 37 to 39 (Raptor); Exhibit A-1, Tab 8, at pages 25-26 (Arden); Exhibit A-1, Tab 9, at pages 13-14 (Kingdon); Exhibit A-1, Tab 12, at pages 8-11 (Haussmann); and Exhibit A-1, Tab 13 (Caxton).

117 *Gaynor, supra*, note 53.

[177] The fact that Gerbro could not and did not wish to hold the investments directly for lack of resources and capacity to build a comparable mix of assets only goes to reinforce its bona fide business reason for investing in the Funds.

[178] Lastly on this point, the fact that Gerbro did not and could not calculate the exact amount of Part I tax it would have paid if it had held the investments directly before it decided to invest in the Funds raises the question of whether the tax deferral reason was simply a reason for investing or a main reason for doing so.

5.5.4.4 Extent to Which the Funds Paid Dividends

[179] The factor in paragraph 94.1(1)(*e*) also favours the conclusion that Gerbro benefited from a tax deferral since the Funds, with the exception of Haussmann, never distributed any income as dividends or otherwise, and Haussmann paid very small dividends. The gains the Funds realized offshore would not be taxed in Gerbro's hands until Gerbro redeemed its shares.

[180] A careful analysis of the Funds' offering memoranda reveals that they all had dividend policies, but did not expect to be paying dividends in the near future.

[181] For reasons that are unknown to this Court, Haussmann declared dividends in the Relevant Period. Compared to the sizeable investment of Gerbro in Haussmann, those dividends were insignificant.

[182] No evidence was presented at trial to establish what the managers' motivations were for structuring the Funds as offshore corporate entities, nor did the Respondent make any assumptions as to what those motivations were.

[183] There are other legitimate reasons for not distributing income, such as maximizing the future return on investment through compounding returns. There is an analogy to be made with high-tech start-ups that systematically reinvest their earnings so as to produce higher future returns. All we know for certain is that Gerbro did not take part in structuring the Funds and that it subscribed for whatever shares of the Funds were offered to it. This being said, the question the Motive Test is concerned with remains: what were Gerbro's main reasons for investing in and holding the shares of the Funds?

[184] Gerbro benefited from a *significant* tax deferral even with respect to its investment in Haussmann, but there is no indication that this factor elevated the tax deferral reason to main reason status.

5.5.4.5 Year-End Transaction Not a Relevant Factor (FIE Rules)

[185] Gerbro's actions in response to the FIE Rules, notably the year-end transactions, are not helpful in allowing us to infer an intention to defer taxes given that the considerations under the very complex FIE Rules were different.

[186] The notable difference between the proposed FIE Rules and the OIFP Rules is the absence of an intention test in the former.[118] As a matter of logic, income would have been imputed yearly under the FIE Rules even to an investor that did not meet the Motive Test under the OIFP Rules. The planning considerations are different for the two sets of rules.

[187] The Crown's argument that Gerbro's year-end transactions demonstrate that obtaining a tax deferral was an important consideration in the investment in the Funds is incorrect. In addition to the fact that the application of the FIE Rules is not subject to a motive test, the year-end transactions triggered gains in the year they were effected[119] and therefore removed any deferral benefit. The actions Gerbro took pursuant to the proposed FIE Rules do not colour its intention for the purpose of the Motive Test and are irrelevant.

[188] Given the high importance of the other business motives Gerbro had for investing in the Funds, it is not unreasonable to conclude that obtaining the tax deferral was of lesser importance. This should therefore not be elevated to the status of a main reason. The tax deferral motive that may be inferred from the location of the Funds in a low-tax jurisdiction and from the lack of distribution is at most an undisclosed secondary reason. Both the commercial reality of investing in hedge funds and the documented investment strategy support this finding.

5.5.5. Credibility of Ms. Gut's Testimony and No Corroboration Necessary

[189] Ms. Gut's credible testimony confirmed the finding that, notwithstanding that Gerbro derived a tax deferral benefit from investing in the Funds, the benefit was not a main reason for investing. A key factor in this determination is the rigorous process that Gerbro documented over the years and which was thoroughly explained at trial.

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118 Wallace G. Conway, "Foreign Investment Entities: The New Proposals", in *Report of the Proceedings of the Fifty-Fifth Tax Conference*, 2003 Conference Report (Toronto: Canadian Tax Foundation, 2003), 23A:1-23A:16, at 23A:6, Appellant's Book of Authorities, Tab 7.

119 See paragraph 41 of the present reasons.

[190] As previously mentioned, the Motive Test is not a *sine qua non* test, but turning that test on its head could have worked against Gerbro. Evidence that Gerbro would not have continued to invest if the tax deferral benefit had been removed would have been fatal to its position. The Respondent did not try to convince the Court that Gerbro would not have continued to invest. The fact that Gerbro continued to invest notwithstanding the imputation of income under the objective criteria of the FIE Rules, though not conclusive, confirms the reasonableness of my factual determination. Even so, tax deferral could have been one of the main reasons for the investments. Nonetheless, I have found on the facts that this tax deferral reason was merely ancillary since it was less important to Gerbro than the commercial reasons.

[191] Ms. Gut's statements that none of the reasons for investing in the Funds were tax motivated, though merely a starting point, were tested against the objective reality to determine that this position was reasonable. Judge Bonner followed this method in *Walton, supra,* in concluding that the *only* reason for holding the interest in the non-resident entity was to pay less Canadian taxes than if the taxpayer had held the shares directly. He stated at paragraph 15 of the decision that "[n]o business-driven non tax reason for the use of Murdoch and Company was suggested." Gerbro has convinced me that it was otherwise in its case.

[192] In assessing Ms. Gut's credibility I was guided by the decision of the British Columbia Court of Appeal in *Faryna v. Chorny*, [1951] B.C.J. No. 152 (QL), [1952] 2 D.L.R. 354. The principles laid out therein state that the trier of facts must consider surrounding circumstances as well as a witness's demeanour in assessing credibility. In addition, the trier of facts must determine whether the testimony is in "harmony with the preponderance of the probabilities which a practical and informed person would readily recognize as reasonable in that place and in those conditions" (at paragraph 11 QL).

[193] More concretely, in the following passage in *Nichols v. Canada,* 2009 TCC 334, [2009] T.C.J. No. 231 (QL), Justice Valerie Miller enumerated factors to consider in determining whether a witness is credible:

> 23 In assessing credibility I can consider inconsistencies or weaknesses in the evidence of witnesses, including internal inconsistencies (that is, whether the testimony changed while on the stand or from that given at discovery), prior inconsistent statements, and external inconsistencies (that is, whether the evidence of the witness is inconsistent with independent evidence which has been accepted by me). Second, I can assess the attitude and demeanour of the witness. Third, I can assess whether the witness has a motive to fabricate evidence or to mislead

> the court. Finally, I can consider the overall sense of the evidence. That is, when common sense is applied to the testimony, does it suggest that the evidence is impossible or highly improbable.

[194] Accordingly, I find that Ms. Gut's testimony was highly credible and in harmony with the preponderance of probabilities. Her testimony was logical, and there were no fundamental internal or external contradictions. Her testimony as to the absence of a tax motive for investing in the Funds was not contradicted by documentary evidence. On the contrary, such evidence supported Gerbro's rigorous investment selection process as described by Ms. Gut in a detailed and clear fashion. The documents supported Gerbro's dominant business reason for investing. Also, there was in Ms. Gut's demeanour no hesitation that might have hinted at deceit.

[195] The Crown sought to impeach Ms. Gut's credibility because of the discrepancy between her testimony about the size of the Canadian hedge fund market and the figure Mr. Seco reported. She testified it was $8 billion in size in the Relevant Period versus the $26 billion figure Mr. Seco presented. The contradiction is overstated given the size of the global hedge fund market (US$ 1.1 trillion). In addition, when the $26.6 billion figure appearing in the task force report in Appendix E of Mr. Seco's expert report is broken down into its components the gap between it and the $8 billion figure narrows. The size of stand-alone hedge funds and funds of hedge funds, which were the types of investments Gerbro was interested in, was only $6.4 billion. Another $1.6 billion invested in Canadian funds was held by foreigners. The sum of those figures, coincidentally, is exactly the amount that Ms. Gut reported. She stated that the $8 billion was the figure she was given at the time. It is reasonable to assume that whoever reported the figure to Ms. Gut would have adapted it in light of Gerbro's needs and excluded the amounts invested by large institutional pension funds, for instance, or the investments in "principal protected notes".

[196] Further, I refuse to draw a negative inference from Gerbro not calling other employees to corroborate Ms. Gut's testimony. On the authority of *Milliken & Co. v. Interface Flooring Systems (Canada) Inc.*, [2000] F.C.J. No. 129 (QL) (FCA), the Respondent urges the Court to draw such a negative inference.[120] Besides the comments in paragraph 11 of the decision being *obiter*, the facts in *Milliken* must be distinguished. *Milliken* stands for the proposition that failure to call a witness on

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120 Respondent's Written Submissions, at paragraphs 104 to 106.

an essential element of the case allows the court to draw the natural inference that the witness not called would have given unfavourable evidence.

[197] Similarly, in *Schafer v. Canada*, 2013 TCC 382, [2013] T.C.J. No. 335 (QL), Justice Sheridan drew a negative inference from the taxpayer not having called other witnesses to enlighten the Court on important questions the taxpayer could not answer himself. The following passage summarizes Justice Sheridan's findings:

> 29 There ended Mr. Schafer's testimony. Portions of it have been quoted at length in these Reasons for Judgment to give a sense of the implausible nature of many of his answers, prime among them the account set out directly above. The transcripts also reveal a certain evasiveness: key questions about why or how certain things had been done went unanswered, his justification being his lack of involvement in the business side of the practice. Yet, in spite of acknowledging this "shortcoming" and having gone to some pains to inform the Court of his extensive legal background, Mr. Schafer chose not to call those to whom he had delegated these tasks. He offered no explanation as to why he had not called Mrs. Schafer or the Accountant, leaving the impression that their absence was more litigation strategy than amateur oversight. In all the circumstances, I accept the submission of counsel for the Respondent that the Court ought to draw a negative inference from the Appellants' failure to call Mrs. Schafer and/or the Accountant to answer questions that Mr. Schafer insisted he could not.
>
> [Emphasis added.]

[198] Gerbro did not fail to introduce valid evidence as to its reasons for investing in the Funds, nor was Ms. Gut evasive in her responses. Who better to testify concerning Gerbro's reasons than its CEO? Calling other employees, in light of the documentary evidence submitted, would only have prolonged the trial. In these circumstances, the choice not to call other witnesses was open to Gerbro's counsel in managing their client's appeal.

6 CONCLUSION

[199] The evidence adduced at trial supports the position that the Funds primarily derived their value, directly or indirectly, from portfolio investments. However, the appeal must succeed on the factual determination that although Gerbro benefited from income tax deferral by investing in the Funds, this was not a *main* reason for investing. The conclusion that it was not a main reason is reasonable considering that the business reasons for investing in the Funds overshadowed any tax benefit obtained incidentally.

7 DISPOSITION

[200] The appeals are allowed and the reassessments are referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that Gerbro did not have to report for the taxation years ended on December 31, 2005 and December 31, 2006 income in the amounts of $841,803 and $754,210 respectively imputed to it under section 94.1 of the ITA.

[201] If either of the parties requests to make submissions on costs, both will have to file written submissions with the Registry on or before August 31, 2016. If no submissions are received, the Appellant will be awarded one set of costs for the two appeals (2012-739(IT)G and 2012-4194(IT)G).

Signed at Ottawa, Canada, this 22nd day of July 2016.

"Lucie Lamarre"

Lamarre A.C.J.

APPENDIX A

2012-739(IT)G
2012-4194(IT)G

TAX COURT OF CANADA

BETWEEN:

GERBRO HOLDINGS COMPANY

Appellant

and

HER MAJESTY THE QUEEN

Respondent

STATEMENT OF AGREED FACTS (PARTIAL)

The parties to this proceeding admit, for the purposes of this proceeding only, the truth of the facts set out in this Statement of Agreed Facts (Partial). The parties hereto agree that this Statement of Agreed Facts (Partial) does not preclude either party from calling evidence to supplement the facts agreed to herein or to establish other facts not set out herein, it being accepted that such evidence and facts may not contradict the facts so agreed herein.

Gerbro Holdings Company

1. The appellant, Gerbro Holdings Company (formerly Gerbro Inc.) (**"Gerbro"**) was, throughout its taxation year ended December 31, 2005 (the **"2005 Taxation Year"**) and throughout its taxation year ended December 31, 2006 (the **"2006 Taxation Year"**) (collectively the **"Relevant Period"**), a Canadian-controlled private corporation.

2. Throughout the Relevant Period, Gerbro's sole shareholder was the Marjorie Bronfman Trust (the **"Trust"**).

3. Throughout the Relevant Period, the Trust was a Canadian-resident testamentary spousal trust created by the Last Will and Testament of the Late Gerald Bronfman ("**Gerald**") executed on June 9, 1982.[1]

4. Under the terms of the Trust, Marjorie Bronfman ("**Marjorie**") was the sole income and capital beneficiary of the Trust during her lifetime.

5. Upon Marjorie's death, the property comprised in the Trust was to be distributed to Marjorie's four children.

6. Throughout the Relevant Period, Gerbro acted as a holding company to hold investments for the benefit of Marjorie (the "**Investments**"), as a beneficiary of the Trust during her lifetime.

7. Prior to January 27, 2014, Gerbro was a corporation formed under the Canada *Business Corporations Act*, under the name of Gerbro Inc.

8. On January 8, 2014, by way of special resolution, Gerbro resolved to apply for a certificate of continuance as an unlimited liability company under the *Companies Act* of Nova Scotia.

9. On January 27, 2014, the Registrar of Joint Stock Companies of the Province of Nova Scotia issued a certificate of continuance, effective that day, certifying that Gerbro was continued in the Province of Nova Scotia under the name of Gerbro Holdings Company.

10. On March 1, 2014, Gerbro and Marbro Holdings Company were amalgamated pursuant to the *Companies Act* of Nova Scotia under the name Gerbro Holdings Company.

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[1] Last Will and Testament of the late Gerald Bronfman dated June 9, 1982 with codicils dated October 20, 1982, October 9, 1984 and, en liasse, the Judgment of the Superior Court of Québec dated February 3, 1987 probating such will and its codicils, Joint Book of Documents, Tab 1.

11. Woodrock Canada Inc. ("**Woodrock**") is a related Canadian-controlled private corporation incorporated on November 24, 2003, and its sole shareholder was Gerbro during the Relevant Period.

12. Gerbro's and Woodrock's fiscal year ends are December 31.

Investment Committee

13. The Trust had an investment committee that met on average four times a year with Gerbro's management (the "**Management**") (the "**Committee**") to discuss, namely, Gerbro's strategies and policies in respect of the Investments.

14. The Committee reviewed asset allocation, selected, supervised and terminated managers and monitored the performance of the Investments, including during the Relevant Period.

15. The investment objectives of Gerbro applicable during the Relevant Period were set out in formal investment guidelines in respect of the Investments.[2]

16. The Management selected independent external investment managers to invest its capital.

17. Equities represented the core of the Investments.

18. The Management allocated a portion of the Investments to alternative investments, comprised of two broad categories:

    a. directional investment funds which maintain some exposure to the market but which attempt to generate returns as well during periods of declining markets; and

    b. non-directional investment funds, which attempt to completely neutralize the effect of broad movements in the market and which tend to produce less volatile returns.

[2] 2005 Investment guidelines of the Marjorie Bronfman Trust and MB Special Trust, Joint Book of Documents, Tab 2.

Offshore Investment Funds

19. During the 2005 Taxation Year, Gerbro acquired and/or held interests in the following offshore investment funds:

    a. The Raptor Global Fund Ltd.;

    b. Arden Endowment Advisers Ltd.;

    c. M. Kingdon Offshore Ltd.; and

    d. Haussmann Holdings N.V.

20. During the 2006 Taxation Year, Gerbro acquired and/or held interests in the following offshore investment funds:

    a. The Raptor Global Fund Ltd.;

    b. Haussmann Holdings N.V.; and

    c. Caxton Global Investment Ltd.

The Raptor Global Fund Ltd.

21. The Raptor Global Fund Ltd. ("**Raptor**") is a non-resident investment corporation incorporated and registered on August 26, 1993 as an exempted company under the Companies Law of the Cayman Islands.

22. Raptor acts as a feeder fund to a master fund, The Raptor Global Portfolio Ltd. ("**Global**").

23. Global is a non-resident investment company incorporated and registered on September 22, 1999 as an exempted limited liability corporation under the laws of the Cayman Islands.

24. Global's investment adviser is Tudor Investment Corporation ("**Tudor**"), a company established in the state of Delaware, U.S.

25. Tudor is eligible for a management fee of 1.5% per annum on Raptor's adjusted net assets and an incentive fee of 20% of Raptor's trading profits, subject to a high water mark.

Raptor Offering Memoranda

26. The Raptor Offering Memorandum dated September 19, 2003 ("**2003 Raptor Memorandum**")[3] described certain particulars of Raptor such as its strategies, objectives, risks and terms of investment.

27. Gerbro made reference to the 2003 Raptor Memorandum when acquiring and/or holding an interest in Raptor, as the case may be, at the time the 2003 Raptor Memorandum was in effect.

28. Gerbro took the statements and information contained in the 2003 Raptor Memorandum at face value when acquiring and/or holding an interest in Raptor, as the case may be, when the 2003 Raptor Memorandum was in effect.

29. The Raptor Notice of Certain Changes dated November 25, 2005 ("**2005 Notice of Changes**")[4] described certain particulars of Raptor such as its strategies, objectives, risks and terms of investment.

30. Gerbro made reference to the 2005 Notice of Changes when acquiring and/or holding an interest in Raptor, as the case may be, when the 2005 Notice of Changes was in effect.

31. Gerbro took the statements and information contained in the 2005 Raptor Memorandum at face value when acquiring and/or holding an interest in Raptor, as the case may be, when the 2005 Notice of Changes was in effect.

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[3] Offering Memorandum for the Raptor Global Fund Ltd., dated September 19, 2003, Joint Book of Documents, Tab 3.
[4] Raptor Global Fund Ltd. Notice of Certain Changes, Joint Book of Documents, Tab 4.

32. The Raptor Offering Memorandum dated December 19, 2005 ("**2005 Raptor Memorandum**")[5] described certain particulars of Raptor such as its strategies, objectives, risks and terms of investment.

33. Gerbro made reference to the 2005 Raptor Memorandum when acquiring and/or holding an interest in Raptor, as the case may be, when the 2005 Raptor Memorandum was in effect.

34. Gerbro took the statements and information contained in the 2005 Raptor Memorandum at face value when acquiring and/or holding an interest in Raptor, as the case may be, when the 2005 Raptor Memorandum was in effect.

35. The Raptor Offering Memorandum dated September 25, 2006 ("**2006 Raptor Memorandum**")[6] described certain particulars of Raptor such as its strategies, objectives, risks and terms of investment.

36. Gerbro made reference to the 2006 Raptor Memorandum when acquiring and/or holding an interest in Raptor, as the case may be, when the 2006 Raptor Memorandum was in effect.

37. Gerbro took the statements and information contained in the 2006 Raptor Memorandum at face value when acquiring and/or holding an interest in Raptor, as the case may be, when the 2006 Raptor Memorandum was in effect.

38. Gerbro continues to take the statements and information contained in the 2003, 2005 and 2006 Raptor Memoranda and the 2005 Notice of Changes at face value.

39. During the Relevant Period, the activities, strategies, investments and structure of Raptor were as described in the 2003, 2005, and 2006 Raptor Memoranda and the 2005 Notice of Changes, as applicable at that time.

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[5] Offering Memorandum of the Raptor Global Fund and Appendices, dated December 19, 2005, Joint Book of Documents, Tab 5.
[6] Offering Memorandum of the Raptor Global Fund and Appendices, dated September 25, 2006, Joint Book of Documents, Tab 6.

Investment Objectives of Raptor

40. Raptor seeks superior total return on assets over time by leveraged trading and investing, both long and short, on a global basis in a broad range of public and private securities and other investments, with an emphasis on U.S. equity exchanges and markets.

41. Global's investment objectives are identical to those of Raptor's.

42. Global conducts business as an open-end investment fund.

43. Raptor invests substantially all of its investable assets in and through Global.

44. Global conducts its trading and investments pursuant to the advice of Tudor.

45. Tudor utilizes a "bottom-up" stock selection process to trade individual equity securities (both long and short). Tudor determines the fund's overall net exposure to the equity markets utilizing a "top-down" macro-economic research approach.

46. Tudor uses both fundamental and technical analyses[7] in directing the fund's trading and investing, on United States foreign markets and exchanges, primarily in common stocks, warrants, preferred stocks, options and certain other instruments.

47. Tudor attempts to manage risk by utilizing hedge techniques, including the use of equity options and equity futures contracts. The fund takes long, short, speculative

[7] The 2003 Raptor Memorandum states: "There are generally two ways of attempting to forecast price behavior in the financial markets: 'fundamental analysis' and 'technical analysis.' Fundamental analysis with respect to individual securities includes the analysis of the balance sheet and income statements of companies in order to forecast their future price movements. Past records of assets, earnings, sales, products, management, markets and other information are considered in an effort to predict future trends in these and other factors. Fundamental analysis with respect to financial markets as well as individual securities also includes analysis of a number of external factors, including interest rates, governmental policies, domestic and foreign political and economic events, and changing trade prospects. Technical analysis involves the analysis of trading factors and historical trading patterns as a way of predicting the future course of price movements. These factors include daily, weekly and monthly price fluctuations, volume variations, and changes in open interest. Trading recommendations are generally based on computer-generated signals, chart interpretation, mathematical measurements, or a combination of such indicators." at p.6 (underlining ours).

and hedged positions, utilizes various forms of leverage and engages in stock lending transactions.

48. Raptor invests primarily in securities and related derivatives including but not limited to: common stocks, preferred stocks and warrants; debt obligations of the United States and non-United States governments; bonds, notes and participations; repurchase and reverse repurchase agreements; securities of public and private entities in developing countries; securities of companies in bankruptcy or reorganization proceedings or in other distressed circumstances; securities of or interests in other investment vehicles; contracts for differences; and options and other rights and interests in respect of the foregoing.

49. Raptor also invests in commodity futures contracts, forward contracts and various other derivative and hybrid instruments, including but not limited to: foreign exchange commitments; spot (cash) commodities; swap and similar transactions; and options and other rights and interests in respect of the foregoing.

Share Capital Structure of Raptor

50. Prior to January 1, 2006, Raptor issued four classes of shares: A, B, C and D.

51. Subsequent to January 1, 2006, Raptor issued five classes of shares: A, B, C, D and E shares.

52. Class E Shares were not subject to, directly or indirectly, any management fee or incentive fee and could only be purchased by Tudor, its affiliates and their respective employees.

53. Class A, B, C and D shares (the **"Investor Shares"**) were identical in most respects, although Class A and B shares were not subject to redemption fees.

54. The Investor Shares were non-voting and participating.

55. The Investor Shares could be transferred as of the first day of each calendar quarter, but only (i) with Raptor's prior written consent, (ii) if the transferee, after giving

effect to the transfer, beneficially owns shares having an aggregate net asset value of at least $1,000,000 and (iii) if the transferor transfers all of its shares or transfers shares having an aggregate net asset value of at least $1,000,000 and retains shares having an aggregate net asset value of at least $1,000,000 after the requested transfer date.

56. Raptor's board of directors or its designee, in its sole discretion, could waive any of the forgoing transfer restrictions with respect to any shareholder. Raptor generally refused to permit a transfer if the transfer would result in a change of beneficial ownership of the transferred shares.

57. Subject to certain limited exceptions, shares could not be transferred within the United States or to United States persons, including, *inter alia*:

    a. a citizen of the United States;

    b. a natural person who is a resident of the United States;

    c. a resident alien of the United States;

    d. a partnership, corporation or other entity created, organized or incorporated in the United States or under the laws of the United States or any state, territory or possession thereof or the District of Columbia, or which has its principal place of business in the United States; and

    e. an estate or trust the income of which is subject to United States income tax.

58. Raptor's minimum initial subscription requirement was $1,000,000 US and additional subscriptions could be made at a minimum of $100,000 US.

59. During the Relevant Period, shareholders could redeem shares issued on or after January 1, 2006 on the last calendar day of each calendar quarter following the second anniversary of the issue of such shares, or such other date following such anniversary as Raptor's board of directors might determine in its sole discretion.

60. Shareholders could continue to redeem shares issued prior to January 1, 2006 as of the last calendar day of each calendar quarter without regard to such holding period.

61. Gerbro's shares in Raptor derived their value, at any particular time during the Relevant Period, from all of the investments held by Raptor at the time, the potential scope of which is described in the 2003, 2005 and 2006 Raptor Memoranda and 2005 Notice of Changes.

62. The Investor Shares derived their value, at any particular time during the Relevant Period, from all of the investments held by Raptor at the time, the potential scope of which is described in the 2003, 2005 and 2006 Raptor Memoranda and 2005 Notice of Changes.

63. On December 5, 2005, Gerbro purchased 2,009.2291 Class C shares in Raptor with an adjusted cost base ("**ACB**") of $3,529,760 which it continued to hold during the 2006 year.

64. On May 10, 2006, Gerbro purchased 25.9104 Class A shares in Raptor with an ACB of $278,177 and 88.1839 Class B shares with an ACB of $426,229.

65. On June 30, 2006, Gerbro purchased 965.3069 Class C shares in Raptor with an ACB of $1,690,201.

66. On December 31, 2006, Gerbro purchased an additional 886.5406 Class C shares in Raptor with an ACB of $1,760,002.

67. During the 2005 and 2006 years, Gerbro did not dispose of any of its shares in Raptor.

Distribution of Earnings of Raptor

68. At all material times, Raptor's policy regarding distribution of earnings is that dividends may be declared at any time by its Board of Directors at the Board's discretion, but that it did not anticipate that any dividends or other distributions

would be paid to shareholders out of current earnings in 2005 or 2006, but rather that the income would be reinvested.

69. During the 2005 and 2006 Taxation Years, Raptor did not issue dividends or make any other distributions to its shareholders, including Gerbro.

Other Aspects

70. Gerbro was aware, when acquiring/and or holding the shares in Raptor, of, *inter alia*, the following statements set out in the Raptor Offering Memoranda:

    a. that Raptor and Global were not subject to direct taxation (income and capital gains tax) by the government of the Cayman Islands; and

    b. that income of Raptor was subject to minimal taxation in the Netherlands Antilles.

71. Gerbro was aware of Raptor's financial statements during the 2004, 2005 and 2006 years when acquiring and/or holding an interest in Raptor.

72. Gerbro accepted as accurate the statements and information contained in the Raptor's 2004, 2005 and 2006 financial statements when acquiring and/or holding an interest in Raptor.

Arden Endowment Advisors Ltd.

73. Arden Endowment Advisors Ltd. ("**Arden**") is a non-resident investment corporation incorporated and registered as an exempted company under the laws of the Cayman Islands on November 9, 2000.

74. During the Relevant Period, Arden sought to achieve capital appreciation through the allocation of its assets among a select group of money managers, each or which employed a variation of investment strategies attempting to capitalize on inefficiencies and pricing anomalies in securities, in options, and instruments

relating to such securities and in various other financial instruments which tend to have a low correlation to the financial markets.

75. These money managers might also focus on non-traditional securities and financial instruments, and the strategies employed typically involved buying a security or group of securities and selling a related security to offset a long position.

76. Arden's investment manager was Arden Asset Management Inc. ("**AAMI**"), a corporation organized under the laws of the state of New York, U.S.

77. AAMI was eligible for a quarterly management fee equal to 1% per annum of ending quarter net assets of the common shares and a quarterly incentive fee of 10% of the net profits (including unrealised gains), if any, attributable to Arden's common shares, subject to a loss carry forward provision, and provided that the relevant common shares earned a return in excess of an annualized noncumulative return equal to the three-month U.S. T-bill rate.

Arden Private Placement Memoranda

78. The Arden Private Placement Memorandum dated December 1, 2000 ("**2000 Arden Memorandum**")[8] described particulars of Arden such as its strategies, objectives, risks and terms of investment.

79. Gerbro made reference to the 2000 Arden Memorandum when acquiring and/or holding an interest in Arden, as the case may be, when the 2000 Arden Memorandum was in effect.

80. Gerbro took the statements and information contained in the 2000 Arden Memorandum at face value when acquiring and/or holding an interest in Arden, as the case may be, when the 2000 Arden Memorandum was in effect.

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[8] Private Placement Memorandum of Arden Endowment Advisors, Ltd., dated December 1, 2000, Joint Book of Documents, Tab 7.

81. The Arden Private Placement Memorandum dated October, 2003 (**"2003 Arden Memorandum"**) including the appendices[9] attached thereto described certain particulars of Arden such as its strategies, objectives, risks and terms of investment.

82. Gerbro made reference to the 2003 Arden Memorandum when acquiring and/or holding an interest in Arden, as the case may be, when the 2003 Arden Memorandum was in effect.

83. Gerbro took the statements and information contained in the 2003 Arden Memorandum at face value when acquiring and/or holding an interest in Arden, as the case may be, when the 2003 Arden Memorandum was in effect.

84. Gerbro continues to take the statements and information contained in the 2000 and 2003 Arden Memoranda at face value.

85. During the 2005 Taxation Year, the activities, strategies, investments and structure of Arden were as described in the 2000 and 2003 Arden Memoranda.

Investment Objectives

86. Arden's investment objectives are to achieve capital appreciation through the allocation of its assets among various hedge fund managers.

87. Arden utilized money managers employing investment strategies which attempt to capitalize on inefficiencies and pricing anomalies in securities and other financial instruments, and in derivatives thereon, including commodity futures and options on futures, which strategies tend to have a low correlation to the equity and other financial markets, i.e., a relative insensitivity.to movements in those markets. Arden's money managers could focus on non-traditional securities and financial instruments, i.e., securities and instruments of companies: undergoing extraordinary corporate transactions such as a merger, spin-off or similar event; having significant financial difficulties; in the process of reorganizing, either in or out of bankruptcy

[9] Private Placement Memorandum of Arden Endowment Advisors, Ltd., dated October 2003, Joint Book of Documents, Tab 8.

court; or seeking to exploit inefficiencies and anomalies in the pricing of related securities and other financial interests.

88. The strategies employed typically involved buying a security or group of securities and selling a related security as an offset to a long position. The Fund's money managers could combine strategies, as in a 'split strike conversion, i.e., buying an equity security, selling a related out of the money call option representing a like amount of underlying shares and purchasing a related put option which is at or out of the money, in which the defined risk and profit parameters are determined when the position is established. Certain of the money managers utilized by Arden (either directly or through investments in other money managers) sought to exploit pricing inefficiencies in fixed income securities worldwide and in derivatives of those securities. Such money managers also invested in options futures and other fixed income derivatives, as well is currencies, equities, financial futures and options thereon, and their derivatives when it is perceived that such investments are mispriced in relation to other investments. The Arden was not required to utilize any fixed guidelines with respect to the money managers selected and the allocation of assets thereto. With respect to transactions in financial futures, Arden's assets were allocated in a manner so that it will not enter (directly or indirectly) into futures transactions for which the initial margin and premium exceed 10% of Arden's net asset value.

Share Capital Structure

89. At all material times, Arden issued two classes of common shares: G and H.

90. The Class G shares were voting, participative and cannot be transferred except with Arden's permission.

91. Arden's minimum initial subscription requirement was $1,000,000 U.S.

92. All classes of Arden's common shares derived their value, at any particular time, during the 2005 Taxation Year, from all of the investments held by Arden at the

time, the potential scope of which is described in the 2000 and 2003 Arden Memoranda.

93. Gerbro's shares in Arden derived their value, at any particular time during the 2005 Taxation Year, from all of the investments held by Arden at the time, the potential scope of which is described in the 2000 and 2003 Arden Memoranda.

94. All classes of Arden's common shares could be redeemed with at least 60 days prior written notice on the last business day of each calendar quarter.

95. On February 26, 2004, Gerbro purchased 66,475.680 Class G, Series 03/04 shares in Arden with an ACB of $9,402,400 CDN.

96. On April 1, 2004, Gerbro redeemed its Class G Series 03/04 and was issued 66,475.031 Class G series 10/03 in Arden with an ACB of $9,402,400 CDN.

97. On October 27, 2005, Gerbro purchased 29,608.725 Class G Series 11/05 shares in Arden with an ACB of $4,093,950 CDN.

Distribution of Earnings

98. At all material times, Arden's policy regarding distribution of earnings was that it did not intend to make distributions, but rather any income earned would be reinvested.

99. During the 2005 Taxation Year, Arden did not issue dividends or make any other distributions to its shareholders, including Gerbro.

Other Aspects

100. Gerbro was aware, when acquiring and/or holding shares in Arden, of the following statements set out in the Arden Offering Memoranda:

    a. that Arden was not subject to income, withholding or capital gains taxes in the Cayman Islands;

b. that a 30% withholding tax in the United States would be payable by Arden on its income from dividends and interest applicable to dividends and certain interest income considered-to be from sources within the United States; and

c. that Arden may be subject to income or withholding taxes imposed by the various non-U.S. jurisdictions in which Arden invests.

101. Gerbro made reference to Arden's financial statements during the 2004 and 2005 years when acquiring and/or holding an interest in Arden.

102. Gerbro accepted as accurate the statements and information contained in Arden's 2004 and 2005 financial statements when acquiring and/or holding an interest in Arden.

103. During the 2005 year, Gerbro was aware of, *inter alia*, the following claims set out in the Arden Offering Memoranda:

a. that Arden was not subject to direct taxation (income and capital gains tax) by the government of the Cayman Islands; and

b. that Arden may be subject to income or withholding taxes imposed by the various non-U.S. jurisdictions in which Arden invests.

104. On December 1, 2005, Gerbro disposed of all its Class G shares (96,083.756) to Woodrock for proceeds of disposition in the amount of $13,467,753 CDN. The sale was performed by way of a reduction of capital.

M Kingdon Offshore Ltd.

105. M Kingdon Offshore Ltd. ("**Kingdon**") was a company incorporated in the Netherland Antilles on March 13, 1986 operating as M. Kingdon Offshore N.V.

106. During the 2005 year, Kingdon was a stand-alone fund (i.e. it did not have a master fund-feeder fund structure).

107. Kingdon's investment manager is Kingdon Capital Management L.L.C. ("**KCM**"), a limited liability company incorporated in the state of Delaware, U.S.

108. KCM was eligible for a management fee of 1.5% per annum and an incentive fee of 20% per annum of Kingdon's net profit including unrealized gains, subject to loss carry forwards.

Kingdon Explanatory Memorandum

109. The Kingdon Confidential Explanatory Memorandum dated January 1, 2005 ("**2005 Kingdon Memorandum**")[10] described certain particulars of Kingdon such as its strategies, objectives, risks and terms of investment.

110. Gerbro made reference to the 2005 Kingdon Memorandum when acquiring and/or holding an interest in Kingdon, as the case may be, when the 2005 Kingdon Memorandum was in effect.

111. Gerbro accepted the statements and information contained in the 2005 Kingdon Memorandum at face value when acquiring and/or holding an interest in Kingdon, as the case may be, when the 2005 Kingdon Memorandum was in effect.

112. Gerbro continues to take the statements and information contained in the 2005 Kingdon Memorandum at face value.

113. During the 2005 Taxation Year, the activities, strategies, investments and structure of Kingdon were as described in the 2005 Kingdon Memorandum.

Investment Objectives

114. Kingdon's investment objective was to maximize risk-adjusted total returns.

115. Kingdon's investment criteria included valuation, both asset and earning based, earnings momentum and relative price momentum.

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[10] Confidential Explanatory Memorandum, M. Kingdon Offshore N.V., Joint Book of Documents, Tab 9.

116. In selecting investments, KCM emphasizes both individual security selection ("bottom-up" approach) and a general economic analysis ("top-down" approach).

117. An internally developed asset allocation model encompassing over 30 economic, technical and valuation factors was utilized by KCM in allocating Kingdon's assets among various investments.

118. Kingdon invested primarily in common stocks and bonds but might have significant investments in put and call options, stock warrants, rights, preferred stocks, convertible securities, commodities, commodity contracts, financial future and stock market index futures.

119. From time to time, the Kingdon engaged in short sales of the above financial instruments. Kingdon invested in futures and options and effects short sales for speculative as well as hedging purposes. Kingdon invested primarily in securities listed on national securities exchanges such as the New York and American Stock Exchanges, or traded in the over-the-counter market. Kingdon also invested in foreign securities not traded in the United States' securities markets and could invest in shares of open-end or closed-end investment companies and foreign currencies. Kingdon occasionally wrote put and call options either against existing securities' positions in the Kingdon's portfolio or on an uncovered basis.

120. In such circumstances as KCM deemed prudent, it sought protection of capital by means of investments in fixed-income instruments (including corporate, government and municipal obligations) or by means of maintenance of cash or cash-equivalent funds including demand deposits and investments in certificates of deposit, in time deposits, in money market instruments, in securities of registered investment companies that invest primarily in short-term money market instruments, or in other short-term debt instruments.

121. Depending on market conditions, KCM emphasized active management of a significant portion of Kingdon's portfolio, with a sensitivity to short-term market trends and price changes in individual securities. This policy was expected to result

in the Kingdon's taking frequent trading positions. As a result, Kingdon's portfolio turnover and brokerage commission expenses were expected to exceed those of most investment entities of comparable size.

Share Capital Structure

122. As at January 1, 2005, Kingdon offered Class A common shares.

123. Class A shares were denominated in US dollars with a minimum initial subscription requirement of $2,000,000 US, unless waived by the managing director.

124. During the Relevant Period, all classes of Kingdon's common shares were voting, and within each series, have equal dividend, distribution and liquidation rights.

125. All classes of Kingdon's common shares derived their value at any particular time during the 2005 Taxation Year, from all of the investments held by Kingdon at the time, the potential scope of which is described in the 2005 Kingdon Memorandum.

126. Gerbro's shares in Kingdon derived their value, at any particular time during the 2005 Taxation Year, from all of the investments held by Kingdon at the time, the potential scope of which is described in the 2005 Kingdon Memorandum.

127. The common shares could be redeemed with at least 30 days prior written notice and could be redeemed on the last day of each quarter.

128. On December 1, 2004, Gerbro purchased 142,859.822 Class A shares in Kingdon with an ACB of $13,485,343 CDN.

Distribution of Earnings

129. At all material times, Kingdon's policy regarding distribution of earnings is that dividends might be declared at any time by its board of directors at the board's discretion, but that it did not anticipate that any dividends or other distributions would be paid to shareholders out of current earnings, but rather that the income would be reinvested.

130. During the 2005 Taxation Year, Kingdon did not issue dividends or make any other distributions to its shareholders, including Gerbro.

Other Aspects

131. Gerbro made reference to Kingdon's financial statements when acquiring and/or holding an interest in Kingdon.

132. Gerbro accepted as accurate the statements and information contained in Kingdon's 2004 and 2005 financial statements when acquiring and/or holding an interest in Kingdon.

133. During the 2005 Taxation Year, Gerbro was aware of, *inter alia*, the following statements set out in the 2005 Kingdon Memorandum:

    a. that Kingdon was subject to a maximum tax liability in the Netherland Antilles of $10,000 US per annum; and

    b. that Kingdon was subject to 30% withholding tax on dividends and certain interest received from the U.S.; and

    c. that Kingdon generally intended to invest in debt obligations, the interest on which is not subject to the 30% U.S. withholding tax.

134. On December 1, 2005, Gerbro disposed of all its Kingdon Class A shares to Woodrock for proceeds of disposition in the amount of $15,311,509 CDN. The sale was performed by way of a reduction of capital.

Haussmann Holdings N.V.

135. Haussmann Holdings N.V. ("**Haussmann**") is a limited liability corporation organized under the laws of the Netherlands Antilles in April of 1969.

136. During the Relevant Period, Haussmann acted as a feeder fund.

137. During the Relevant Period, Haussmann was listed on the Irish Stock Exchange.

138. As of December 5, 2005 Haussmann's investment manager was HH Management Limited ("**HHML**"), a company incorporated in the British Virgin Islands.

139. HHML was eligible for a management fee and financial advisor fee at a combined rate of 1.90% per annum of the average of the net asset values of the shares for the relevant quarter but was not eligible for an incentive fee.

Haussmann Explanatory Memorandum

140. The available excerpts of the Haussmann Explanatory Memorandum for 1991 ("**1991 Haussmann Memorandum**")[11] described certain particulars of Haussmann such as its strategies, objectives, risks and terms of investment.

141. Gerbro made reference to excerpts of the 1991 Haussmann Memorandum when acquiring and/or holding an interest in Haussmann, as the case may be, when the 1991 Haussmann Memorandum was in effect.

142. Gerbro accepted the statements and information contained in the 1991 Haussmann Memorandum at face value when acquiring and/or holding an interest in Haussmann as the case may be, when the 1991 Haussmann Memorandum was in effect.

143. The Haussmann Explanatory Memorandum dated February 19, 1999 ("**1999 Haussmann Memorandum**")[12] described certain particulars of Haussmann such as its strategies, objectives, risks and terms of investment.

144. Gerbro made reference to the 1999 Haussmann Memorandum when acquiring and/or holding an interest in Haussmann, as the case may be, when the 1999 Haussmann Memorandum was in effect.

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[11] Excerpt from Haussmann Holdings N.V. Explanatory Memorandum – February 15, 1989/ 1991, Joint Book of Documents, Tab 10.

[12] Explanatory Memorandum of Haussmann Holdings N.V., dated February 1, 1999, Joint Book of Documents, Tab 11.

145. Gerbro accepted the statements and information contained in the 1999 Haussmann Memorandum at face value when acquiring and/or holding an interest in Haussmann as the case may be, when the 1999 Haussmann Memorandum was in effect.

146. The Haussmann Explanatory Memorandum dated January 2, 2003 ("**2003 Haussmann Memorandum**")[13] describes certain particulars of Haussmann such as its strategies, objectives, risks and terms of investment.

147. Gerbro made reference the 2003 Haussmann Memorandum when acquiring and/or holding an interest in Haussmann, as the case may be, when the 2003 Haussmann Memorandum was in effect.

148. Gerbro accepted the statements and information contained in the 2003 Haussmann Memorandum at face value when acquiring and/or holding an interest in Haussmann as the case may be, when the 2003 Haussmann Memorandum was in effect.

149. Gerbro continues to take the statements and information contained in the 1991, 1999 and 2003 Haussmann Memoranda at face value.

150. During the Relevant Period, the activities, strategies, investments and structure of Haussmann were as described in the 1991, 1999 and 2003 Haussmann Memoranda.

Investment Objectives

151. Haussmann's primary investment objective during the Relevant Period was to achieve capital appreciation with lower risk than traditional investments by investing all of its assets with various other funds of recognized standing or discretionary securities investment accounts managed primarily by independent investment managers who use alternative investment strategies.

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[13] Explanatory Memorandum of Haussmann Holdings N.V., dated January 2, 2003, Joint Book of Documents, Tab 12.

152. Generating current income through the receipt of interest or dividends was only a secondary objective.

153. Haussmann invested, among other things, in other hedge funds, or independent investment managers (e.g. the Kingdon and Raptor funds).

154. These independent investment managers had investment styles such as: US long/short hedge, European hedge, Japan hedge, macro managers, US emerging growth, global equity long, emerging markets and event driven.

155. The independent investment managers could engage in hedging and leveraging activities, and could also purchase and sell puts, calls and other option instruments to supplement their hedging and leveraging activities. In addition, investment managers could also invest in various commodities futures contracts and might take positions in foreign currencies.

Share Capital Structure

156. As of February 1, 1999, Haussmann offered two classes of common shares for subscription: A and B:

    a. Class A shares were voting, participating and denominated in US dollars; and

    b. Class B shares were non-voting, participating, denominated in US dollars with a minimum initial subscription of $100,000 US.

157. As of January 2, 2003, Haussmann offered three classes of common shares for subscription: A, B and C:

    a. Class A shares are voting, participating and denominated in US dollars;

    b. Class B shares are non-voting, participating, denominated in US dollars with a minimum initial subscription of $100,000 US; and

    c. Class C shares are non-voting, participating and denominated in Euros.

158. All of the shares are offered at their respective net asset value and are redeemable on "Dealing Day" (i.e. the last business day of each calendar month) or any other day determined by the board upon 20 days prior written notice for an amount equal to the net asset value of each class of shares less the redemption fee.

159. The shares derived their value, at any particular time during the Relevant Period, from all of the investments held by Haussmann at the time, the potential scope of which is described in the 1991, 1999 and 2003 Haussmann Memoranda.

160. Gerbro's shares in Haussmann derived their value, at any particular time during the Relevant Period, from all of the investments held by Haussmann at the time, the potential scope of which is described in the 1991, 1999 and 2003 Haussmann Memoranda.

161. On March 10, 2004, Gerbro purchased 1,780.658 Class B shares with an ACB of $4,021,486 CDN.

162. During the 2005 and 2006 Taxation Years, Gerbro held 2070 Class A shares with an ACB of $1,388,892 CDN.

163. On November 7, 2005, Gerbro purchased an additional 1850,876 Class B shares with an ACB of $4,156,928 CDN.

164. During the 2006 Taxation Year, Gerbro held 3,631.534 Class B shares with an ACB of $8,178,414 CDN.

165. During the Relevant Period, Gerbro did not dispose of any of its shares in Haussmann.

Distribution of Earnings

166. At all material times, the generation of interest or dividends was not the primary objective of Haussmann but dividends could be paid to shareholders at Haussmann's discretion.

167. Gerbro received a dividend from Haussmann during the 2005 Taxation Year in the amount of $8,915.82.

168. Gerbro received a dividend from Haussmann during the 2006 Taxation Year in the amount of $26,311.44.

Other Aspects

169. Gerbro made reference to Haussmann's financial statements during the 2004, 2005 and 2006 when acquiring and/or holding an interest in Haussmann.

170. Gerbro accepted as accurate the statements and information contained in Haussmann's 2004, 2005 and 2006 financial statements when acquiring and/or holding an interest in Haussmann.

171. Gerbro was aware of, *inter alia*, the following statements set out in the 1991, 1999 and 2003 Haussmann Offering Memoranda:

a. that to the extent that Haussmann's income consists of capital gains (either short or long term) realized from the sale or redemption of securities of funds or other corporations incorporated in the Netherlands Antilles or in the United States, which in the past has constituted most of its income, Haussmann was not subject to any Netherlands Antilles or United States Federal income taxes;

b. that the application of income taxes to capital gains realized from the sale or redemption of securities of funds or other corporations incorporated in countries other than the Netherlands Antilles or the United States depended on the laws of the taxing country;

c. that dividend income received by Haussmann from funds or other corporations incorporated in the United States was subject to a United States withholding tax of 30 per cent, on the gross amount of such dividend; and

d. that dividend and interest income was taxable at a rate of 2.4% on its first 100,000 Netherland Florins (about $56,000 US in 2005) and 3% in excess

thereof. However, during the 2005 Taxation Year, Haussmann was subject to a maximum level of tax liability in the Netherland Antilles of $10,000 US per annum, due to a tax ruling that Haussmann had received.

Caxton Global Investments Ltd.

172. Caxton Global Investments Limited ("**Caxton**") is a non-resident trading and investment fund organized and registered in March of 1995 as an exempted company under the laws of the British Virgin Islands.

173. Caxton is recognized under the *British Virgin Islands Mutual Funds Act 1996* as a Professional Mutual Fund and its principal offices are located in Hamilton, Bermuda.

174. Caxton commenced operations on February 1, 1996 and acts as a feeder fund to a master fund, Caxton International Limited ("**Caxton International**").

175. Caxton International, a British Virgin Islands corporation, is a subsidiary of Caxton.

176. Caxton's investment and trading activities were supervised, during the Relevant Period, by Caxton Associates L.L.C. ("**Caxton Associates**"), a limited liability company in the state of Delaware, U.S.

177. Caxton Associates acted as a trading advisor to both Caxton and Caxton International.

178. Caxton Associates was eligible for an advisory fee of 3% per annum on Caxton's aggregate net assets and an annual incentive fee of 30% of Caxton's net profits attributable to its preference shares.

Caxton Explanatory Memorandum

179. The Caxton Explanatory Memorandum dated June 30, 2006 (**"2006 Caxton Memorandum"**)[14] described certain particulars of Caxton such as its strategies, objectives, risks and terms of investment.

180. Gerbro made reference to the 2006 Caxton Memorandum when acquiring and/or holding an interest in Caxton, as the case may be, when the 2006 Caxton Memorandum was in effect.

181. Gerbro took the statements and information contained in the 2006 Caxton Memorandum at face value when acquiring and/or holding an interest in Caxton.

182. Gerbro continues to take the statements and information contained in the 2006 Caxton Memorandum at face value.

183. During the 2006 Taxation Year, the activities, strategies, investments and structure of Caxton were as described in the 2006 Caxton Memorandum.

Investment Objectives

184. Caxton's primary investment objective was to achieve capital appreciation and its principal activity is trading in the international currency, financial, commodities and securities markets mainly through its investment in Caxton International.

185. Caxton had a broad mandate to trade in all exchange and over-the-counter markets, and to trade derivative products and other instruments.

186. During the 2006 Taxation Year, Caxton invested up to 15% - 18% of its net assets in strategic investments.

187. Caxton's trading methods were highly discretionary and judgemental, relying upon the subjective analysis of the markets as well as quantitative strategies. Trading

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[14] Caxton Explanatory Memorandum and Offer to Subscribe for Non-Voting Preference Shares U.S. $0.1 Par Value, Joint Book of Documents, Tab 13.

decisions were based on a combination of technical and fundamental analysis. A range of monitoring and analytical techniques were utilized to make risk management more rational and effective.

188. In its trading in major international and "exotic" currencies, Caxton attempted to profit from exchange rate fluctuations, and engaged in currency-crosses in which it attempted to profit from the relative price movement between two currencies.

189. Caxton also traded futures contracts on a wide variety of commodities, including, but not limited to, financial instruments, indices, precious metals and agricultural products.

190. Caxton also pursued trading strategies involving options, derivatives, physicals and other commodity interests in markets worldwide.

191. Caxton engaged in a broad range of securities trading including U.S. and non-U .S. equity and debt securities (including options, warrants and other rights with respect thereto) on both a discretionary basis and separately on the basis of computerized trading programs.

192. Caxton also traded U.S. and non-U.S. government securities with related financing through repurchase, reverse repurchase agreements and other financing arrangements. It pursued strategies involving interest rate and other swap agreements, and other derivative products both for purposes of risk management and profit objectives.

193. Caxton further expanded its trading activities to include various relative value strategies involving U.S. and non-U .S. government securities, mortgage backed and mortgage related securities, corporate debt and equity securities, as well as convertibles, warrants, options and other derivatives and instruments.

194. At all material times, Caxton pursued its investment objectives through the investment of its capital in Caxton International.

195. Caxton International's investment objectives were identical to those of Caxton's.

Share Capital Structure

196. Caxton's authorized share capital consisted of:

a. during the 2006 Taxation Year, all issued and outstanding common shares were held 1,000 voting common shares with a par value of $0.01 per share (which were all held by Caxton's directors); and

b. 34.5 million non-voting preference shares with a par value of $0.01 per share.

197. At all material times, Caxton issued four classes of preference shares:

a. Standard Preference Shares ("**Class A**");

b. Class B;

c. Restricted Class E ("**Class E**"); and

d. Class E series 1.

198. During the 2006 Taxation Year, no Class B shares remained outstanding.

199. Classes E and E series 1 shares are held exclusively by former shareholders of another investment entity that was a shareholder of Caxton International.

200. A limited number of Class E series 1 shares were issued solely in connection with certain deferred incentive fee arrangements with Caxton Associates.

201. Class E series 1 shares were identical to Class E shares except that they are charged reduced management and incentive fees and may be subject to limited redemptions rights.

202. Class E shares were identical to the Class A shares except that they did not participate in the secondary market and could be redeemed on substantially the same monthly basis that was available with respect to such holder's indirect or direct (as applicable) investment in Caxton International.

203. Caxton's minimum initial subscription requirement was $100,000 US.

204. As of June 30, 2006, some or all of the standard preference shares could be redeemed as of the last day of each year with at least 60 days prior written notice, subject to certain terms and conditions.

205. Gerbro's shares in Caxton derived their value, at any particular time during the 2006 Taxation Year, from all of the investments held by Caxton at the time, the potential scope of which is described in the 2006 Caxton Memorandum.

206. On May 2, 2006, Gerbro purchased 1,565 Class E shares in Caxton with an ACB of $955,810.

207. On August 16, 2006, Gerbro purchased 1,472 Class A shares in Caxton with an ACB of $900,852.

208. On August 30, 2006, Gerbro purchased an additional 7,743 Class A shares in Caxton with an ACB of $4,710,237.

209. During the 2006 year, Gerbro did not dispose of any of its shares in Caxton.

Distribution of Earnings

210. At all material times, Caxton's policy regarding distribution of earnings is that dividends may be declared at any time by its board of directors if sufficient profits were available at the board's discretion. However, Caxton did not anticipate that any dividends or other distributions would be paid to shareholders out of current earnings in 2006, but rather that the income would be reinvested so as to achieve its primary objective of capital appreciation.

211. At all material times, no dividends could be paid on the Caxton common shares.

212. During the 2006 Taxation Year, Caxton did not issue dividends or make any other distributions to its shareholders, including Gerbro.

Other Aspects

213. Gerbro made reference to Caxton's financial statements during the 2006 Taxation Year when acquiring and/or holding an interest in Caxton.

214. Gerbro accepted as accurate the statements and information contained in Caxton's 2005 and 2006 financial statements when acquiring and/or holding an interest in Caxton.

215. Gerbro was aware of, *inter alia*, the following claims set out in the 2006 Caxton Memorandum:

    a. that interest, dividends and other revenue as well as capital gains received by Caxton might be subject to withholding or similar taxes imposed by the country in which such interest, dividends or other revenues originate;

    b. that Caxton would in only limited circumstances be eligible to benefit from any treaties for relief from double taxation;

    c. that it was possible that Caxton would derive income that is effectively connected with the conduct of a U.S. trade or business. Any such income would be subject to U.S. federal income tax on a net basis (after giving effect to deductions, if a tax return is timely filed) and, in addition, would generally cause Caxton to be subject to U.S. branch profits tax;

    d. that Caxton might be subject to tax in one or more foreign jurisdictions as a result of particular strategic investments; and

    e. that, save for a fixed government annual British Virgin Islands license fee of $1,000 and an annual government professional fund recognition fee of $350, Caxton was not subject to income, capital gains and withholding tax under Bermuda and British Virgin Islands law.

Gerbro's Income Tax Reporting and Assessments

216. Gerbro prepared consolidated financial statements for 2005 and 2006 (the **"financial statements, 2005 and 2006"**)[15], [16]

217. For its taxation year ended December 31, 2004 (the **"2004 Taxation Year"**) and its 2005 Taxation Year, Gerbro filed its income tax returns in accordance with the proposed Foreign Investment Entity (**"FIE"**) rules in connection with its investments in Raptor, Arden and Kingdon with the exception of Haussmann.

218. Gerbro elected the mark to market method for its investments in Arden and the imputed income method (accrual method) for its investments in Kingdon and Raptor.

219. During the 2006 Taxation Year, Gerbro re-filed its income tax returns for its 2004 and 2005 Taxation Years in order to reverse its election to report income in accordance with the proposed FIE rules in connection with its investments in Raptor, Arden and Kingdon on the basis that the proposed FIE rules would come into force effective only for its taxation year ended December 31, 2007.

220. During the 2005 year, Woodrock reported income pursuant to the proposed FIE Rules in connection with its investment in Arden and elected the imputed income method (accrual method).

221. During the 2006 Taxation Year, Gerbro did not file its income tax return in accordance with the proposed FIE Rules as they were proposed to become effective beginning in 2007.

222. On January 14, 2010, the Canada Revenue Agency (the **"CRA"**) issued a notice of reassessment with respect to Gerbro's 2005 Taxation Year (the **"2005 Reassessment"**).[17] As a result, the CRA:

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[15] Gerbro Inc. consolidated financial statements for fiscal year ending December 31, 2005, Joint Book of Documents, Tab 14.
[16] Gerbro Inc. consolidated financial statements for fiscal year ending December 31, 2006, Joint Book of Documents, Tab 15.

a. added an aggregate amount of $841,803 to Gerbro's income by virtue of section 94.1 of the *Act*, in connection with Gerbro's investment in the Funds;

b. added an amount of $234,896 to Part I tax payable; and

c. charged arrears interest and refund interest in the aggregate amount of $73,857.11.

223. On April 7, 2010, Gerbro filed a notice of objection against the 2005 Reassessment.[18]

224. On July 27, 2010, the CRA issued a notice of reassessment with respect to Gerbro's 2006 Taxation Year (the "**2006 Reassessment**").[19] As a result, the CRA:

a. added an aggregate amount of $754,2010 to Gerbro's income by virtue of section 94.1 of the *Act*, in connection with Gerbro's investments in the Funds;

b. added an amount of $167,444 of Part I tax payable; and

c. charged arrears interest and refund interest in the aggregate amount of $39,200.36.

225. On October 22, 2010, Gerbro filed a notice of objection against the 2006 Reassessment.[20]

226. The Canada Revenue Agency (CRA) prepared an audit report for the 2005 and 2006 taxation years.[21]

227. The CRA prepared a report on objection for 2005.[22]

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[17] Notice of Reassessment issued by the Canada Revenue Agency with respect to the Appellant's taxation year ended December 31, 2005, Joint Book of Documents, Tab 16.
[18] Notice of Objection with respect to the Appellant's taxation year ended December 31, 2005, Joint Book of Documents, Tab 17.
[19] Notice of Reassessment issued by the Canada Revenue Agency with respect to the Appellant's taxation year ended December 31, 2006, Joint Book of Documents, Tab 18.
[20] Notice of Objection with respect to the Appellant's taxation year ended December 31, 2006, Joint Book of Documents, Tab 19.
[21] T20 Audit Report with respect to the relevant Period and appendices, Joint Book of Documents, Tab 20.

228. The CRA prepared a report on objection for 2006.[23]

229. By notice of confirmation dated July 26, 2012, the CRA confirmed the 2006 Reassessment.

The Proposed FIE Rules

230. Following the 1999 federal budget announcing the proposed FIE rules, successive draft amendments to section 94.1 of the *Income Tax Act* ("**ITA**") were proposed,[24] each proposing to repeal and replace current section 94.1 of the ITA.

231. Draft legislation was initially issued by the Department of Finance on June 22, 2000.[25]

232. The effective date of the proposed legislation was deferred to taxation years commencing after 2001, by press release of the Department of Finance issued on September 7, 2000.

233. The Department of Finance issued revised draft legislation on August 2, 2001.[26]

234. In December 2001, the Department of Finance further deferred the application of the new rules to years commencing after 2002.[27]

235. New revised drafts of the proposals were later successively issued on October 11, 2002,[28] October 30, 2003[29] and July 18, 2005,[30] each supplanting the prior proposals.

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[22] T401 Report on Objection with respect to the 2005 Taxation Year, Joint Book of Documents, Tab 21.
[23] T401 Report on Objection with respect to the 2006 Taxation Year, Joint Book of Documents, Tab 22.
[24] 1999 federal budget of Canada entitled "The Budget Plan 1999, Including Supplementary Information and Notice of Ways and Means Motions – Building today for a better tomorrow" published by the Department of Finance, Canada, Joint Book of Documents, Tab 23.
[25] Department of Finance Release No. 2000-050: "Legislative Proposals and Explanatory Notes on Taxation of Non-Resident Trusts and Foreign Investment Entities", Joint Book of Documents, Tab 24.
[26] Department of Finance Release No. 2001-067: "Legislative Proposals and Explanatory Notes on Taxation of Non-Resident Trusts and Foreign Investment Entities", Joint Book of Documents, Tab 25.
[27] Finance Canada document number 2001-120, "News Release", Joint Book of Documents, Tab 26.
[28] Department of Finance Release No. 2002-084: "Legislative Proposals and Explanatory Notes on Taxation of Non-Resident Trusts and Foreign Investment Entities", Joint Book of Documents, Tab 27.

236. On November 9, 2006, the sixth iteration of the proposals was introduced by Notice of Ways and Means Motion[31] and, once again, deferred the application of the proposed rules to taxation years commencing after 2006.

237. On November 22, 2006, Bill C-33 of the 1st Session of the 39th Parliament was introduced before the House of Commons, containing the proposals.

238. However, Bill C-33 died on the order paper as Parliament was later prorogued.[32]

239. On October 29, 2007, Bill C-10 of the 2nd Session of the 39th Parliament[33] was introduced before the House of Commons, re-introducing former Bill C-33.[34] Bill C-10 was passed by the House of Commons.[35]

240. The Senate did not adopt Bill C-10 and mandated the Standing Senate Committee on Banking, Trade and Commerce to review it.

241. The Standing Senate Committee on Banking, Trade and Commerce recommended that the Department of Finance undertake a thorough review of Bill C-10, inter alia, with respect to proposed section 94.1 of the ITA.[36]

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[29] Department of Finance Release No. 2003-054: "Notice of Ways and Means Motion to Amend the Income Tax Act Re Non-Resident Trusts and Foreign Investment Entities and Explanatory Notes", Joint Book of Documents, Tab 28.

[30] Department of Finance Release No. 2005-049: "Draft Legislation and Explanatory Notes to Amend the Income Tax Act", Joint Book of Documents, Tab 29.

[31] Department of Finance Release No. 2006-065: "Notice of Ways and Means Motion and Explanatory Notes to Amend the Income Tax Act", Joint Book of Documents, Tab 30.

[32] Proclamation Proroguing Parliament to October 16, 2007 published in Canada Gazette, Part II, EXTRA Vol. 141, No. 2, Joint Book of Documents, Tab 31.

[33] Hansard Official Report of Debates of the Senate, 39th Parliament, 2nd Session, Volume 144, Number 19, Joint Book of Documents, Tab 32.

[34] Bill C-33, 39th Parliament, 1st Session, "An Act to Amend the Income Tax Act, Including Amendments in Relation to Foreign Investment Entities and Non-Resident Trusts, and to Provide for the Bijural Expression of the Provisions of that Act" as passed by the House of Commons and as at First Reading in the Senate, Joint Book of Documents, Tab 33.

[35] Bill C-10, 39th Parliament, 2nd Session, "An Act to Amend the Income Tax Act, Including Amendments in Relation to Foreign Investment Entities and Non-Resident Trusts, and to Provide for the Bijural Expression of the Provisions of that Act" as passed by the House of Commons and as at Second Reading in the Senate, Joint Book of Documents, Tab 34.

[36] Transcripts & minutes of meetings of the Standing Senate Committee on Banking, Trade and Commerce relating to Bill C-10, 39th Parliament, 2nd Session, "An Act to Amend the Income Tax Act, Including Amendments in Relation to Foreign Investment Entities and Non-Resident Trusts, and to Provide for the Bijural Expression of the Provisions of that Act" *en liasse*, Joint Book of Documents, Tab 35.

242. As part of the 2010 federal budget, the proposed amendments to section 94.1 of the ITA were essentially abandoned, thus reverting to current section 94.1 of the ITA.[37]

DATED at the City of Toronto, Ontario, on this 29 day of October, 2014.

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[37] 2010 federal budget of Canada entitled " Budget 2010 – Leading the Way on Jobs and Growth" published by the Department of Finance, Canada, Joint Book of Documents, Tab 36.

2012-739(IT)G
2012-4194(IT)G

TAX COURT OF CANADA

BETWEEN:

GERBRO HOLDINGS COMPANY

Appellant

and

HER MAJESTY THE QUEEN

Respondent

STATEMENT OF AGREED FACTS (PARTIAL)

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