Docket: 2017-4685(IT)G

BETWEEN:

3295940 CANADA INC.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeal heard on September 8, 2020, at Ottawa, Canada.

Before: The Honourable Justice Réal Favreau

Appearances:

Counsel for the appellant:	Roger Taylor Marie-Claude Marcil Stéphanie Valois
Counsel for the respondent:	Yanick Houle Sara Jahanbakhsh Dominic Bédard-Lapointe

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JUDGMENT

The appeal from the reassessment dated November 21, 2008, for the appellant's taxation year ending March 31, 2005, is dismissed, with costs to the respondent, in accordance with the attached reasons for judgment.

Signed at Montreal, Quebec, this 30th day of June 2022.

"Réal Favreau"

Favreau J.

Translation certified true
on this 24th day of August 2022.
François Brunet, Revisor

Citation: 2022CCI68
Date: 20220630
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REASONS FOR JUDGMENT

Favreau J.

[1] This is an appeal from a reassessment made under the *Income Tax Act*, R.S.C., 1985, c. 1 (5th Supp.), as amended (the "Act") by the Minister of National Revenue (the "Minister"), dated November 21, 2008 regarding the appellant's taxation year ending March 31, 2005.

[2] According to this reassessment, the Minister added a $31,500,000 capital gain in calculating the appellant's income after applying the general anti-avoidance rule (the "GAAR"), provided for in section 245 of the Act.

[3] The facts in this case are not being contested and were the subject of a partial agreed statement of facts that has been reproduced in its entirety at the end of this judgment.

[4] The background is appropriate to explain this litigation.

[5] At the core of this litigation is a company specialized in developing, producing and distributing generic injectable drugs, notably morphine.

[6] This company, known as Sabex Inc. ("Sabex") was incorporated in 1973 under the *Canada Business Corporations Act*.

[7] In 1980, Sabex was acquired by Michel Saucier ("Saucier") and Gilles R. Dupuis ("Dupuis"), who each held 50% of the company's shares at the time.

[8] In 1996, Dupuis sold his stake in Sabex to Saucier, who financed the transaction with the assistance of the Caisse de dépôt et placement du Québec ("CDPQ"), which in turn received 25% of the company's shares.

[9] In 2001, Saucier wanted to divest himself of all his shares in Sabex, but if necessary would agree to remain involved in Sabex for a certain period of time to facilitate the transaction.

[10] The tax attributes of the blocks of shares held by Sabex shareholders at that time were as follows:

Shareholders	Adjusted cost base (ACB)	Fair market value (FMV)	Safe income
Michel Saucier	$2,000	$172,500,000	$23,000,000
CDPQ/ Sofinov	$7,500,000	$57,500,000	N/A

[11] On January 25, 2002, the investment fund known as RoundTable Healthcare Partners, L.P. and RoundTable Investors L.P. (collectively, "RoundTable") offered Saucier the opportunity to purchase 80% of Sabex. Saucier accepted RoundTable's proposal. RoundTable Healthcare Partners L.P. Is an American investment fund (based in the state of Illinois).

I. Partial sale of 80% of Sabex in 2002

[12] To implement the 80% purchase of Sabex, the following transactions, including CDPQ's sale of its 25% stake in Sabex, were put in place:

a) On March 19, 2022, Sabex 2002 Inc. ("Sabex 2002") and Sabex 2002 Holdings Inc. ("Sabex 2002 Holdings") were incorporated under the *Canada Business Corporations Act*, and Sabex purchased a Class B common share in Sabex 2002 and Sabex 2002 Holdings for a nominal amount;

b) On April 10, 2002, Gestion Micsau inc. ("Micsau") was incorporated under the *Canada Business Corporations Act*;

c) On April 17, 2002, Saucier transferred all his Sabex shares to Micsau, specifically 13,5000,000 common shares, 8,000,000 Class A preferred shares and 500,000 Class C preferred shares, in exchange for 120 common shares of Micsau. This transaction was subject to a joint election under subsection 85(1) of the Act, and the amount agreed upon by the parties was a nominal amount;

d) On April 18, 2002, Sabex sold all its shares to Sabex 2002 for $256,562,000. In exchange, Sabex received the assumption of $26,562,000 of its debts, a note payable in the amount of $176,000,000 and 1,999,999 Class B common shares, representing 20% of the common shares of Sabex 2002. The payment also included a $10,000,000 contingent consideration based on future performance. This transaction was also subject to a joint election under subsection 85(1) of the Act;

e) On April 18, 2002, CDPQ sold all its Sabex shares to Micsau in exchange for two notes payable totalling $47,460,000;

f) On April 18, 2002, Sabex transferred all its Sabex 2002 shares (2,000,000 Class B common shares) to Sabex 2002 Holdings in exchange for 1,999,999 Class B common shares of Sabex 2002 Holdings. This transaction was subject to a joint election under subsection 85(1) of the Act, and the amount agreed upon by the parties was a nominal amount;

g) On April 18, 2002, RoundTable purchased 8,000,000 Class A common shares of Sabex 2002 Holdings for $69,115,784;

h) On April 18, 2002, Sabex 2002 Holdings purchased 8,000,000 Class A common shares of Sabex 2002 Holdings for $69,115,784;

i) On April 18, 2002, Sabex 2002 borrowed $110,000,000 from a financial institution;

j) On April 18, 2002, Sabex 2002 paid off the $176,000,000 note payable to Sabex;

k) On April 18, 2002, Sabex paid a $47,460,000 dividend to Micsau;

l) On April 18, 2002, Micsau paid off the two notes payable totalling $47,460,000 to CDPQ.

[13] After RoundTable purchased 80% of Sabex's shares, the situation was as follows:

a) Saucier held 100% of shares in Micsau;

b) Micsau held 100% of shares in Sabex, whose corporate name had been changed to 3295940 Canada inc. ("3295940") pursuant to a certificate of amendment dated April 25, 2002;

c) 3295940 held 2,000,000 Class B shares, representing 20% of shares in Sabex 2002 Holdings, whose corporate name had been changed to Sabex Holdings Ltd. ("Holdings") pursuant to a certificate of amendment dated April 1, 2004. These shares involved a nominal amount in terms of paid-up capital (PUC) and ACB.

d) RoundTable held 80% of shares in Holdings, i.e., 8,000,000 Class A shares;

e) Holdings held 100% of shares in Sabex 2002;

f) Sabex 2002 was operating the pharmaceutical company.

[14] At all relevant times, 3295940 and Micsau were Canadian-controlled private corporations within the meaning of subsections 125(7) and 248(1) of the Act.

[15] The ACB for all shares that Micsau held in 3295940 was $48,100,000 pursuant to section 54 and subsection 248(1) of the Act.

[16] Pursuant to the agreement concluded in 2002, in 2004 Holdings and RoundTable each had the option to buy or redeem, as applicable, 500,000 of the 2,000,000 Class B shares held by 3295940 for $13,310,000, and 3295940 could equally force Holdings to redeem said shares from them at the same price in 2004.

II. Sale of 100% of Sabex 2002 shares to Novartis Pharmaceuticals Canada Inc. ("Novartis")

[17] On June 25, 2004, pursuant to the agreement entered into with RoundTable in 2002, which is described in paragraph 16 below, RoundTable exercised its option to force the redemption of 500,000 Class B shares in Holdings held by 3295940 for $13,310,000.

[18] The "safe income" for those 500,000 Class B shares in Holdings was $1,700,000 within the meaning of subsection 55(5) of the Act.

[19] Given that the fees related to this transaction were $60,000 and that the PUC and ACB for those shares were a nominal amount, 3295940 realized a capital gain of $11,550,000 (i.e., $13,310,000 - $1,700,000 - $60,000) under subsection 55(2) of the Act.

[20] As a result of this redemption, 3295940 realized a taxable capital gain of $5,780,000, and that amount was credited to the capital dividend account ("CDA") of 3295940 pursuant to paragraph 38(1)(a) and subsection 89(1) of the Act, respectively.

A. The reorganization carried out in 2004 before proceeding with the sale of Sabex 2002

(1) Extraction of "safe income"

[21] On January 29, 2004, Holdings increased the PUC of 1,500,000 Class B shares by $4,000,000, which resulted in increasing the "safe income" of those shares to $4,000,000 within the meaning of subsection 55(5) of the Act.

[22] Consequently, Holdings is deemed to have spent, and 3295940 is deemed to have received, a $4,000,000 dividend pursuant to subsection 84(1) of the Act.

[23] Given that this entire dividend came from "safe income" credited to 1,500,000 Class B shares, subsection 55(2) of the Act did not apply in terms of deeming this dividend a capital gain.

[24] Furthermore, the ACB for 1,500,000 Class B shares in Holdings held by 3295940 increased by $4,000,000 pursuant to paragraph 53(1)(b) of the Act.

(2) Reorganization of the capital of 3295940 and incorporation of 4244851 Canada Inc. ("4244")

[25] On June 29, 2004, 3295940 amended its articles of incorporation to make it possible to create a new class of shares, Class D preferred shares, which are non-voting shares that are redeemable by the corporation or the shareholder at $1 per share.

[26] On June 30, 2004, 3295940 redeemed all shares of its capital stock held by Micsau, which at the time had an ACB of $48,100,000 and a FMV of $101,800,000. In exchange, Micsau received 31,500,000 Class B preferred shares and 100 common shares from 3295940.

[27] This transaction was subject to a joint election under subsection 85(1) of the Act, and the amount agreed upon by the parties was established at $48,100,000. The ACB and FMV of the 31,500,000 Class B preferred shares in 3295940 held by Micsau were established at $31,500,000 pursuant to paragraph 85(1)(g) of the Act, while the ACB of the 100 common shares in 3295940 held by Micsau were established at $16,600,000 pursuant to paragraph 85(1)(h) of the Act.

[28] The PUC of the 31,500,000 Class D preferred shares and the 100 common shares in 3295940 were established at a nominal amount (see table at paragraph 41 of the partial agreed statement of facts).

[29] On June 21, 2004, 4244851 Canada Inc. ("4244") was incorporated, and Micsau purchased a common share for a nominal amount when it was incorporated.

[30] On June 30, 2004, Micsau gave 4244 the 31,500,000 Class D preferred shares in 3295940 in exchange for 31,500,000 Class D preferred shares of the capital stock of 4244.

[31] The Class D preferred shares in 4244 were non-voting shares that are redeemable by the corporation or the shareholder at $1 per share. The PUC for these shares was nominal, while the ACB and FMV were $31,500,000, respectively.

[32] No gains were made as a result of this transaction since the FMV of the 31,500,000 Class D preferred shares in 3295940 that Micsau disposed of was equal to their ACB (see table at paragraph 47 of the partial agreed statement of facts).

(3) The sale of Holdings shares to 4244

[33] On June 30, 2004, 3295940 disposed of the 1,500,000 Class B shares in Holdings (worth $88,500,000) to 4244 in exchange for 57,000,000 Class D preferred shares and 31,500,000 common shares of the capital stock of 4244.

[34] This transaction was subject to an agreement under subsection 85(1) of the Act, and the amount agreed upon by the parties was established at $57,000,000. In accordance with paragraph 85(1)(g) of the Act, the ACB of the 57,000,000 Class D preferred shares in 4244 held by 3295940 was established at $57,000,000. Pursuant to paragraph 85(1)(h) of the Act, the ACB of the 31,500,000 common shares in 4244 held by 3295940 was established at a nominal amount. The PUC of the 57,000,000 Class D preferred shares and the 31,500,000 common shares in 4244 held by 3295940 was established at a nominal amount.

[35] Given that the ACB for the 1,500,000 Class B shares in Holdings was $4,000,001 and that the amount agreed upon by the parties was $57,000,000, 3295940 made a $52,999,999 capital gain, $26,500,000 of which is taxable. In accordance with subsection 89(1) of the Act, the CDA of 3295940 increased by $26,500,000 to reach $32,280,000 (see table at paragraph 56 of the partial agreed statement of facts).

(4) Cross redemption of shares

[36] On August 11, 2004, 3295940 redeemed the 31,500,000 Class D preferred shares in its capital stock held by 4244 in exchange for a $31,500,000 note payable.

[37] In accordance with subsection 84(3) of the Act, 3295940 is deemed to have paid to 4244, and 4244 is deemed to have received a $31,499,999 dividend. This dividend is deemed a capital dividend as result of 3295940 so electing under subsection 83(2) of the Act. This dividend was not supposed to be included in calculating the income of 4244. It must be transferred from the CDA of 3295940 to the CDA of 4244 pursuant to the definition of "capital dividend account" found in subsection 89(1) of the Act.

[38] On August 11, 2004, 4244 redeemed the 31,500,000 common shares and 110,000 of the 57,000,000 Class D preferred shares in its capital stock held by 3295940 in exchange for a $31,500,000 promissory note.

[39] Pursuant to subsection 84(3) of the Act, 4244 is deemed to have paid, and 3295940 is deemed to have received, a $31,389,999 dividend on the common shares and a $110,000 dividend on the Class D preferred shares. These dividends are

deemed capital dividends as a result of 4244's so electing under subsection 83(2) of the Act. These dividends were not supposed to be included in calculating the income of 3295940. They must be transferred from the CDA of 4244 to the CDA of 3295940 pursuant to the definition of "capital dividend account" found in subsection 89(1) of the Act.

[40] On August 11, 2004, the $31,500,000 notes payable that 3295940 and 4244 owe each other balance each other out (see table at paragraph 67 of the partial agreed statement of facts).

(5) The sale of shares in 4244 to 3295940

[41] On August 12, 2004, Micsau transferred its common share and its 31,500,000 Class D preferred shares in 4244 to 3295940 in exchange for 31,500,000 Class D preferred shares of the capital stock of 4244.

[42] This transaction was subject to a joint election under subsection 85(1) of the Act; The amount agreed upon by the parties was established at $31,500,000. In accordance with paragraph 85(1)(g) of the Act, the ACB of the 31,500,000 Class D preferred shares in 3295940 held by Micsau was established at $31,500,000. No gain was made as a result of this transaction because the FMV of the common share and the 31,500,000 Class D preferred shares in 4244 that Micsau disposed of was equal to the respective ACB of those shares.

[43] Following this transaction, 3295940 held a common share and 88,390,000 Class D preferred shares with an ACB of $88,390,000 (see table at paragraph 73 of the partial agreed statement of facts).

[44] On August 13, 2004, 3295940 sold its common share and 88,390,000 Class D preferred shares in 4244 to Novartis in exchange for $88,390,000. The fees for this transaction were $170,000. Given the $88,390,000 ACB for the common share and 88,390,000 Class D preferred shares in 4244 held by 3295940 and the $170,000 fees for the transaction, 3295940 incurred a $170,000 capital loss (see table at paragraph 76 of the partial agreed statement of facts).

(6) The redemption of Micsau's shares in 3295940

[45] On August 16, 2004, 3295940 redeemed the 31,500,000 Class D preferred shares in its capital stock held by Micsau in exchange for $31,500,000.

[46] In accordance with subsection 84(3) of the Act, 3295940 is deemed to have paid to Micsau, and Micsau is deemed to have received, a $31,500,000 dividend. Pursuant to paragraph (j) of the definition of “proceeds of disposition” set out in section 54 of the Act, Micsau is deemed to have disposed of 31,500,000 Class D preferred shares in 3295940 for proceeds equal to nil and consequently incurred a capital loss of $31,500,000 since the ACB of these shares was $31,500,000. In accordance with subsection 112(3) of the Act, this loss is deemed to be equal to nil.

[47] Following these transactions, the ACB of the 100 common shares in 3295940 held by Micsau increased to $16,600,000.

[48] Following various transactions carried out by 3295940, the capital gains realized and capital losses incurred by 3295940 are as follows:

Redemption of 500,000 Class B preferred shares in Holdings	$11,500,000 (gain)
Sale of 1,500,000 Class B preferred shares in Holdings	$53,000,000 (gain)
Sale of a common share and 88,500,000 Class D preferred shares in 4244	$170,000 (loss)
Total:	$64,380,000 (net gain)

III. Concession by 3295940

[49] For the purposes of its appeal only, 3295940 concedes that the transactions put in place and described in paragraphs 30 to 74 in the partial agreed statement of facts, which culminated in the sale of 3295940’s indirect holdings in the pharmaceutical company known as Sabex 2002 through a sale of the shares it held in 4244 to Novartis, allowed 3295940 to reduce the capital gain amount by $31,500,000 that it would have otherwise realized if 3295940 had sold directly to Novartis, following 4244’s redemption of its 500,000 Class B shares held by 3295940 and its 1,500,000 Class B shares in Holdings. Consequently, 3295940 concedes that the transactions concerned constitute a series of transactions for the purposes of subsection 245(3) of the Act that resulted in a tax benefit, within the meaning of the definition of that expression found in subsection 245(1) of the Act, in the amount of $31,500,000. For this reason, the transactions concerned constitute avoidance transactions within the meaning of subsection 245(3) of the Act.

IV. Testimony

[50] Jacques Gauthier, an accountant for Ernst & Young until 2009 and Michel Saucier's advisor, and Pierre Fréchette, President and Chief Operating Officer of the pharmaceutical company operated by Sabex 2002 from 2002 to 2004 and currently associate at RoundTable, both testified at the hearing. They confirmed the facts presented in the partial agreed statement of facts as well as their respective roles in the transactions described therein.

[51] Tax planning for the transactions described in the partial agreed statement of facts was carried out by Ernst & Young in 2004. The documents explaining the different planning options considered, including three (3) alternative reorganization projects, were entered into evidence.

V. Issue

[52] The only issue consists of determining whether the series of transactions resulted in abusively defeating the object, purpose and spirit of the provisions pertaining to calculating capital gains set out in sections 38, 39 and 40 of the Act and to calculating capital dividend and CDA set out in subsections 83(2), 89(1) and 55(2) of the Act.

VI. Statutory provisions

[53] The relevant statutory provisions of the Act enabling the Court to dispose of this appeal are subsections 55(2), 83(2), 89(1) and 245(1) to (5). A copy of these provisions, from the version applying to the 2005 tax year, are attached to this judgment.

VII. Positions of the parties

Position of the appellant

[54] According to counsel for the appellant, the planning done by Ernst & Young is both legitimate and non-abusive because it is part of the *bona fide* sale of the Holdings subsidiary to a corporation at arm's length from the corporate group (Novartis).

[55] Since some of the transactions were carried out in years preceding the year at issue in this case, the parent company (Micsau) held a stake with a high ACB in the appellant. Consequently, Michel Saucier did everything in his power to sell the 3295940 shares, but RoundTable and Novartis refused given their lack of interest and out of fear of inheriting certain liabilities from 3295940. The purpose of the 2004 reorganization was therefore to account for the acquisition cost in calculating the capital gain during the sale of shares in Holdings.

[56] The appellant submits that using the ACB of the shares held by the parent corporation for selling its stake in Holdings does not result in an abuse or misuse of the Act. Based on comments from the Finance Minister of Canada, counsel for the appellant conclude that transferring deductions, credits or losses within the same corporate group cannot result in an abuse or misuse of the provisions regarding calculating capital gain. The acknowledged capital gain from selling the shares in Holdings simply reflects the reality of accounting for the acquisition cost and should not be double-taxed. Lastly, the overall result of such a sale should not result in taxation except in terms of net capital gain. Counsel mainly based their arguments on a comment of Mr. Justice Noël in *Triad Gestco Ltd. v. Canada*, 2012 FCA 258 [*Triad Gestco*].

[57] Based on the holding of *Oxford Properties Group Inc. v. The Queen*, 2016 TCC 204, overturned on appeal, 2018 FCA 30, [*Oxford*], the appellant explained that the GAAR cannot apply to a purpose not specifically set out in a provision. For example, in *Oxford*, *supra*, even though subsection 100(1) of the Act prevents the avoidance of a latent recapture, the GAAR cannot apply when the taxpayer bumps the tax base. Indeed, there can be no abuse or misuse of the provision if that is not what the provision was intended to prevent. Similarly, the GAAR cannot apply to the series of transactions concerned, given the fact that the purpose of the CDA scheme and subsection 55(2) of the Act is not to prevent using the tax base through implicit bumping.

[58] Counsel for the appellant do not see that this is clearly an abuse or misuse of the provisions regarding capital dividend. The capital dividend mechanism, which is interrelated with the CDA mechanism, supports the principle of fairness of the Act by ensuring that an amount can be imposed once only. The provisions in issue instead ensured that half of the capital gain remained non-taxable and was transferred into the hands of its real shareholder, once again without taxation.

[59] The election to designate a capital dividend, when permitted by the CDA, is not an abuse or misuse in and of itself of subsection 55(2) of the Act. Indeed, this

anti-avoidance provision applies only to taxable dividends, meaning capital dividends are consequently not included.

[60] Counsel for the appellant argued that the reorganization, as it was carried out, was not the most beneficial alternative for the appellant. Indeed, three proposals were submitted to RoundTable to minimize the fiscal impact on the appellant from selling their stake in Holdings. These three proposals were all rejected due to lack of time and interest from both the buyer and RoundTable. That being the case, the corporate group that the appellant is a part of proceeded with a reorganization that allowed for a capital gain that was lower but still higher than would have been possible through the previous proposals. Counsel for the appellant highlighted the scope of the alternative transactions for establishing the wrongful nature of the transactions based on the decision of Mr. Justice Webb of the Federal Court of Appeal in *Univar Holdco Canada ULC v. The Queen*, 2016 TCC 159, 2017 FCA 207 [*Univar*].

[61] According to that case, the alternative transactions are a relevant factor in deciding whether there was abuse or misuse in applying the provisions of the Act. If the taxpayer is able to demonstrate that they could have achieved the same result without triggering any tax, this would tip the scale towards not applying the GAAR. According to counsel for the appellant, the alternative transactions would have resulted in an honest outcome, where the acquisition cost for a stake in the company corresponded with the product received at the time of the final sale of that same stake in the company.

[62] Lastly, the appellant stated indicated that in their opinion, the relevance of the alternative transactions should not be determined based on the possibility that they could have been carried out, but rather based on whether they would have produced the same result. In this way, the alternative transactions that the appellant proposed to RoundTable and Novartis would have resulted in relatively lower taxes, that is to say a more significant tax benefit.

Position of the respondent

[63] The GAAR allows the minister, and ultimately the Court, to “deny the tax benefits of certain arrangements that comply with a literal interpretation of the provisions of the Act, but amount to an abuse of the provisions of the Act.”

[64] Although the transactions comply with the letter of the provisions in issue, it must be determined whether these transactions comply with the object, purpose and spirit of these provisions. It is up to the respondent to describe the object and purpose

of these statutory provisions and to prove abuse of those provisions in accordance with one of the following circumstances:

i. It achieves an outcome the statutory provision was intended to prevent;
ii. The transaction defeats the underlying rationale of the provision; or
iii. The transaction circumvents the provision in a manner that frustrates or defeats its object, spirit or purpose.

[65] According to the respondent, the series of transactions put in place by 3295940 made it possible to circumvent the application of subsection 55(2) of the Act through the inappropriate use of the CDA scheme to reduce the capital gain realized by 3295940 from disposing of shares in Holdings by $31,500,000.

[66] Through various transactions, the appellant shifted the tax base held by its parent corporation (Micsau) to thereby achieve this tax base in the unrealized capital gain of shares in Holdings. Indeed. the CDA amount for 3295940 from the realization of a portion of the gain on the shares in Holdings was transferred to 4244 then returned to 3295940 through the cross redemption of shares. The CDA from this partial realization of the gain was used to erase the remaining portion of 3295940's gain from shares in Holdings.

[67] Consequently, the transactions at issue achieved an outcome that subsection 55(2) of the Act was intended to prevent, namely surplus stripping by declaring inter-corporate dividends that are taxable but also deductible within the meaning of Part I of the Act. The Crown is partially relying on *D & D Livestock Ltd. v. The Queen*, 2013 TCC 318 [*D&D Livestock*] to support its arguments concerning the abuse of subsection 55(2) of the Act by drawing a parallel between the double use of safe income in *D&D Livestock* and the circular and double use of a capital dividend in this case.

[68] The series of transactions was therefore not carried out for a *bona fide* purpose. Indeed, according to the respondent, the appellant was seeking only to reduce the capital gain attributed to the sale of their block of shares and consequently the tax payable on the sale. In this way, if one of the transactions in the series was not performed primarily for a *bona fide* non-tax purpose, it is an avoidance transaction and the GAAR then removes the tax benefit resulting from the series of transactions.

[69] Since there was abusive tax avoidance under subsection 55(2) of the Act and the sections relating to capital dividend, and given the fact that a portion of the

appreciation of 3295940's stake in Holdings will never be taxed, the Minister was justified in applying section 245 of the Act to include $31,500,000 in capital gain in calculating their income for the 2005 tax year. The assessment was therefore designed to eliminate the tax benefit obtained by the appellant.

[70] According to the respondent, the overall outcome of the series of operations does not account for the separate legal entities of the corporation, the shareholder or the capital gains tax regime. In this way, the inappropriate use of the CDA scheme did not comply with the principle of integration set out in the Act.

[71] The alternative transactions presented by the appellant cannot be weighed in the way that the opposing party has done within the meaning of *Univar*, *supra*. According to the respondent, the three proposals do not represent comparable scenarios that could have achieved the same outcome since the shares sold would have been 3295940's shares. Based mainly on *Fiducie financière Satoma v. The Queen*, 2017 TCC 84, upheld on appeal 2018 FCA 74 [*Satoma*], the Crown argued that the alternative transactions proposed must at the very least be examples of valid comparison because the very essence of the transactions must be essentially the same in each of the alternatives.

VIII. Analysis

Application of the general anti-avoidance rule (GAAR)

[72] The general conditions of application of the GAAR are set out in paragraphs 30 to 44 of the judgment I rendered in *Pomerleau v. The Queen*, 2016 TCC 228, upheld on appeal by Noël, J., 2018 FCA 129. Those paragraphs have been reproduced below, unaltered.

> [30] The landmark case with respect to the relevant test criteria in applying the GAAR was decided by the Supreme Court of Canada: *Canada Trustco Mortgage Co. v. Canada*, [2005] 2 SCR 601. That case decided that three conditions must be met for the GAAR to apply, in which case subsection 245(2) of the Act allows the Minister to deny the tax benefit arising from the series of avoidance transactions at issue and to determine what the reasonable tax consequences should be.
>
> [31] In paragraphs 65 and 66 of *Canada Trustco Mortgage Co. v. Canada*, *supra*, the Supreme Court of Canada explained the approach that the courts must follow when performing this type of analysis:
>
>> 65 For practical purposes, the last statement is the important one. The taxpayer, once he or she has shown compliance with the wording of a

provision, should not be required to disprove that he or she has thereby violated the object, spirit or purpose of the provision. It is for the Minister who seeks to rely on the GAAR to identify the object, spirit or purpose of the provisions that are claimed to have been frustrated or defeated, when the provisions of the Act are interpreted in a textual, contextual and purposive manner. The Minister is in a better position than the taxpayer to make submissions on legislative intent with a view to interpreting the provisions harmoniously within the broader statutory scheme that is relevant to the transaction at issue.

66 The approach to s. 245 of the *Income Tax Act* may be summarized as follows.

1. Three requirements must be established to permit application of the GAAR:

> (1) A *tax benefit resulting from a transaction* or part of a series of transactions (s. 245(1) and (2));
>
> (2) that the transaction is an *avoidance transaction* in the sense that it cannot be said to have been reasonably undertaken or arranged primarily for a *bona fide* purpose other than to obtain a tax benefit; and
>
> (3) that there was *abusive tax avoidance* in the sense that it cannot be reasonably concluded that a tax benefit would be consistent with the object, spirit or purpose of the provisions relied upon by the taxpayer.

2. The burden is on the taxpayer to refute (1) and (2), and on the Minister to establish (3).

3. If the existence of abusive tax avoidance is unclear, the benefit of the doubt goes to the taxpayer.

4. The courts proceed by conducting a unified textual, contextual and purposive analysis of the provisions giving rise to the tax benefit in order to determine why they were put in place and why the benefit was conferred. The goal is to arrive at a purposive interpretation that is harmonious with the provisions of the Act that confer the tax benefit, read in the context of the whole Act.

5. Whether the transactions were motivated by any economic, commercial, family or other non-tax purpose may form part of the factual context that the courts may consider in the analysis of abusive tax avoidance allegations under s. 245(4). However, any finding in this respect would form only one part of the underlying facts of a case, and would be insufficient by itself to

> establish abusive tax avoidance. The central issue is the proper interpretation of the relevant provisions in light of their context and purpose.
>
> 6. Abusive tax avoidance may be found where the relationships and transactions as expressed in the relevant documentation lack a proper basis relative to the object, spirit or purpose of the provisions that are purported to confer the tax benefit, or where they are wholly dissimilar to the relationships or transactions that are contemplated by the provisions.
>
> 7. Where the Tax Court judge has proceeded on a proper construction of the provisions of the *Income Tax Act* and on findings supported by the evidence, appellate tribunals should not interfere, absent a palpable and overriding error.

[32] The parties acknowledged that the first two criteria to be met for the GAAR to apply—the presence of an avoidance transaction in the series of transactions and a tax benefit—were satisfied. Thus, the only issue to be resolved to dispose of this appeal is whether the avoidance transaction or series of avoidance transactions giving rise to the tax benefit was abusive within the meaning of subsection 245(4) of the Act.

<u>Burden of proof</u>

[33] It is for the Minister to prove that, on the balance of probabilities, abusive tax avoidance has occurred within the meaning of subsection 245(4) of the Act. To do this, the Minister must demonstrate that, considering the text, context and purpose of the provisions at issue, the avoidance transaction or series of avoidance transactions frustrates the object, spirit or purpose of the provisions of the Act.

The GAAR will therefore apply where, according to a literal or strict interpretation of the relevant provisions, their application has been circumvented and the object, spirit or purpose of the provisions in question is thereby frustrated (see paragraph 66 of *Canada Trustco Mortgage Co. v. Canada, supra*, and paragraph 21 of *Lipson v. Canada*, [2009] 1 SCR 3).

[35] As the Supreme Court of Canada noted in paragraph 66 of *Canada Trustco Mortgage Co. v. Canada, supra*, if it is unclear whether the avoidance transaction or series of avoidance transactions constitutes abusive tax avoidance, the benefit of the doubt goes to the taxpayer.

Abusive tax avoidance

[36] As the Supreme Court of Canada stated in *Canada Trustco Mortgage Co. v. Canada, supra*, section 245(4) of the Act imposes a two-part inquiry to determine whether an avoidance transaction or a series of avoidance transactions frustrates the object, spirit or purpose of the Act:

> 55 In summary, s. 245(4) imposes a two-part inquiry. The first step is to determine the object, spirit or purpose of the provisions of the *Income Tax Act* that are relied on for the tax benefit, having regard to the scheme of the Act, the relevant provisions and permissible extrinsic aids. The second step is to examine the factual context of a case in order to determine whether the avoidance transaction defeated or frustrated the object, spirit or purpose of the provisions in issue.

[37] Therefore, the first step consists in determining the object, spirit and purpose of the provisions giving rise to the tax benefit by conducting a unified textual, contextual and purposive analysis of those benefits. Indeed, it may happen that "[t]he rationale that underlies the words may not be captured by the bare meaning of the words themselves (see paragraph 70 of *Copthorne Holdings Ltd. v. Canada*, [2011] 3 SCR 721).

[38] The second step is to determine whether the object, spirit or purpose of the provisions at issue has been frustrated by the avoidance transaction or the series of avoidance transactions (see paragraph 65 of *Canada Trustco Mortgage Co. v. Canada, supra*). This step "requires a close examination of the facts in order to determine whether allowing a tax benefit would be within the object, spirit or purpose of the provisions relied upon by the taxpayer" (see paragraph 59 of *Canada Trustco Mortgage Co. v. Canada, supra*).

[39] Due to their importance, it is necessary to reproduce hereinafter paragraphs 44, 45, 46, 49 and 50 of *Canada Trustco Mortgage Co. v. Canada, supra*:

> 4 The heart of the analysis under s. 245(4) lies in a contextual and purposive interpretation of the provisions of the Act that are relied on by the taxpayer, and the application of the properly interpreted provisions to the facts of a given case. The first task is to interpret the provisions giving rise to the tax benefit to determine their object, spirit and purpose. The next task is to determine whether the avoidance transaction falls within or frustrates that purpose. The overall inquiry thus involves a mixed question of fact and law. The textual, contextual and purposive interpretation of specific provisions of the *Income Tax Act* is essentially a question of law but the application of these provisions to the facts of a case is necessarily fact-intensive.

45 This analysis will lead to a finding of abusive tax avoidance when a taxpayer relies on specific provisions of the *Income Tax Act* in order to achieve an outcome that those provisions seek to prevent. As well, abusive tax avoidance will occur when a transaction defeats the underlying rationale of the provisions that are relied upon. An abuse may also result from an arrangement that circumvents the application of certain provisions, such as specific anti-avoidance rules, in a manner that frustrates or defeats the object, spirit or purpose of those provisions. By contrast, abuse is not established where it is reasonable to conclude that an avoidance transaction under s. 245(3) was within the object, spirit or purpose of the provisions that confer the tax benefit.

46 Once the provisions of the *Income Tax Act* are properly interpreted, it is a question of fact for the Tax Court judge whether the Minister, in denying the tax benefit, has established abusive tax avoidance under s. 245(4). Provided the Tax Court judge has proceeded on a proper construction of the provisions of the Act and on findings supported by the evidence, appellate tribunals should not interfere, absent a palpable and overriding error.

[…]

49 In all cases where the applicability of s. 245(4) is at issue, the central question is, having regard to the text, context and purpose of the provisions on which the taxpayer relies, whether the transaction frustrates or defeats the object, spirit or purpose of those provisions. The following points are noteworthy:

> 1) While the Explanatory Notes use the phrase "exploit, misuse or frustrate", we understand these three terms to be synonymous, with their sense most adequately captured by the word "frustrate".
>
> (2) The Explanatory Notes elaborate that the GAAR is intended to apply where under a literal interpretation of the provisions of the *Income Tax Act*, the object and purpose of those provisions would be defeated.
>
> (3) The Explanatory Notes specify that the application of the GAAR must be determined by reference to the facts of a particular case in the context of the scheme of the *Income Tax Act*.
>
> (4) The Explanatory Notes also elaborate that the provisions of the *Income Tax Act* are intended to apply to transactions with real economic substance.

> 50 As previously discussed, Parliament sought to address abusive tax avoidance while preserving consistency, predictability and fairness in tax law and the GAAR can only be applied to deny a tax benefit when the abusive nature of the transaction is clear.

[40] In *Lipson, supra*, a majority of the Supreme Court of Canada described paragraphs 44 and 45 of *Canada Trustco Mortgage Co. v. Canada, supra*, as capturing the essence of the approach used by the Court when the GAAR is in issue. In paragraph 40, the Court wrote:

> According to the framework set out in *Canada Trustco*, a transaction can result in an abuse and misuse of the Act in one of three ways: where the result of the avoidance transaction (a) is an outcome that the provisions relied on seek to prevent; (b) defeats the underlying rationale of the provisions relied on; or (c) circumvents certain provisions in a manner that frustrates the object, spirit or purpose of those provisions (*Canada Trustco*, at para. 45).

[41] At paragraph 44 of *Gwartz v. The Queen*, 2013 TCC 86, Hogan J. reviewed certain principles in relation to "(i) tax planning in general, (ii) the appropriateness of using the GAAR as a gap-filling measure, (iii) the existence of a general policy in the ITA regarding surplus stripping."

[42] Hogan J. did indeed refer to *Canada Trustco Mortgage Co. v. Canada* and *Copthorne, supra*. Each of these cases reiterated the principle that any tax planning to reduce a taxpayer's tax bill does not, by itself, constitute abusive tax avoidance within the meaning of subsection 245(4) of the Act. In *Canada Trustco Mortgage Co. v. Canada, supra*, the Supreme Court of Canada stated the following:

> 61 A proper approach to the wording of the provisions of the *Income Tax Act* together with the relevant factual context of a given case achieve balance between the need to address abusive tax avoidance while preserving certainty, predictability and fairness in tax law so that taxpayers may manage their affairs accordingly. Parliament intends taxpayers to take full advantage of the provisions of the Act that confer tax benefits. Parliament did not intend the GAAR to undermine this basic tenet of tax law.

[43] In other words, "[a]busive tax avoidance cannot be found to exist if a taxpayer can only be said to have abused some broad policy that is not itself grounded in the provisions of the ITA" (see paragraph 47 of *Gwartz, supra*). It would therefore be "inappropriate, where the transactions do not otherwise conflict with the object, spirit and purpose of the provisions of the ITA to apply the GAAR to deny a tax benefit resulting from a taxpayer's reliance on a previously unnoticed legislative gap" (see paragraph 50 of *Gwartz, supra*).

[44] Paragraph 50 of *Gwartz, supra*, noted that the courts have repeatedly held that surplus stripping does not inherently constitute abusive tax avoidance. The

Supreme Court reiterated this in *Copthorne, supra*, in which paragraph 118 reads as follows:

> Copthorne submits that such a conclusion could only rest upon a *general* policy against surplus stripping. It argues that no such general policy exists and therefore the object, spirit and purpose of s. 87(3) cannot be to prevent surplus stripping by the aggregation of PUC. This argument is based upon this Court's admonition in *Trustco* that "courts cannot search for an overriding policy of the Act that is not based on a unified, textual, contextual and purposive interpretation of the specific provisions in issue" (para. 41). What is not permissible is basing a finding of abuse on some broad statement of policy, such as anti-surplus stripping, which is not attached to the provisions at issue. However, the tax purpose identified in these reasons is based upon an examination of the PUC sections of the Act, not a broadly stated policy. The approach addresses the rationale of the PUC scheme specifically in relation to amalgamation and redemption and not a general policy unrelated to the scheme under consideration.

Statutory provisions at issue

[73] The analysis should focus on the object, spirit or purpose of the provisions that give rise to the tax benefit, and on whether the transactions at issue frustrate or defeat those provisions (see paragraph 69 of *Canada Trustco Mortgage Co. v. Canada*, [2005] 2 SCR 601 [*Trustco*]).

[74] In this case, the Minister contends that the series of transactions allowed the taxpayer to circumvent the application of subsections 55(20, 83(2) and 89(1) of the Act in a manner inconsistent with the object, spirit or purpose of each of these provisions, resulting directly or indirectly in an abuse of the provisions of the Act, read as a whole.

The object, spirit and purpose of subsections 83(2) and 89(1) of the Act

Textual analysis

[75] In cases involving the GAAR, the literal interpretation of a provision cannot generally be sufficient to determine whether the provision has been abused or circumvented. However, the actual language of the provision remains relevant for the purposes of determining the object, purpose or spirit that it embodies (see paragraph 88 of *Copthorne Holdings Ltd. v. The Queen*, [2011] 3 SCR 721 [*Copthorne*]).

[76] Hogan, J., in paragraph 39 of the decision in *The Gladwin Realty Corporation v. Canada*, 2019 TCC 62 [*Gladwin* TCC], upheld by the Federal Court of Appeal, 2020 FCA 142 [*Gladwin FCA*], analyzed the provisions pertaining to the CDA, which is the interpretation that Noël, J. used to support the decision upheld in the Federal Court of Appeal in paragraphs 22 and 23:

> [39] It is widely accepted that a Capital Dividend Account is a notional account maintained by private corporations to keep track of certain types of tax-free surpluses accumulated over time. In this regard, the definition of "Capital Dividend Account" allows a private corporation to determine its CDA balance at a particular time so that it may elect in a prescribed form to pay a tax-free capital dividend to its shareholders without incurring a liability under Part III of the Act. To this end, CDA balance at a particular time is determined, in accordance with the definition found at subsection 89(1), by adding, inter alia, (i) the tax-free portion of capital gains, (ii) the amount of tax-free capital dividends received by the corporation from other corporations and (iii) the proceeds of certain life insurance policies and subtracting, inter alia, (iv) the non-deductible portion of capital losses and (v) capital dividend distributions made before the particular time. [.. .]

[77] In *Gladwin FCA*, Noël, J. added:

> Because a CDA is computed by reference to the qualifying amounts that may be distributed tax-free, it must, by definition, reflect a positive amount. Mathematically, however, amounts that impact negatively on the CDA are kept track of even when they bring the balance below zero in which case the CDA cannot become positive again unless and until the negative balance is compensated by additional qualifying amounts specified in subsection 89(1). [.. .]
>
> [58] When a private corporation has a positive CDA balance, it may distribute those surpluses, tax-free, by way of a capital dividend, but only to the extent of the corporation's CDA balance immediately before the dividend becomes payable (subsection 83(2)). Should a corporation elect to pay a capital dividend in excess of

> the CDA, it incurs the additional tax on excessive elections imposed under Part III of the Act, specifically subsection 184(2), unless it elects, with the agreement of the relevant shareholders, to treat the excess as a regular taxable dividend (subsection 184(3) and 184(4)).

[78] More specifically, a CDA makes it possible to identify the tax-free amounts accumulated by a corporation so that it can later be distributed to the shareholders through capital dividends.

[79] The election to pay a capital dividend comes from subsection 83(2) of the Act. The election to pay a capital dividend must be in respect of the full amount of the dividend (Canada Revenue Agency, Interpretation Bulletin IT-66R6, Capital Dividends (May 31, 1991), paragraph 1). When a private corporation elects, in the prescribed form (T2054), to pay a capital dividend to its shareholders, no part of the dividend is included in computing the income of the shareholder.

[80] If the capital dividend is received by a corporation, the full amount of the dividend is added to its CDA, thereby allowing the corporation to in turn pay a tax-free dividend for its own shareholders (Canada Revenue Agency, Interpretation Bulletin IT-66R6, Capital Dividends (May 31, 1991), paragraph 14).

[81] Whether the dividend is received by a shareholder corporation or by an individual shareholders, the capital dividend is not included in calculating the income of the shareholder in question (see paragraph 40 of *Gladwin TCC*).

Contextual analysis

[82] In *Copthorne*, *supra*, the Supreme Court of Canada stated at paragraph 91 that "The consideration of context involves an examination of other sections of the Act, as well as permissible extrinsic aids [.. .]. However, not every other section of the Act will be relevant in understanding the context of the provision at issue. Rather, relevant provisions are related 'because they are grouped together' or because they 'work together to give effect to a plausible and coherent plan' [.. .]."

[83] In *Gladwin TCC*, *supra*, at paragraph 23, Hogan, J. explains that "the legislative history of the CDA regime confirmed that subsections 89(1), 83(2), and 184(2) were implemented to give effect to what is commonly referred to as the principle of integration." Those provisions were indeed enacted as a result of the 1966 *Report of the Royal Commission on Taxation* to encourage Canadians to invest and start a business in their own name or through a corporation.

[84] It is worth specifying here that any amendments made to subsection 89(1) since the introduction of the Act are not relevant to the issue herein.

[85] In terms of the similarity between the CDA scheme and the mechanism for paying capital dividends, in *Gladwin FCA*, Noël, J. explained the following:

> [76] I note in this respect that the existence of a positive CDA balance, however generated, is the sole condition that governs a taxpayer's right to declare a capital dividend. [.. .]

Purposive analysis

[86] At this stage of the analysis, the Crown must demonstrate the underlying spirit of the provision at issue with precision (see paragraph 94 of *Lipson v. Canada*, [2009] 1 SCR 3 (*Lipson*), paragraph 41 of *Trustco, supra*, and paragraph 30 of *Evans v. The Queen*, 2005 TCC 684).

[87] The provisions pertaining to the CDA scheme allow the non-taxable portion of capital gains realized by a private corporation to be distributed without generating additional taxation. Consequently, the amount of tax to be paid remains the same, whether the gain is realized by an individual or through a corporation.

[88] The concept was put forward once again in *2529-1915 Québec Inc. v. Canada*, 2008 FCA 398, wherein Noël, J. said the following:

> [8] Before going further, a few words on the operation of CDAs are in order. A CDA is composed of the non-taxable portion of a capital gain generated by a corporation (i.e., half of the gain realized during the period at issue). The legislative objective is to ensure that a capital gain is taxed in the same manner, whether it is earned directly by an individual or indirectly through a corporation. To this end, the system provides that, subject to the prescribed elections being made, the non-taxable portion of a capital gain, once included in a CDA by the corporation that realized it, remains tax-exempt when transferred from one corporation to another by way of dividend, until it is ultimately distributed to an individual in the form of a non-taxable dividend, also called a "capital dividend".

[89] In fact, the CDA regime "neutraliz[es] the impact of the interposition of a corporation in the manner in which capital gains are taxed. Given that only one half of capital gains is taxable (section 38), Parliament provided for a mechanism whereby a corporation can preserve the tax-free portion of the gain for distribution to a shareholder without attracting an extra level of tax—this mechanism governs the manner in which the CDA is computed. In essence, the CDA regime ensures that

no more than the tax-free portion is distributed to shareholders by way of a capital dividend so as to mirror the tax treatment of an individual taxpayer who generates the underlying gain directly." (*Gladwin FCA*, at para. 60).

The object, spirit and purpose of subsection 55(2) of the Act

[90] As I indicated in *101139810 Saskatchewan Ltd. v. The Queen*, 2017 TCC 3 [*Saskatchewan*], the interpretation of section 55 has been discussed many times in the past. At times, the doctrine and the case law (see *D&D Livestock*, *supra* at para. 26 as well as *Lamont Management Ltd. v. Canada,* [2000] 3 FC 508, [2000] 54 DTC 6256 (FCA), at para. 20) characterized the provision as being complex and lacking clarity. However, it should be noted that the intended purpose or object of a provision cannot replace clear legislative language (*Canada v. Placer Dome Inc.*, [1996] FCJ No 1435 (QL) — [1997] 1 CTC 72).

Textual analysis

[91] In GAAR cases, although the literal application of the provisions at issue will not generally preclude a tax benefit the taxpayer seeks by entering into the transaction or series, the very language of the provision does remain relevant for the purposes of determining the object, spirit or purpose of the provision (see paragraph 88 of *Copthorne*, supra).

[92] The rule found in subsection 55(2) of the Act applies when the following conditions are met (see *Saskatchewan, supra*, at para. 12):

> [12] [.. .]
>
> (a) the taxpayer is a corporation resident in Canada;
>
> (b) the taxpayer received a taxable dividend in respect of which it is entitled to a deduction under subsections 112(1) or (2);
>
> (c) the dividend is received as part of a transaction or series of transactions which is deemed by subsection 248(10) of the Act to include any related transactions or events completed in contemplation of the series; and
>
> (d) where dividends are declared and paid by a corporation, one of the purposes of the dividend was to effect a significant reduction in a capital gain that would, but for the dividend, have been realized on a disposition at fair market value of any share; or in the case of deemed dividends under subsection 84(3) of the Act, which is the situation in these appeals, if the result (not the purpose) of the dividend is to effect a significant reduction in

> a capital gain that would, but for the deemed dividend, have been realized on a disposition at fair market value of any share.

[93] There are four exceptions to subsection 55(2), however:

1. The first exception is included in the charging provision and covers situations where the dividend can reasonably be attributable to anything other than income earned or realized by any corporation after 1971 ("safe income"). Safe income is protected from the application of subsection 55(2) because this income has been subject to corporate income tax and should therefore be allowed to be paid as an additional tax-free dividend (*Saskatchewan, supra* at para. 13). In this case, all the safe income that could potentially have been extracted from Holdings was extracted, and the benefit of that exception was maximized by 3295940.
2. The second is provided for in paragraph 55(3)(a) and covers dividends received in the course of certain related-party transactions provided there was not, at any particular time, a disposition of property or a significant increase in the total direct interest in a corporation in the circumstances described in subparagraphs 55(3)(a)(i) to (v) (*Saskatchewan, supra*, at para. 14). The purpose of the exception provided for in paragraph 55(3)(a) is to facilitate reorganizations between affiliated corporations. It does not apply in this case, because the dividends paid between 329540 and 4244 were part of a series of transactions resulting in the completion of a significant transaction with an unaffiliated third party.
3. The third exception is provided for in paragraph 55(3)(b) and covers dividends received as part of a butterfly or divisive reorganization, wherein corporate property is distributed *pro rata* among corporate shareholders on a tax-deferred basis. The object or purpose of paragraph 55(3)(b) is to allow corporate shareholders to separate their common interests while the company's business continues, which did not happen in this case. The object or purpose of this exception is not to allow the tax-free sale of corporate assets or of shareholders' stake in the corporation to a third party (*Saskatchewan, supra,* at para. 14).
4. The fourth exception is included in the charging provision and covers situations where the dividend is subject to Part IV taxes and where that tax is not reimbursed through the payment of a dividend to a corporation as part of the same series of transactions. In this case, this exception is not relevant because Part IV taxes do not apply to capital dividends.

[94] This textual analysis confirms that subsection 55(2) of the Act does not apply to an amount that was already corporately taxed, such as safe income or capital dividends. In this case, had it not been for the designation as a capital dividend, subsection 55(2) of the Act would have applied to the dividends deemed to have been paid between 3295940 and 4244 at the time of the cross redemption of shares on August 11, 2004 (see paragraphs 57 to 67 of the partial agreed statement of facts).

[95] According to paragraph 35 of *Canada v. Kruco Inc.*, 2003 FCA 284, [2003] FCJ No 1012 (QL), subsection 55(2) of the Act converts dividends that would otherwise be taxable into a capital gain for the corporation that is effectively receiving the dividend:

> Subsection 55(2) (when read in conjunction with paragraph 55(5)(f)) provides, in effect, that when a dividend (paid or deemed) has effected a significant reduction of the capital gain which would have resulted from a notional sale of the shares at fair market value, and this gain can reasonably be attributed to anything other than "income earned or realized" after 1971, the dividend is deemed to be a capital gain to the extent of the portion so attributed. Conceptually, this approach captures the tax applicable to the portion of the notional gain attributable to an increase in value of the underlying assets while maintaining the tax-free treatment of that part of this gain attributable to "income earned or realized" since 1971.

[96] "Put another way, subsection 55(2) asks: if the corporation had sold any shares before it received the dividend, what would have been the amount of the capital gain? This capital gain is the starting point of the comparison." (*Saskatchewan, supra*, at para. 38).

Contextual analysis

[97] Subsection 55(2) of the Act is part of the legislative scheme applied to capital gains and losses. This legislative scheme was developed in 1972. Before then, capital gains were not taxed (*Triad Gestco*, *supra,* at para. 27).

[98] Since 1972, capital gains have been taxed at a rate established by legislative bodies. That rate was set at 50%, 66.7% or 75% depending on the time period and was set at 50% for the period concerned in this case.

[99] To determine the amount of the gain or loss resulting from the disposition of property, several provisions of the Act must be applied concurrently. Usually, capital gains are realized when an asset is sold for the "proceeds of disposition" beyond the "adjusted cost base." These concepts are defined in section 54 of the Act.

[100] In paragraph 41, of *Triad Gestco, supra*, Noël, J. reiterated the comments formulated by the House of Lords in *WT Ramsay Ltd v. Inland Revenue Commissioners*, [1981] 1 A11 ER 865, (at page 873):

> The capital gains tax was created to operate in the real world, not that of make-belief. As I said in *Aber-deen Construction Group Ltd. v. Inland Revenue Com-missioners* [19781 A.C. 885, it is a tax on gains (or I might have added gains less losses), it is not a tax on arithmetical differences.

[101] Consequently, in Canada, the object or purpose of the regime governing tax on capital gains is to tax increases in economic power at 50%. Furthermore, to ensure that actual gains and losses are taken into consideration, the Act includes several specific anti-avoidance provisions to reflect the economic reality of the taxpayer. This includes but is not limited to subsection 55(2) of the Act.

[102] In paragraph 11 of *Saskatchewan, supra*, I indicated that subsection 55(2) of the Act was introduced in the 1979 federal budget: "It was directed against arrangements designed to use the intercorporate dividend exemption to unduly reduce a capital gain on a sale of shares."

[103] In 1988, however, the earlier version of subsection 55(1) of the Act was repealed in conjunction with the adoption of the GAAR. The Finance Minister's Explanatory Notes for the year in question indicated the following:

> Subsection 55(1) of the Act is an anti-avoidance provision aimed at transactions designed to artificially or unduly reduce a capital gain or increase or create a capital loss on a disposition of property.
>
> Subsection 55(1) is repealed as a consequence of the introduction of new section 245 of the Act, which constitutes a general anti-avoidance rule. Because the scope of that general anti-avoidance rule is broad enough to cover the transactions to which subsection 55(1) was intended to apply, that subsection is no longer necessary.

Rules for bumping

[104] Although the rules for bumping set out in paragraphs 88(1)(c) and (d) of the Act cannot apply to the facts in this case, they are still part of the context of the application of subsection 55(2). Bumping rules apply in situations where a Canadian corporation is held by another Canadian corporation and one of those corporations is being wound up or vertically amalgamated.

[105] If, during wind-up or merger with a subsidiary, the amount engaged by the parent corporation to acquire the shares of the subsidiary is higher than the cost of the subsidiary's property, that excess amount can, under certain conditions, be spread across the property of the subsidiary to increase their ACB.

[106] This is to avoid double taxation on capital transactions carried out by corporations for which the Act provides bumping rules. The rationale for these rules is clearly explained by the Federal Court of Appeal in *Oxford, supra*:

> [77] The bump provided for in paragraphs 88(1)(c) and (d) rectifies this situation by first calculating the difference between the ACB of the parent's shares and the tax cost of the subsidiary's property. This amount is then allowed to be added to the tax cost of the non-depreciable capital property which the parent inherited from its subsidiary. In other words, the tax cost of this property is bumped. The bump essentially allows any ACB that would otherwise be lost on a vertical amalgamation to be preserved and transferred to different property that is taxed the same way.

[107] Two conditions need to be met to obtain this bumping benefit, however. Firstly, only the ACB of property that was held by a corporation during its last acquisition of control can be bumped under subparagraphs 88(1)(c)(ii) and (iii). Secondly, the excess amount of the ACB of a corporation's shares that can be used for the purposes of the bumping rules must be reduced by an amount equal to the sum of the dividends paid on those shares.

[108] In this case, the two required conditions were not met, and paragraphs 122 to 126 of the respondent's proposals summarize the situation well:

> 122. When Saucier became the majority shareholder of 3295 in 1996, his shares had a nominal ACB, and 3295 did not hold the shares in Holdings.
>
> 123. As a result, no premium can be considered to have been paid at the time of the acquisition of control of 3295 in 1996 that would not have been reflected in the ACB for Holdings shares. Through this condition, Parliament explicitly settled that the ACB of 3295's shares could not be used to increase the ACB of Holdings shares acquired in 2002.
>
> 124. In addition, when Micsau acquired shares in 3295 from CDPQ in 2002, a dividend corresponding to the ACB amount of these shares was paid by 3295 to finance this acquisition. Other dividends totalling $58 million were also paid immediately before the series of transactions in 2004 began to take place. Essentially, all the money considered received in 2002 during the sale of 3295's assets was redistributed to Micsau in the form of dividends between 2002 and 2004.

> 125. Consequently, since a value higher than the ACB of 3295's shares was distributed by 3295 in the form of dividends, the ACB of these assets could not have been bumped as part of a wind-up or merger in anticipation of the sale of Holdings to Novartis. This bumping restriction implies that without these dividends, the ACB of 3295's property would have been greater than the ACB of 3295's shares. According to Parliament, no double taxation can consequently result from not using the ACB of 3295's shares for the sale of its assets.
>
> 126. In summary, Parliament specifically provided for bumping rules to avoid double taxation in the context of a capital gain realized by a corporation whose shares have a considerable ACB. However, 3295 and Micsau were not able to apply those rules, because in light of the Act, no double taxation resulted from the sale of Holdings' shares in 2004.

Purposive analysis

[109] The 1994 Explanatory Notes of the Minister of Finance explain the reasoning behind subsection 55(2) as follows:

> Subsection 55(2) of the Act is an anti-avoidance provision directed against certain arrangements designed to convert a capital gain on a disposition of shares into a tax-free dividend. It treats the dividend received in these circumstances either as a capital gain or as proceeds of disposition that are taken into account in computing a capital gain.

[110] An analysis of the object and purpose of subsection 55(2) of the Act has already been carried out in many cases, including in *Saskatchewan, supra*, at para. 46 to 52:

> [46] A number of cases have attempted to describe the general purpose of subsection 55(2). It is clear that subsection 55(2) is an anti-avoidance provision that exists to prevent what is commonly known as "capital gains stripping" or the conversion of taxable capital gains into tax-free intercorporate dividends (see *Placer Dome,* cited above, at paragraph 1).
>
> [47] In order to prevent double taxation at the corporate level, the Act provides that, generally, dividends paid from one corporation to another are in effect exempt from income tax pursuant to subsection 112(1) of the Act. Without such provision, the corporation earning income giving rise to a dividend would be taxed, and the dividend recipient corporation would also be subject to taxation on the dividend income.
>
> [48] However, as a result of these tax-free intercorporate dividends, there is an incentive to pay such dividends to reduce the fair market value of the shares, thereby decreasing the capital gain that would result on the disposition of the shares.

Subsection 55(2) is designed to impose limitations on the use of tax-free intercorporate dividends to ensure that the unrealized appreciation since 1971 in the value of the underlying assets of the corporation is not avoided. In *Lamont Management Ltd.*, cited above, Justice Rothstein described at paragraphs 3 and 4, the mischief subsection 55(2) is intended to address:

> 3 The *Income Tax Act* provides that, in accordance with specified provisions, dividends received by one corporation from another are exempt from income tax. The purpose of the exemption is to preclude double taxation at the corporate level, i.e. once by the corporation earning the income giving rise to the dividend and again by the corporation receiving the dividend income.
>
> 4 In circumstances where the *Income Tax Act* provides that dividends paid from one corporation to another are exempt from taxation, there is an incentive for the shareholding corporation to receive capital gains in the form of dividends. Section 55 is an anti-avoidance provision that is intended to limit use of tax exempt intercorporate dividends where they would otherwise be taxable. Where the limitation applies, the intercorporate dividend will be deemed not to be a dividend, but rather, proceeds of disposition of property, or a gain, of the recipient corporation, subject to tax at the rate applicable to capital gains. However, where the intercorporate dividend is attributable to "income earned or realized by any corporation", the anti-avoidance provision does not apply and the intercorporate dividend will continue to be treated as a dividend. This is sometimes referred to as "safe income".

[49] Justice Lamarre Proulx in *Gestion Jean-Paul Champagne Inc. v Minister of National Revenue*, 97 DTC 155, [1996] 2 CTC 2537 (TCC), at paragraph 51 interpreted Parliament's intention through a broader lens:

> We are surely dealing here with a provision whose purpose is to regulate tax avoidance and, more particularly, a provision that supplements the effect of subsection 84(3) of the Act. In a situation in which a corporate redeems its own shares where those shares are held by another corporation, Parliament's intent is to prevent everything from being a non-taxable intercorporate dividend.

[50] Justice Woods (as she then was) in *729658 Alberta Ltd*, cited above, was of the view that the legislative scheme was not apparent from subsection 55(2) and deferred to the description by the government described by Noël J.A. in *Kruco Inc.*, cited above:

> The goal was to ensure that the capital gain inherent in the shares of a corporation that is attributable to an unrealized appreciation since 1971 in the value of the underlying assets of the corporation was not

> avoided by the use of intercorporate tax-free dividends (subsection 112(1)).
>
> At the same time, Parliament did not want to impede the tax-free flow of dividends that were attributable to income which had already been taxed.
>
> Conceptually, this approach captures the tax applicable to the portion of the notional gain attributable to an increase in value of the underlying assets while maintaining the tax-free treatment of that part of this gain attributable to "income earned or realized" since 1971.

[51] In *Ottawa Air*, cited above, Justice Lamarre (as she was then) found that the 1979 federal budget clearly described the purpose of subsection 55(2) as an anti-avoidance provision to ensure that a capital gain is recognized to the extent of the unrealized and untaxed appreciation since 1971 in the value of underlying assets:

> 27 The mischief that subsection 55(2) is aimed at is clearly described in the 1979 federal budget which introduced this provision. Because of its importance in these appeals, I reproduce the relevant passage in its entirety:
>
> Important amendments will be introduced to clarify and reinforce the intent of the anti-avoidance provision relating to artificial or undue reductions in capital gains.
>
> Concerns have been expressed as to the legislative scope and intended application of this anti-avoidance provision. A number of plans have been developed whereby, as a preliminary step to certain sales of shares, a corporate vendor extracts what are in substance sale proceeds in the form of tax-free intercorporate dividends or deemed dividends to decrease the value—or increase the cost base—of the shares to the point where capital gains tax is avoided. These tax-free dividends frequently exceed the earnings of the corporation to be sold. Such excessive dividends are usually motivated only by the vendor's desire to reduce his exposure to capital gains tax.
>
> As a general rule, the objective of the tax law is that on most arm's-length and on certain non-arm's-length intercorporate share sales, a capital gain should arise at least to the extent that the sale proceeds reflect the unrealized and untaxed appreciation since 1971 in the value of underlying assets. This objective will generally be achieved where tax-free dividends on shares are limited to post-1971 taxed retained earnings.

> Rules will be introduced to clarify the intention of the law in this respect. These rules will ensure that where it can reasonably be considered that one of the main purposes of a tax-free intercorporate dividend was to reduce the proceeds on a disposition of a share, the capital gain otherwise determined will be adjusted to reflect the extent to which aggregate tax-free dividends have exceeded post-1971 taxed retained earnings.

> [52] From the foregoing, it is clear that Parliament intended to limit tax-free intercorporate dividends; however, only to the extent that the unrealized and untaxed appreciation in the value of underlying assets is realized such that income that has already been taxed should not be caught by subsection 55(2).

[111] In general, capital gains stripping occurs when a corporation that wants to sell its shares to another corporation first receives a dividend then sells its shares at a reduced price of the amount of the dividend received, making it possible to decrease the unrealized capital gain that otherwise would have been realized. The point is really to prevent an artificial decrease of a gain or the artificial increase of a loss from the disposition of a property.

[112] The object and purpose of the introduction of subsection 55(2) of the Act is therefore to ensure that the capital gain inherent in the shares of a corporation that is attributable to an unrealized appreciation since 1971 in the value of the underlying assets of the corporation was not avoided by the use of intercorporate tax-free dividends. At the same time, Parliament did not want to impede the tax-free flow of dividends that were attributable to income which had already been taxed (*Canada v. Kruco Inc.*, 2003 FCA 284, at para. 32).

Was the object, spirit or purpose of the provisions at issue frustrated or defeated?

[113] Firstly, since the appellant admitted that there was a tax benefit arising from a series of avoidance transactions, the reasons for this reorganization are irrelevant for the purpose of determining whether these transactions frustrated or defeated the object, spirit or purpose of the relevant provisions (see paragraphs 34 to 38 of *Lipson*, *supra*). In this case, the fact that Novartis and RoundTable did not want to acquire 3295940 out of fear of inheriting potential liabilities for any other reason is therefore not useful.

[114] Secondly, the GAAR does not apply as soon as it has been established that a series of transactions has given rise to a tax benefit. Rather, the GAAR applies if that

series of transactions frustrated, defeated or abused the object, spirit or purpose of the provision at issue (see paragraphs 44, 57 and 59 of *Trustco, supra*).

[115] As the Supreme Court of Canada explained in *Lipson*, "the entire series of transactions should be considered in order to determine whether the individual transactions within the series abuse one or more provisions of the Act" (see paragraph 34).

[116] In its analysis to determine whether the transactions were abusive, the Court must give effect to the transactions as they unfolded and refrain from assessing the abuse on the basis of the overall result achieved. What must be shown is that the provisions used to achieve this result, when construed with a focus on their object, spirit and purpose, reveal a clear underlying rationale that was frustrated by the series of transactions (*Gladwin FCA, supra*, at para. 70).

[117] Since subsection 55(2) of the Act is a specific anti-avoidance provision, the comments recently made by Noël, J. in *Gladwin FCA, supra*, allows for a significant nuance: the use of an anti-avoidance provision to obtain a tax benefit does not constitute abusive tax planning in every instance. Abuse occurs when the anti-avoidance provision is used to obtain the outcome it is designed to prevent. Lastly, at this stage, it must be shown that "the anti-avoidance provision was used in a manner that defeats its underlying rationale."

[118] In this case, the textual, contextual and purposive analysis revealed that the object, purpose or spirit of subsection 83(2), 89(1) and 55(2) of the Act is to prevent a taxpayer from using a tax-free dividend to avoid the capital gain inherent in the shares of a corporation that is attributable to an unrealized appreciation, which would go against the principle of integration that the CDA scheme is pursuing.

[119] To determine whether the avoidance transactions carried out by the appellant were abusive, the appellant's CDA must be reviewed at each stage of the plan. On June 30, 2014, when the 1,500,000 shares held by the appellant in Holdings were transferred, the appellant's CDA increased by half of the capital gain, namely $26,500,000, for a total of $32,280,000. This transfer also resulted in a cross redemption between 4244 and the appellant. On August 11, 2004, by first redeeming the appellant's shares held by 4244, 3295940 was able to transfer nearly all its CDA to 4244 through a capital dividend. That same day, 4244 did the same thing. All that was therefore left to do was to transfer the shares of the parent corporation in 4244 to the appellant by means of rollover and proceed with the sale of 4244 to Novartis to achieve the desired outcome.

[120] Through its series of choices, the appellant succeeded in avoiding the application of subsection 55(2) at the time of the cross redemption of its shares and 4244's shares. Knowing that subsection 55(2) would have converted the taxable dividend paid by 4244 at the time that the shares were redeemed by the appellant, the only way to avoid this unfavourable outcome was to move the CDA—which was later restored in its initial location—through capital dividend. The capital dividend was used in a way that does not conform with its purpose: instead of making it possible to track the tax-free amounts to the top of corporate group, it was moved then ultimately returned to its original location, i.e., belonging to 3295940.

[121] Recycling the capital dividend in this way prevented the application of subsection 55(2) and prevented the dividend that was deemed to have been paid by 4244 to 3295940 from being converted into a capital gain. The application of subsection 55(2) would have made it possible for the entire appreciation in value of Holdings' shares to be taxed and thereby would have maintained the integrity of the capital gains tax regime.

[122] The climax of this case is this: moving the CDA made it possible to establish the appellant's stake in the newly incorporated corporation at a value equal to its FMV, resulting in no tax payable during the sale of 4244's shares to Novartis. The appellant experienced only some of the disadvantages related to nominal tax base of its stake in Holdings.

[123] In paragraph 76 of *Gladwin FCA*, Noël, J. indicated that "the existence of a positive CDA balance, however generated, is the sole condition that governs a taxpayer's right to declare a capital dividend." Without question, the provisions related to the CDA regime do not prevent the circular payment of a capital dividend, given their wording. The rationale for these provisions does not prevent it, but by proceeding in this way, the object or purpose of subsection 55(2) was frustrated. The CDA move-around indirectly impacted the unrealized capital gain of the shares held by the appellant in 4244. To avoid the tax payable in connection with the unrealized capital gain, they simply had to sell their stake. However, subsection 55(2) should have applied to this decrease in capital gain.

[124] The strategy used in this case is very similar to that used in *D&D Livestock*: even though the GAAR was not invoked, the double use of safe income made it possible for the appellant to avoid triggering subsection 55(2), which, according to Mr. Justice Graham, resulted in capital gains stripping, which is an outcome the provision is intended to prevent.

[125] Like in *D&D Livestock*, the appellant succeeded in isolating the positive impact using capital dividend and to make their shareholder profit from it, without having to experience the adverse effects of their nominal tax base. Such a strategy defeats the purpose of subsection 55(2) of the Act.

[126] In this case, the overall effect of the series of transaction is that 3295940 declared a total capital gain of $64,600,000 following the disposition of its shares in Holdings, while the unrealized capital gain in those same shares was $96,100,000.

[127] Had it not been for the series of transactions, the disposition of shares in Holdings by 3295940 would have resulted in a $96,100,000 capital gain, which represents the appreciation of the value of these shares that have never been taxed. That is the result that would have aligned with the structure of the capital gains tax regime, the purpose of which is to tax a taxpayer on 50% of the appreciation of the value of their property, not on a random lower percentage from one transaction to another.

[128] In this case, subsection 55(2) is intended to prevent, among other things, individuals from stripping surplus amounts in the form of capital gains in which the payment of a tax-free inter-corporate dividend would result in reducing or avoiding the capital gain when shares are sold.

[129] Prior to the 2004 reorganizations, the ACB of Holdings' shares was nominal. Consequently, the capital gain that would have been realized with a disposition of Holdings shares at their FMV before the reorganization would have been essentially the same as the FMV of the shares, i.e. $101,800,000.

[130] Several transactions were then carried out properly. The capital paid from shares increased the ACB and decreased the FMV of the shares. The subsequent sale of the shares resulted in increasing the ACB by $57,000,000, and the appellant was taxed on that amount. The unrealized capital gain of the shares at that time was $31,500,000. At that time, as a result of the process of circulating capital dividend and rolling over shares with an ACB equal to their FMV, the unrealized capital gain in the Holdings' shares was avoided.

[131] The decrease in the unrealized capital gains in the Holdings shares was therefore due to the implicit use of the bumping principle set out in section 88 of the Act and the CDA regime, not a general rule against the stripping of surplus amounts as was the case in *McMullen*, cited in *Gwartz*. By thoughtfully and specifically using the provisions at issue, the appellant was able to circumvent the application of

subsection 55(2) and thereby avoid taxation during the sale of shares to an arm's length third party.

[132] The stripping of surplus tax-free amounts, whether through capital gains or dividends, should have been taxable. And it is subsection 55(2) that should have ensured the integrity of the tax system.

[133] Counsel for the appellant submits the following principle: selling their interest (regardless of whether it is direct or indirect) would result in the same economic and tax implications for the parties. More specifically, regardless of whether the ACB of the shares was attributed to the parent corporation or the wholly-owned subsidiary, what was sold was, ultimately, the same 20% stake in the pharmaceutical company.

[134] In this way, moving the tax consequence (the ACB of the shares, which was slightly over $47 million) within the corporate group should have no impact on compliance or non-compliance with the object and purpose of the provisions of the Act.

[135] Although the CRA does not consider the transfer of tax consequences within a corporate group to be abusive, this position is supported by mechanisms indeed provided for in the Act. The transfer of tax losses between affiliated corporations is allowed within the limitations of subsection 69(11), and increasing the ACB of shares is allowed, for example, when the PUC is increased by virtue of subsection 84(1) of when the specific conditions set out in paragraphs 88(1)(c) and (d) are met.

[136] In this case, even though bumping in the context of a merger or wind-up was not a viable option, the result was nonetheless the same: the tax consequence was moved through the corporate group to make it possible to decrease the capital gain at the time the Holdings' shares were sold.

[137] According to a well-known principle, if Parliament had intended to accept the movement of such a tax consequence, it would have explicitly allowed it. Indeed, Parliament said what it wanted to say and wanted to say what it said.

[138] A parallel can be drawn with *Oxford, supra*, wherein a publicly traded Canadian corporation proceeded with a reorganization to divest itself of certain immovable property.

[139] Through the incorporation of several limited partnerships, said property was transferred by way of rollover in accordance with subsection 97(2) of the Act. At the

time of the merger of the limited partnerships, the corporation resulting from the merger was able to proceed with bumping within the meaning of subsection 88(1) of the Act and thereby increased the ACB of its stakes in the partnerships. This series of transactions was carried out several times to maximize the ACB of stakes. Given the high ACB of the stakes in the partnerships, the sale generated only a slight taxable capital gain, if any, and the tax on the latent recapture and unrealized gains that accrued on the immovable property was completely avoided.

[140] In the Federal Court of Appeal, it was a matter of applying the GAAR, or more specifically the "abuse" aspect of the series of avoidance transactions, given the parties' admissions in relation to the two first conditions. While the Minister lost the case in the Tax Court of Canada, the Federal Court of Appeal arrived at the opposite conclusion.

[141] According to Chief Justice Noël, the two bumps made it possible to circumvent the application subsection 100(1). Through vertical mergers carried out after the rollovers, the ACB of the stakes in the corporations could be bumped:

> [76] In a vertical amalgamation, paragraph 88(1)(a) deems the parent corporation to have acquired the property of its subsidiary at the subsidiary's tax cost. Prior to the windup, however, it is possible that the parent's tax cost of the shares in its subsidiary (the ACB of the shares) will exceed the tax cost of the subsidiary's underlying property. Upon a vertical amalgamation, these shares will disappear. Without further adjustment, the tax cost in those shares would also disappear, thereby giving rise to potential double taxation in the event that the underlying property is subsequently sold. This is because the deemed cost of the underlying property in the hands of the parent, being equal to the subsidiary's tax cost, would not reflect any appreciation in value up to the time of the wind-up.
>
> [77] The bump provided for in paragraphs 88(1)(c) and (d) rectifies this situation by first calculating the difference between the ACB of the parent's shares and the tax cost of the subsidiary's property. This amount is then allowed to be added to the tax cost of the non-depreciable capital property which the parent inherited from its subsidiary. [.. .]

[142] However, given that it is not possible to bump the tax base of all property received during the vertical merger or wind-up (depreciable property and other types of property subject to a 100% inclusion rate cannot be bumped), Noël, J. concluded that ineligible property (i.e., depreciable property) had been indirectly bumped. This consequently frustrated the object, purpose and spirit of paragraphs 88(1)(a) and (d) as well as subsection 98(3) of the Act (*Oxford*, *supra*, at para. 82 and 97).

[143] In comparison with the facts submitted in this case, the appellant exercised the capital dividend mechanism to decrease the value of their shares and thereby benefit from a reduced capital gain. Through the series of transactions, the appellant was able to achieve the same result as if the bump had been applied to the shares held by them, but without having to meet the required conditions.

[144] The reorganization made it possible for 3295940 to decrease their capital gain using a part of the ACB of its own shares (held by Micsau) in a convoluted way to increase the ACB of its assets, namely the shares in Holdings. In the context of bumping rules, the Act explicitly sets out the limited circumstances where the cost of a corporation's shares can be allocated to some of its property. Seeing as these conditions were not met in this case, 3295940 attempted, through a series of transactions that circumvent subsection 55(2), to achieve an outcome that the cost-bumping rules would simply not allow. If Parliament had wanted to allow the use of the ACB accrued by 3295940 through the sale of its own assets, the bumping rules would have explicitly allowed this. Contrary to what 3295940 is suggesting in this case, Parliament therefore does not consider that double taxation results in this case from the inability to use the ACB of 3295940's shares in the sale of its own assets.

Alternative transactions presented by the appellant

[145] The extent of the alternative transactions proposed but not selected by the appellant and buyers must be determined in the light of the Federal Court of Appeal's holding in *Univar, supra*. A brief reminder of the facts is in order.

[146] CVC, a British financing company, acquired a Dutch company known as Univar NV in 2007. Indirectly, CVC thereby acquired a Canadian operating subsidiary with a surplus of over $889 million. CVC then carried out a series of transactions to strip this Canadian subsidiary of its surplus without being subject to tax withholding. The only issue to be resolved before the Court concerned abuse within the meaning of subsection 245(4) of the Act.

[147] Removing sums from the Canadian subsidiary could have resulted in the application of the provision in section 212.1 of the Act. However, there is some relief from this anti-avoidance provision: subsection 212.1(4). The objective of the series of transactions in this case was therefore to intentionally and cautiously benefit from this exception. After the series of artificial transactions, the subsidiaries were part of the same corporate structure, but Univar Canada had been stripped of its surplus.

[148] There was an ideal acquisition structure that would have made it possible to not apply the provision stipulated in 212.1, but the circumstances were not favourable to such a structure. This was at the core of the controversy, according to the Federal Court of Appeal. What is the role of alternative transactions in determining whether abuse occurred within the meaning of subsection 245(4) of the Act?

[149] Although the Tax Court of Canada, based on *Friedberg v. Canada*, [1991] F.C.J. No. 1255, [1992] 1 CTC 1, dismissed the alternative transactions argument, the Federal Court of Appeal took the opposite position in paragraphs 19 and 22:

> If the taxpayer can illustrate that there are other transactions that could have achieved the same result without triggering any tax, then, in my view, this would be a relevant consideration in determining whether or not the avoidance transaction is abusive.
>
> [.. .]
>
> Whether the surplus of the Canadian corporation is removed by completing the alternative transactions described in paragraph 17 above or by completing the transactions that were done in this case, the same surplus is removed from Canada.

[150] Ultimately, the Court concluded that, given the fact that there were other ways to achieve the same outcome (i.e., without being taxed), the transactions were not subjected to subsection 212.1(2) of the Act and complied with the limitations of that provision. The Federal Court of Appeal seems to have adopted an approach based on the economic reality of the transactions.

[151] The case law is scanty in relation to alternative transactions in the context of the application of subsection 245(4) of the Act.

[152] In this case, based on the evidence submitted at trial and the testimony of Mr. Authier that the three following proposals were considered so that the appellant could divest themselves of their Holdings shares on behalf of Novartis:

a) Merger between 3295940 and Holdings: 3295940 would have been merged with Holdings then sold to Novartis by Micsau. Novartis would have consequently acquired a corporation that combined 3295940 and Holdings, and the shares sold by Micsau would have had the same tax consequences as the shares of 3295940.

b) A tuck-under reorganization: Micsau would have exchanged 3295940's shares for shares in Holdings so that there would be cross redemption of shares between 3295940 and Holdings. These new shares of Holdings would then have been sold to Novartis so that the buyer would have acquired both 3295940 and Holdings;
c) Sale of 3295940 to RoundTable: RoundTable would have acted as an intermediary to acquire 3295940 to then wind it up. As part of this wind-up, the ACB of 3295940's shares would have been applied to Holdings' shares. Ultimately, all Holdings' shares would have been sold to Novartis, and 3295940's other assets and liabilities would have remained with RoundTable.

[153] According to the appellant, these three options would have made it possible for them to benefit from the ACB of their shares held by Micsau in the context of the Holdings' sale. These scenarios were rejected by RoundTable or Novartis, however.

[154] According to the Crown, alternative transactions cannot be used to determine whether abuse occurred within the meaning of subsection 245(4) since these are not comparable scenarios. Indeed, the proposed scenarios involve the sale of the appellant's shares, whereas the transaction at issue in this case instead involved the sale of Holdings' shares.

[155] Because these are not the same shares, the sale price and business and economic impact of these proposals are inconsistent with the transaction that was actually carried out.

[156] The Crown also argues that the scenarios presented by the appellant cannot be considered comparable scenarios because the buyers rejected them.

[157] I cannot agree with that argument, because in *Univar*, *supra*, the alternate scenario could not be implemented due to the factual circumstances of the reorganization. However, this did not prevent the Federal Court of Appeal from using this alternative transaction to determine whether abuse occurred within the meaning of subsection 245(4) of the Act.

[158] In an even more recent case, specifically in *Satoma*, *supra*, part of the appellant's argument was based on the fact that there were alternative transactions that could have resulted in similar tax outcome:

> [71] As for the appellant's arguments that a different course of action could have achieved the same result, as shown by the examples provided, they do not change my conclusion.
>
> [72] On the one hand, as the Federal Court of Appeal pointed out in *Perrault v. The Queen*, [1979] 1 F.C. 155, page 163, cited by the appellant, the tax obligation must be determined in the context of what was actually done and not on the basis of various other methods that could have allowed the appellant to avoid being taxed.
>
> [73] On the other hand, the examples given of cases where funds were invested directly in a corporation, instead of going through a trust, are not valid comparisons. The tax system differs depending on whether the transactions are between corporations or with individuals (including trusts). Once the evidence shows that the trust was an essential part of the plan, it cannot be shown that the result would have been the same without the use of a trust. A valid comparison could have been an investment made directly by Fiducie familiale Louis Pilon, without paying the dividends received from Gennium to 9134. In that case, the results would not have been the same since that family trust would have been taxed on the dividends it did not distribute to its beneficiaries, as it was not a reversionary trust.

[159] If we compare that case to this case, it was shown that the sale of Holdings' shares was essential. That being said, the alternative transactions related to the sale of 3295940's shares cannot be used for comparison because the outcome is not necessarily the same—not in relation to economic reality in any case. The three proposed alternative scenarios involved, in one way or another, the disposition of 3295940's shares and not a sale of Holdings' shares by 3295940.

[160] These consequently cannot be considered comparable scenarios, because the purpose of the sale, the price and the business implications would have been different.

[161] According to *Univar*, *supra*, taking alternative transactions into consideration in the abuse analysis must in no way change the analytical framework. Reviewing alternative transactions remains a tool that can be used to inform the Court of the object, purpose and spirit of the transactions that actually took place (see paragraph 21 of the decision). Since the alternative transactions would not achieve the same outcome in this case, whether there was abuse of the Act through the execution of these transactions is not particularly relevant.

[162] For all of these reasons, the appellant's appeal is dismissed with costs to the respondent.

Signed at Montreal, Quebec, this 30th day of June 2022.

"Réal Favreau"

Favreau J.

Translation certified true
on this 24th day of August 2022.
François Brunet, Revisor

APPENDIX

APPENDIX – RELEVANT STATUTORY PROVISIONS

Section 55

Deemed proceeds or capital gain

(2) Where a corporation resident in Canada has received a taxable dividend in respect of which it is entitled to a deduction under subsection 112(1) or 112(2) or 138(6) as part of a transaction or event or a series of transactions or events, one of the purposes of which (or, in the case of a dividend under subsection 84(3), one of the results of which) was to effect a significant reduction in the portion of the capital gain that, but for the dividend, would have been realized on a disposition at fair market value of any share of capital stock immediately before the dividend and that could reasonably be considered to be attributable to anything other than income earned or realized by any corporation after 1971 and before the safe-income determination time for the transaction, event or series, notwithstanding any other section of this Act, the amount of the dividend (other than the portion of it, if any, subject to tax under Part IV that is not refunded as a consequence of the payment of a dividend to a corporation where the payment is part of the series)

(a) shall be deemed not to be a dividend received by the corporation;

(b) where a corporation has disposed of the share, shall be deemed to be proceeds of disposition of the share except to the extent that it is otherwise included in computing such proceeds; and

(c) where a corporation has not disposed of the share, shall be deemed to be a gain of the corporation for the year in which the dividend was received from the disposition of a capital property.

Section 83

Capital dividend

(2) Where at any particular time after 1971 a dividend becomes payable by a private corporation to shareholders of any class of shares of its capital stock and the corporation so elects in respect of the full amount of the dividend, in prescribed manner and prescribed form and at or before the particular time or the first day on which any part of the dividend was paid if that day is earlier than the particular time, the following rules apply:

(a) the dividend shall be deemed to be a capital dividend to the extent of the corporation's capital dividend account immediately before the particular time; and

(b) no part of the dividend shall be included in computing the income of any shareholder of the corporation.

Section 89

capital dividend account of a corporation at any particular time means the amount, if any, by which the total of

(a) the amount, if any, by which

(i) the total of all amounts each of which is the amount if any, by which

(A) the amount of the corporation's capital gain from a disposition (other than a disposition that is the making of a gift after December 8, 1997, that is not a gift described in subsection 110.1(1)) of a property in the period beginning at the beginning of its first taxation year (that began after the corporation last became a private corporation and that ended after 1971) and ending immediately before the particular time (in this definition referred to as "the period") exceeds the total of

(B) the portion of the capital gain referred to in clause (A) that is the corporation's taxable capital gain, and

(C) the portion of the amount, if any, by which the amount determined under clause (A) exceeds the amount determined under clause (B) from the disposition by it of a property that can reasonably be regarded as having accrued while the property, or a property for which it was substituted,

(I) except in the case of a disposition of a designated property, was a property of a corporation (other than a private corporation, an investment corporation, a mortgage investment corporation or a mutual fund corporation),

(II) where, after November 26, 1987, the property became a property of a Canadian-controlled private corporation (otherwise than by reason of a change in the residence of one or more shareholders of the corporation), was a property of a corporation controlled directly or indirectly in any manner whatever by one or more non-resident persons, or

(III) where, after November 26, 1987, the property became a property of a private corporation that was not exempt from tax under this Part on its taxable income, was a property of a corporation exempt from tax under this Part on its taxable income, exceeds

(ii) the total of all amounts each of which is the amount, if any, by which

(A) the amount of the corporation's capital loss from a disposition (other than a disposition that is the making of a gift after December 8, 1997, that is not a gift described in subsection 110.1(1)) of a property in that period exceeds the total of

(B) the part of the capital loss referred to in clause (A) that is the corporation's allowable capital loss, and

(C) the portion of the amount, if any, by which the amount determined under clause (A) exceeds the amount determined under clause (B) from the disposition by it of a property that can reasonably be regarded as having accrued while the property, or a property for which it was substituted,

(I) except in the case of a disposition of a designated property, was a property of a corporation (other than a private corporation, an investment corporation, a mortgage investment corporation or a mutual fund corporation),

(II) where, after November 26, 1987, the property became a property of a Canadian-controlled private corporation (otherwise than by reason of a change in the residence of one or more shareholders of the corporation), was a property of a corporation controlled directly or indirectly in any manner whatever by one or more non-resident persons, or

(III) where, after November 26, 1987, the property became a property of a private corporation that was not exempt from tax under this Part on its taxable income, was a property of a corporation exempt from tax under this Part on its taxable income,

(b) all amounts each of which is an amount in respect of a dividend received by the corporation on a share of the capital stock of another corporation in the period, which amount was, by virtue of subsection 83(2), not included in computing the income of the corporation,

(c) the total of all amounts each of which is an amount required to have been included under this paragraph as it read in its application to a taxation year that ended before February 28, 2000,

(c.1) the amount, if any, by which

(i) half of the total of all amounts each of which is an amount required by paragraph 14(1)(b) to be included in computing the corporation's income in respect of a business carried on by the corporation for a taxation year that is included in the period and that ended after February 27, 2000, and before October 18, 2000, exceeds

(ii) where the corporation has deducted an amount under subsection 20(4.2) in respect of a debt established by it to have become a bad debt in a taxation year that is included in the period and that ended after February 27, 2000, and before October 18, 2000, or has an allowable capital loss for such a year because of the application of subsection 20(4.3), the amount determined by the formula

$$V + W$$

where

V

is 1/2 of the value determined for A under subsection 20(4.2) in respect of the corporation for the last such taxation year that ended in the period, and

W

is 1/3 of the value determined for B under subsection 20(4.2) in respect of the corporation for the last such taxation year that ended in the period, and

(iii) in any other case, nil,

(c.2) the amount, if any, by which

(i) the total of all amounts each of which is an amount required by paragraph 14(1)(b) to be included in computing the corporation's income in respect of a business carried on by the corporation for a taxation year that is included in the period and that ends after October 17, 2000, exceeds

(ii) where the corporation has deducted an amount under subsection 20(4.2) in respect of a debt established by it to have become a bad debt in a taxation year that is included in the period and that ends after October 17, 2000, or has an allowable capital loss for such a year because of the application of subsection 20(4.3), the amount determined by the formula

X + Y

where

X

is the value determined for A under subsection 20(4.2) in respect of the corporation for the last such taxation year that ended in the period, and

Y

is a third of the value determined for B under subsection 20(4.2) in respect of the corporation for the last such taxation year that ended in the period, and

(iii) in any other case, nil,

(d) the amount, if any, by which the total of

(i) all amounts each of which is the proceeds of a life insurance policy of which the corporation was a beneficiary on or before June 28, 1982, received by the corporation in the period and after 1971 in consequence of the death of any person, and

(ii) all amounts each of which is the proceeds of a life insurance policy of which the corporation was a beneficiary on or before June 28, 1982, received by the corporation in the period and after 1971 in consequence of the death of any person, and

exceeds the total of all amounts each of which is the adjusted cost basis (within the meaning assigned by subsection 148(9)) of a policy referred to in subparagraph (i) or (ii) to the corporation immediately before that person's death,

(e) the amount of the corporation's life insurance capital dividend account immediately before May 24, 1985, and

(f) all amounts each of which is an amount in respect of a distribution made in the period by a trust to the corporation in respect of capital gains of the trust equal to the lesser of

(i) the amount, if any, by which

(A) the amount of the distribution exceeds

(B) the amount designated under subsection 104(21) by the trust (other than a designation to which subsection 104(21.4) applies) in respect of the net taxable capital gains of the trust attributable to those capital gains, and

(ii) the amount determined by the formula

A x B

where

A

is the fraction or whole number determined when 1 is subtracted from the reciprocal of the fraction under paragraph 38(a) applicable to the trust for the year, and

B

is the amount referred to in clause (i) (B), and

(g) all amounts each of which is an amount in respect of a distribution made by a trust to the corporation in the period in respect of a dividend (other than a taxable dividend) paid on a share of the capital stock of another corporation resident in Canada to the trust during a taxation year of the trust throughout which the trust was resident in Canada equal to the lesser of

(i) the amount of the distribution, and

(ii) the amount designated under subsection 104(20) by the trust in respect of the corporation in respect of that dividend,

exceeds the total of all capital dividends that became payable by the corporation after the commencement of the period and before the particular time; (compte de dividendes en capital)

Section 245

(1) In this section,

tax benefit means a reduction, avoidance or deferral of tax or other amount payable under this Act or an increase in a refund of tax or other amount under this Act, and includes a reduction, avoidance or deferral of tax or other amount that would be payable under this Act but for a tax treaty or an increase in a refund of tax or other amount under this Act as a result of a tax treaty; (avantage fiscal)

tax consequences to a person means the amount of income, taxable income, or taxable income earned in Canada of, tax or other amount payable by or refundable to the person under this Act, or any other amount that is relevant for the purposes of computing that amount; (attribut fiscal)

transaction includes an arrangement or event. (opération)

General anti-avoidance provision

(2) Where a transaction is an avoidance transaction, the tax consequences to a person shall be determined as is reasonable in the circumstances in order to deny a tax benefit that, but for this section, would result, directly or indirectly, from that transaction or from a series of transactions that includes that transaction.

Avoidance transaction

(3) An avoidance transaction means any transaction

(a) that, but for this section, would result, directly or indirectly, in a tax benefit, unless the transaction may reasonably be considered to have been undertaken or arranged primarily for *bona fide* purposes other than to obtain the tax benefit; or

(b) that is part of a series of transactions, which series, but for this section, would result, directly or indirectly, in a tax benefit, unless the transaction may reasonably be considered to have been undertaken or arranged primarily for *bona fide* purposes other than to obtain the tax benefit.

Application of subsection (2)

(4) Subsection (2) applies to a transaction only if it may reasonably be considered that the transaction

(a) would, if this Act were read without reference to this section, result directly or indirectly in a misuse of the provisions of any one or more of

(i) this Act,

(ii) the *Income Tax Regulations*,

(iii) the *Income Tax Application Rules*,

(iv) a tax treaty, or

(v) any other enactment that is relevant in computing tax or any other amount payable by or refundable to a person under this Act or in determining any amount that is relevant for the purposes of that computation; or

(b) would result directly or indirectly in an abuse having regard to those provisions, other than this section, read as a whole.

Determination of tax consequences

(5) Without restricting the generality of subsection (2), and notwithstanding any other enactment,

(a) any deduction, exemption or exclusion in computing income, taxable income, taxable income earned in Canada or tax payable or any part thereof may be allowed or disallowed in whole or in part,

(b) any such deduction, exemption or exclusion, any income, loss or other amount or part thereof may be allocated to any person,

(c) the nature of any payment or other amount may be recharacterized, and

(d) the tax effects that would otherwise result from the application of other provisions of this Act may be ignored,in determining the tax consequences to a person as is reasonable in the circumstances in order to deny a tax benefit that would, but for this section, result, directly or indirectly, from an avoidance transaction.

2017-4685(IT)G

TAX COURT OF CANADA

BETWEEN:

3295940 CANADA INC.

Appellant

and

HER MAJESTY THE QUEEN

Respondent

PARTIAL AGREED STATEMENT OF FACTS

The parties agree on the following facts for the sole purposes of this appeal and without prejudice to their right to demonstrate, at the appeal hearing, additional facts that are not inconsistent with the facts mentioned herein.

A – Corporate background

1. Sabex Inc. (*Sabex*) is a limited liability company that was incorporated under the *Canada Business Corporations Act* (C**BCA**) in 1973.[1]

2. Sabex operates a company that specializes in developing, producing and distributing generic injectable drugs, notably morphine.[2]

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[1] See all incorporation documents for Savex (renamed 3295940 Canada Inc. on April 25, 2002).

- Certificate of amalgamation dated September 13, 1996, **Appendix 1.**
- Amendment certificate dated March 30, 1999, **Appendix 2.**
- Amendment certificate dated November 28, 2001, **Appendix 3.**
- Amendment certificate dated April 25, 2002, **Appendix 4.**
- Notice of Change of Directors dated April 25, 2002, **Appendix 5.**
- Amendment certificate dated June 29, 2004, **Appendix 6.**

[2] See Confidential Information Memorandum (**CIM**) prepared by EY in 2002, **Appendix 7**, p. 6.

3. In 1980, Michel Saucier (Saucier) and Gilles R. Dupuis (Dupuis) acquired Sabex.[3] At the time, each of them held 50% of the corporation's shares.[4]

4. In 1996, Dupuis sold his interest in Sabex, and Saucier financed the transaction with assistance of the Caisse de dépôt et placement du Québec (CDPQ). Saucier then held 75% of the corporation's shares, and the CDPQ owned the remaining 25%.[5]

I – The partial sale of Sabex's pharmaceutical company in 2002

5. In 2001, Saucier wanted to divest himself of his interest in Sabex.[6]

6. Ernst & Young (EY) was hired to find potential buyers. A Confidential Information Memorandum (CIM) was then prepared for distribution to potential buyers.[7]

7. Saucier wanted nothing more than to sell all his Sabex shares[8]; however, if necessary he was willing to remain involved in Sabex for a certain period of time to facilitate the transition.[9]

8. At that point, the tax attributes of the block of shares held by Sabex shareholders were as follows[10]:

Shareholder	**ACB**	**FMV**	**Safe income**
Michel Saucier	$2,000	$172,500,000	$23,000,000
CDPQ/Sofinov	$7,500,000	$57,500,000	N/A
		$230,000,000	

[3] See CIM, **Appendix 7**, p. 24.
[4] See transcript of Jacques Authier's examination for discovery (**Authier transcript**), **Appendix 8**, p. 44, line 21.
[5] See CIM, **Appendix 7**, pp. 7 and 24.
[6] See Authier transcript, **Appendix 8**, p. 50–51, p. 55, lines 15–18, p. 60, line 18, p, 61, line 15.
[7] See Authier transcript, **Appendix 8**, p. 52, lines 6–9.
[8] See Authier transcript, **Appendix 8**, p. 55, lines 15–18, p. 60, line 18 to p. 61, line 15.
[9] See CIM, **Appendix 7**, p. 7.
[10] See memorandum from EY dated February 1, 2002 (revised March 4, 2002), **Appendix 9**, p. 3.

9. Following preliminary discussions with a few major pharmaceutical companies, more serious discussions were held between EY and the investment fund known as RoundTable Healthcare Partners, L.P. And RoundTable Investors, L.P. (RoundTable)[11]

10. On January 25, 2002, RoundTable offered to buy 80% of Sabex to Michel Saucier.[12] The main terms and conditions of the proposal are as follows:

Proposal:

Purchase Price & Consideration: RoundTable proposes to effectively purchase all the assets and assume all the liabilities of Sabex through an entity (NewSabex as defined herein) which will be owned post-closing as to 80% by RoundTable and 20% by Sabex. Specifically, NewSabex will purchase all of the assets of Sabex and assure all of its liabilities for a consideration of $176 million payable in cash at closing and the issue of equity stock in NewSabex to the Company representing an equity participation of 20% in NewSabex post-closing. This cash at closing portion of the purchase consideration implies an equity purchase price of $220 million with additional earn-out consideration and equity participation as detailed below.

Specifically, at closing., we would deliver a cash payment of $176 million to Sabex as well as an equity stake in NewSabex (as discussed below) to the Company. For the purposes hereof, Sabex or the Company is also referred to as the Seller.

Structure and Retained Ownership: RoundTable will form a new company (NewSabex) to purchase all of the assets of Sabex and assume all of its liabilities. The Proposed Transaction will be based om the draft Asset Purchase Agreement previously provided to us from the Company and will contain agreements, representations and warranties, conditions, and indemnities from the Seller and the Seller's shareholders customary in a transaction of this type. Post-closing, RoundTable will own 80% of NewSabex and Sabex 20%, subject to dilution for both shareholders pro rata from the management stock option plan (see below) and potential warrants issued in conjunction with subordinated debt incurred related to the Proposed Transaction. All parties agree to cooperate to structure the Proposed Transaction tax-efficiently for all parties, taking into account that the Company will retain an equity participation of 20% in NewSabex. RoundTable will require that the Company's 20% equity interest in NewSabex will be owned directly or indirectly by Michel Saucier. The Company will keep RoundTable informed of all arrangements entered into by its shareholders in connection with the Proposed Transaction and provide adequate documentation in respect thereof.

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[11] See Authier transcription, **Appendix 8**, pp. 58–60.

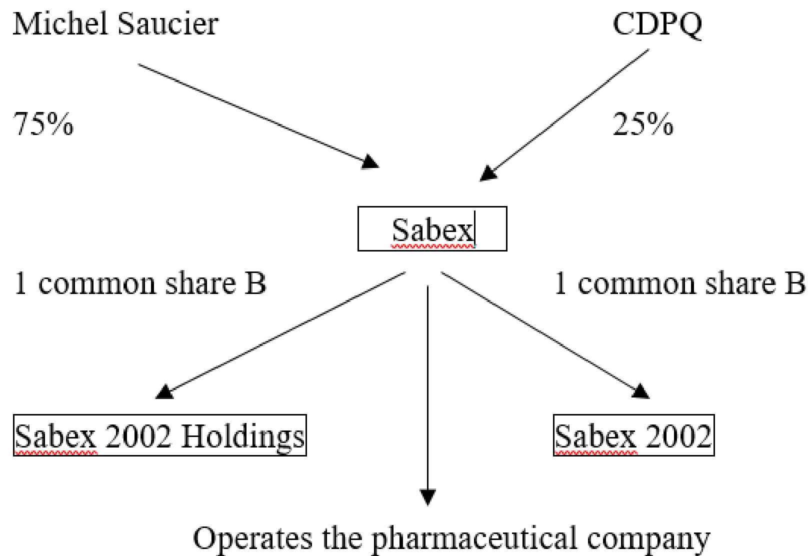
[12] See the letter of intent dated January 25, 2002, **Appendix 10.**

Company Liquidity Provision: The Company and RoundTable will structure a liquidity provision related to a portion of the Company's 20% ownership stake in New Sabex. Specifically, the Company and RoundTable both desire to provide the Company with an ability to sell, and the ability for RoundTable to purchase, as the case may be, one quarter of its post-closing [shareholding] and prior to any dilution ownership stake in NewSabex (the Liquidity Provision). The Liquidity Provision shall have an initial liquidation price of $11 million for one quarter, or 5%, of the Company's 20% equity stake in New Sabex. The Liquidity Provision shall become exercisable on the second anniversary of the closing of the Proposed Transaction and be exercisable for six months thereafter. The liquidation price of the Liquidity Provision, when exercisable, shall be $13.31 million. New Sabex or RoundTable, as the case may be, shall have up to two years from the exercise date of the Liquidity Provision to fund the liquidation price of the Liquidity Provision. The unpaid balance of the Liquidity Provision shall be increased to convey an annual rate of increase of 10% and will be structured so such increases in liquidation price shall not be accounted for as an expense in New Sabex's financial statements. The Liquidity Provision shall be funded by New Sabex or RoundTable, at RoundTable's sole discretion.

11. Saucier accepted RoundTable's proposal.

12. To implement the 80% purchase of the Sabex pharmaceutical company by RoundTable, the following transactions,[13] including CDPQ's sale of its 25% stake in Sabex, were put in place by the parties[14]:

a) On March 19, 2002, Sabex 2002 Inc (**Sabex 2002**)[15] and Sabex 2002 Holdings Inc. (**Sabex 2002 Holdings**)[16] were incorporated under the CBCA. Sabex then purchased a Class B common share in Sabex 2002 and a Class B common shares in Sabex 2002 Holdings for a nominal amount.



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[13] See the following documents:
- EY's memorandum dated February 11, 2002 (revised March 4, 2002), **Appendix 9**.
- EY's memorandum dated March 27, 2002 (revised April 12, 2002), **Appendix 11**.
- Closing agenda for the transfer of all Sabex Inc.'s assets to Sabex 2002 Inc and for RoundTable to invest in Sabex 2002 Holdings Inc., **Appendix 12**.

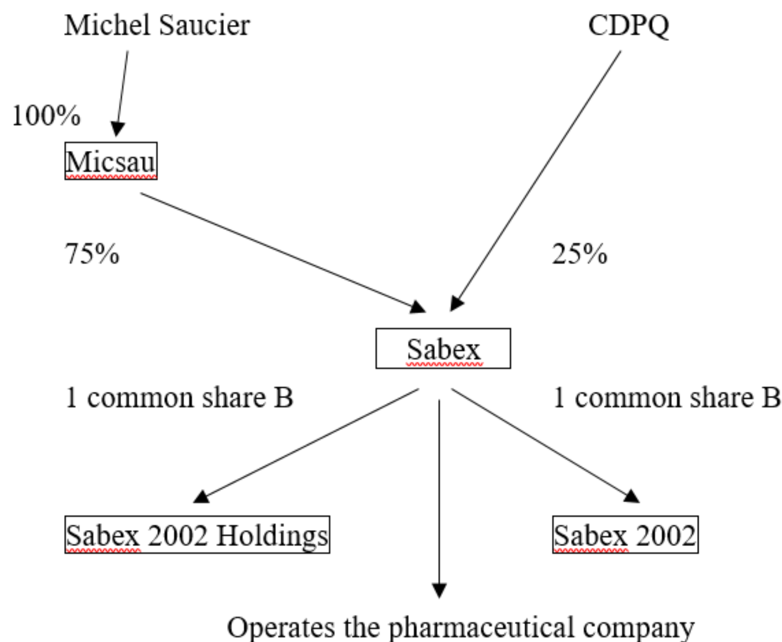
[14] See letter from RoundTable dated April 18, 2002, **Appendix 13**.

[15] See all Sabex 2002's governing documents:
- Certificate of incorporation dated March 18, 2002, **Appendix 14**.
- Amendment certificate dated April 9, 2002, **Appendix 15**.
- Amendment certificate dated April 1, 2004, **Appendix 16**.
- Amendment certificate dated February 4, 2005, **Appendix 17**.
- Amendment certificate dated December 21, 2005, **Appendix 18**.

[16] See all Sabex 2002 Holdings' governing documents:
- Certificate of incorporation dated March 19, 2002, **Appendix 19**.
- Amendment certificate dated April 3, 2002, **Appendix 20**.
- Amendment certificate dated April 10, 2002, **Appendix 21**.
- Amendment certificate dated April 1, 2004, **Appendix 22**.

b) On April 10, 2002, Gestion Micsau Inc. (Micsau) was incorporated under the CBCA.[17]

c) On April 17, 2002, Michel Saucier transferred all his Sabex shares to Micsau, specifically 13,5000,000 common shares, 8,000,000 Class A preferred shares and 500,000 Class C preferred shares, in exchange for 120 common shares of Micsau. This transaction was subject to a joint election under subsection 85(1) of the *Income Tax Act* (ITA). The amount agreed upon by the parties was a nominal amount[18]:

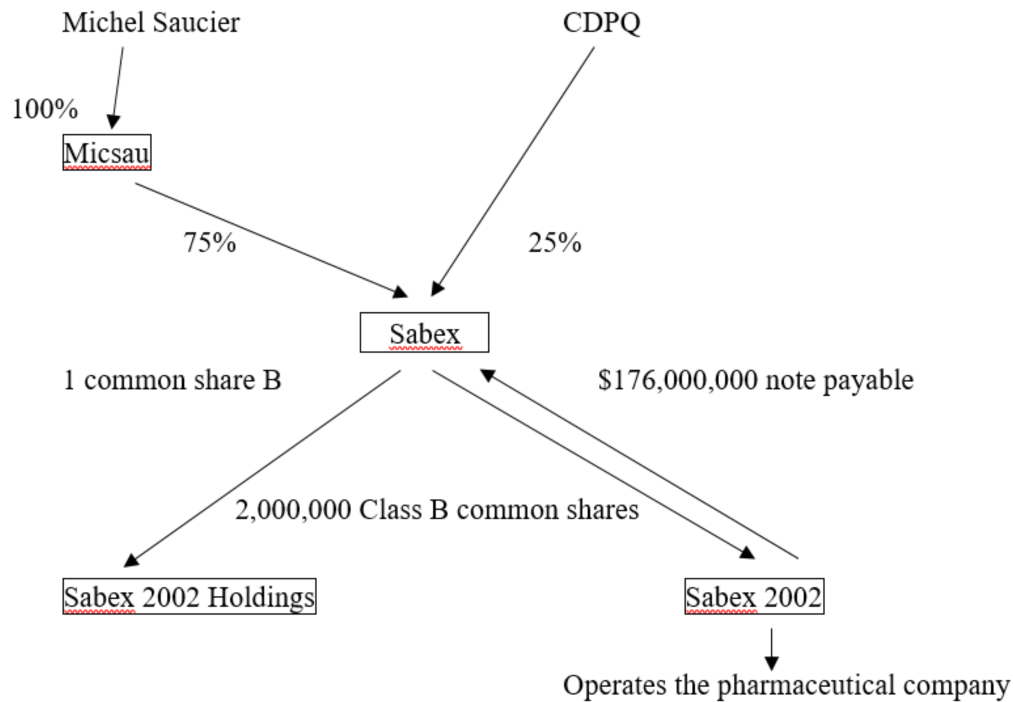


[17] See all Micsau's governing documents:

- Certificate of incorporation dated April 10, 2002, **Appendix 23.**
- Amendment certificate dated December 5, 2002, **Appendix 24**.
- Amendment certificate dated December 13, 2002, **Appendix 25**.

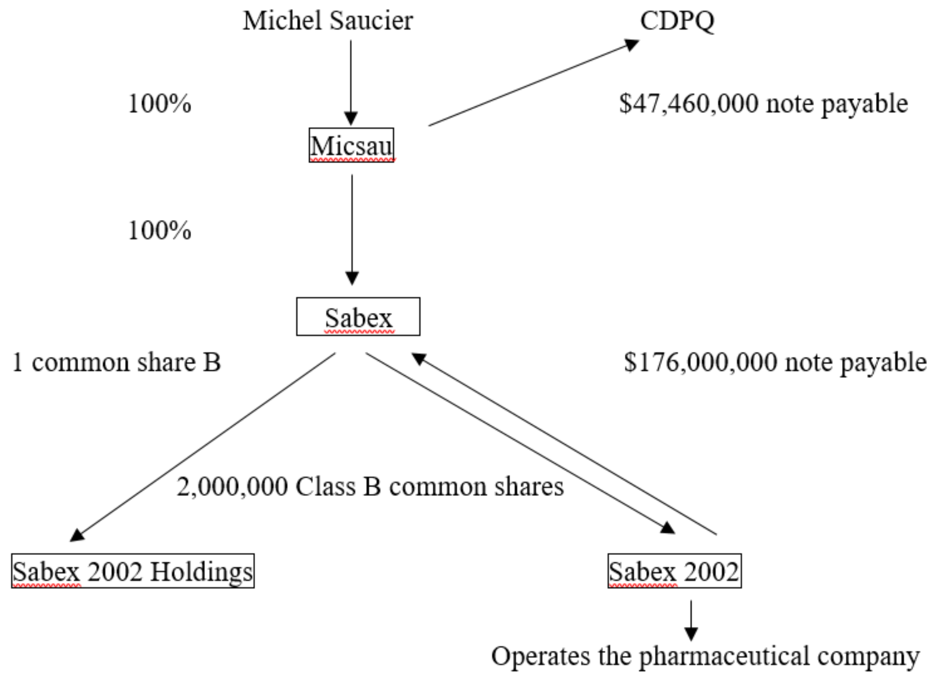
[18] See Share Purchase Agreement dated April 17, 2002, **Appendix 26**, and T2057, **Appendix 37.**

d) On April 18, 2002, Sabex sold all its shares to Sabex 2002 for $256,562,000. In exchange, Sabex received the assumption of $26,562,000 of its debts, a note payable in the amount of $176,000,000 and 1,999,999 Class B common shares, representing 20% of the common shares of Sabex 2002. The payment also included a $10,000,000 contingent consideration based on future performance.[19] This transaction was subject to a joint election under subsection 85(1) of the ITA:



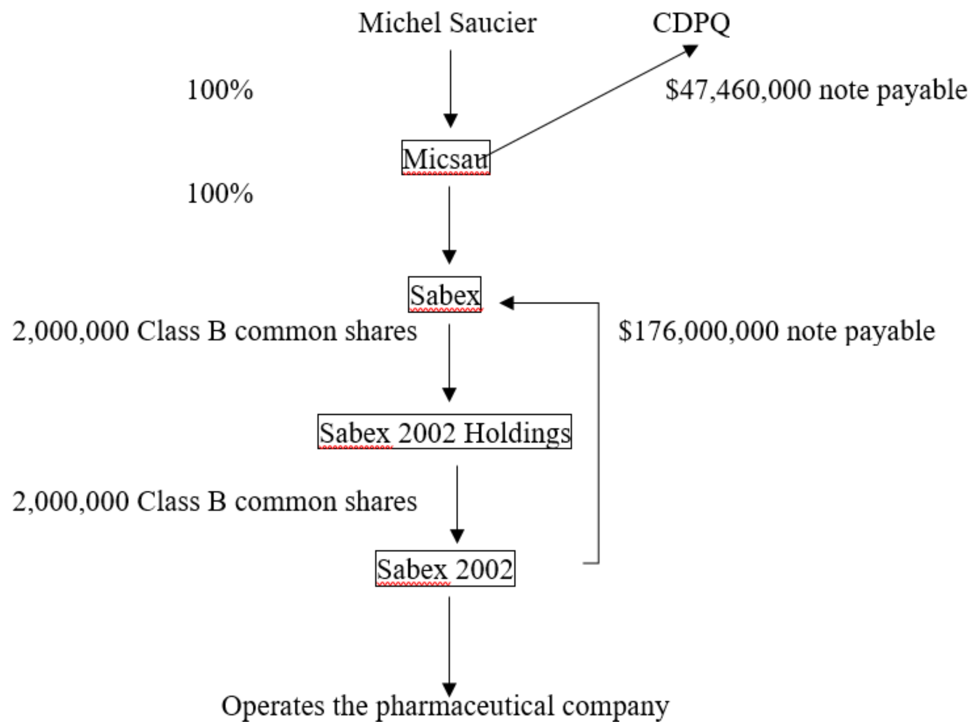
[19] See 3245940's financial statements dated March 31, 2003, Appendix 28, as well as the Asset Purchase Agreement dated April 18, 2002, and its appendix 3.6, **Appendix 29.**

e) On April 18, 2002, CDPQ sold all its Sabex shares to Micsau in exchange for two notes payable totalling $47,460,000[20]:



[20] See Share Purchase Agreement and notes payable dated April 18, 2002, **Appendix 30.**

f) On April 8, 2002, Sabex transferred all its Sabex 2002 shares (2,000,000 Class B common shares) to Sabex 2002 Holdings in exchange for 1,999,999 Class B common shares of Sabex 2002 Holdings. This transaction was subject to a joint election under subsection 85(1) of the ITA. The amount agreed upon by the parties was a nominal amount[21]:



g) On April 18, 2002, RoundTable purchased 8,000,000 Class A common shares of Sabex 2002 Holdings for $69,115,784.[22]

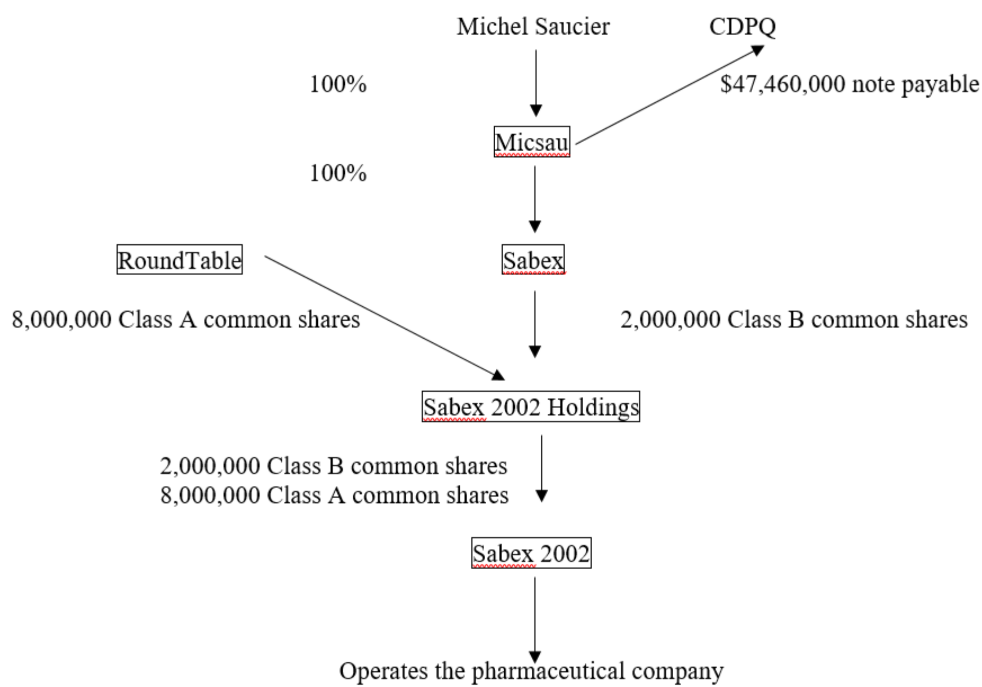
[21] See T2057, **Appendix 31.**

[22] See closing agenda for the transfer of all Sabex Inc.'s assets to Sabex 2002 Inc. and for RoundTable to invest in Sabex 2002 Holdings Inc., **Appendix 12.**

h) On April 18, 2002, Sabex 2002 Holdings purchased 8,000,000 Class A common shares of Sabex 2002 for $69,115,784.[23]

i) On April 18, 2002, Sabex borrowed $110,000,000 from a financial institution.[24]

j) On April 18, 2002, Sabex 2002 paid off the $176,000,000 note payable to Sabex[25]:



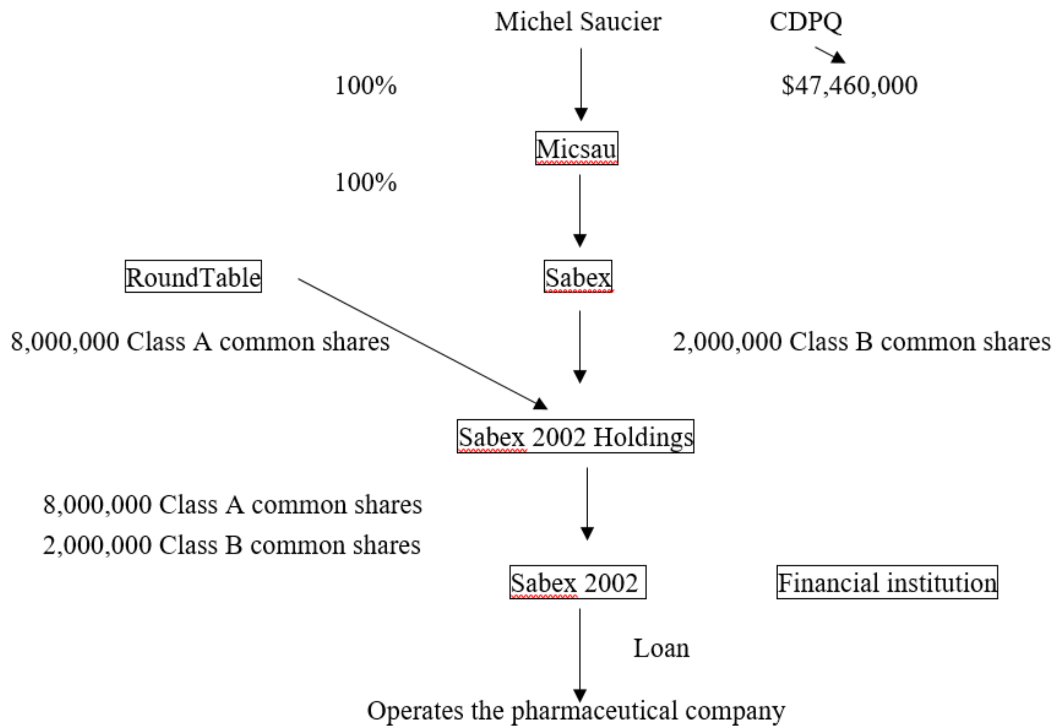
23 See closing agenda for the transfer of all Sabex Inc.'s assets to Sabex 2002 Inc. and for RoundTable to invest in Sabex 2002 Holdings Inc., **Appendix 12**.

24 See EY's memorandum dated March 27, 2002 (revised April 12, 2002), **Appendix 11.**

25 See closing agenda for the transfer of all Sabex Inc.'s assets to Sabex 2002 Inc. and for RoundTable to invest in Sabex 2002 Holdings Inc., **Appendix 12**.

k) On April 18, 2002, Sabex paid a $47,460,000 dividend to Micsau.[26]

l) On April 18, 2002, Micsau paid off the two notes payable totalling $47,460,000 to CDPQ[27]:



[26] See EY's memorandum dated March 27, 2002 (revised April 12, 2002), **Appendix 11.**

[27] See EY's memorandum dated March 27, 2002 (revised April 12, 2002), **Appendix 11.**

13. In summary, following RoundTable's 80% purchase of Sabex:

    a) Saucier held 100% of shares in Micsau.

    b) Micsau held 100% of Sabex's shares (now known under the corporate name 3295940 Canada Inc. (**3295940**))[28]

    c) 3295940 held 20% of Sabex 2002 Holdings (now known under the corporate name Sabex Holdings Ltd.[29] (**Holdings**)).

    d) RoundTable held 80% of the remaining Holdings' shares.

    e) Holdings held 100% of shares in Sabex 2002.

    f) Sabex 2002 was operating the pharmaceutical company.

14. At all relevant times, 3295940 and Micsau were Canadian-controlled private corporations (CCPCs) within the meaning of subsections 125(7) and 248(1) of the ITA.

15. Following the transactions mentioned above, the adjusted cost base (ACB) of all shares that Micsau held in 3295940 was established at $48,100,000 within the meaning of section 54 and subsection 248(1) of the ITA.

16. As for the 2,000,000 Class B shares in Holdings held by 3295940, they represented 20% of the common shares issues and outstanding.

17. Their corresponding a paid-up capital (PUC) was a nominal amount within the meaning of subsection 89(1) and 248(1) of the ITA as well as a nominal ACB within the meaning of section 54 and subsection 248(1) of the ITA.

18. Pursuant to the agreement entered into with RoundTable in 2002, in 2004, Holdings or RoundTable had the option to redeem 500,000 of the 2,000,000 Class B common shares held by 3295940 for $13,310,000. In accordance with this Memorandum of Understanding, 3295940 could also force Holdings to redeem 500,000 of the 2,000,000 Class B shares that it held to them for $13,310,000.[30]

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[28] See certificate of amendment dated April 25, 2002, **Appendix 4**.

[29] See amendment certificate dated April 1, 2004, **Appendix 22**.

[30] See the Sabex 2002 Shareholders' Agreement dated April 18, 2002, **Appendix 32**.

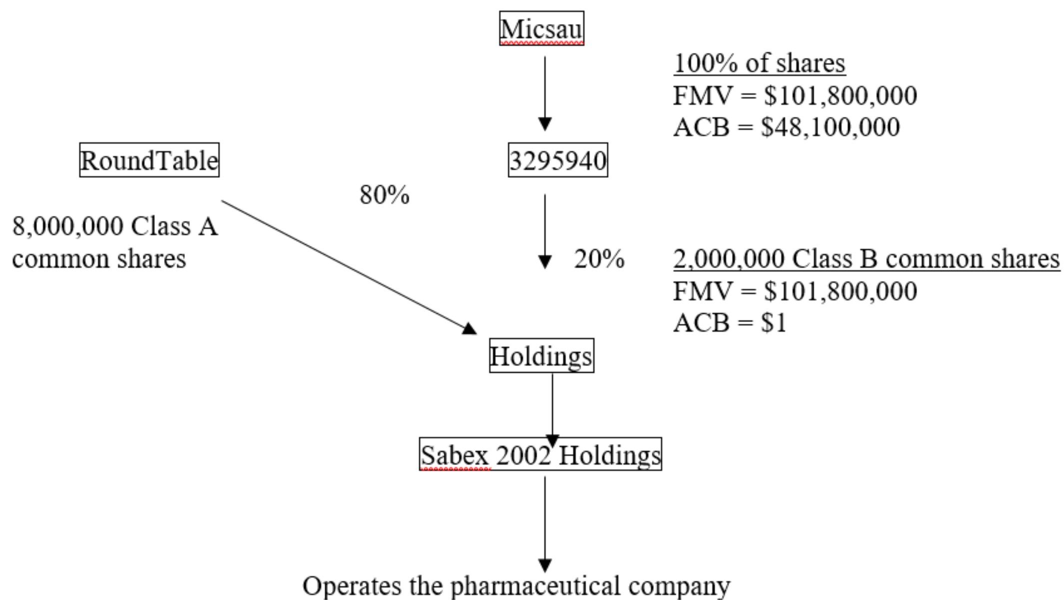
19. RoundTable held 8,000,000 Class A shares in Holdings, representing the 80% remaining Holdings shares issued and outstanding.

II – The complete sale of the Sabex 2002 pharmaceutical company to Novartis

20. In early 2004, RoundTable initiated negotiations regarding the sale of all shares in Holdings Novartis Pharmaceuticals Canada Inc. (Novartis).

21. During these negotiations with Novartis, only the major shareholder of Holdings—RoundTable—was involved, and 3295940 remained relatively uninformed of how these negotiations were going.

22. At that time, the fair market value (FMV) of the 2,000,000 Class B shares in Holdings held by 3295940, and consequently the FMV of 3295940, was $101,800,000. The shares held by Micsau, 3295940 and Holdings at that time were detailed as follows:



23. On June 25, 2004, pursuant to the agreement entered into with RoundTable in 2002,[31] which is described in paragraph 18 above, RoundTable exercised its option according to the terms and conditions of the *Liquidity Provision* stipulated in paragraph 10 above and forced Holdings to redeem 500,000 of their 2,000,000 Class B common shares held by 3295940 for $13,310,000.[32]

24. The safe income for those 500,000 Class B shares in Holdings held by 3295940 was $1,700,000 within the meaning of subsection 55(5) of the ITA.

25. The fees related to this transaction were $60,000.

26. Given the nominal ACB and PUC in relation to these 500,000 Class B common shares in Holdings, 3295940 realized a $11,550,000 capital gain ($13,310,000 - $1,700,000 - $60,000) by applying subsection 55(2) of the ITA.

27. As a result of this redemption, the taxable capital gain realized by 3295940 and the amount added to 3295940's capital dividend account (CDA) was $5,780,0000 [sic] within the meaning of paragraphs 38(1)(a) and 89(1) of the ITA, respectively.

B – The reorganization implemented in 2004

28. Before proceeding with the complete sale of the Sabex 2002 pharmaceutical company to Novartis, a reorganization was implemented.

29. Given RoundTable's and Novartis' rejection of the sales structure that would have directly or indirectly included shares in 3295940, Micsau and 3295940 implemented the following reorganization[3]

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[31] See the Sabex 2002 Shareholders' Agreement dated April 18, 2002, **Appendix 32**.

[32] See Share Purchase Agreement dated June 25, 2004, **Appendix 33**.

[33] See EY's memorandum dated July 13, 2004 (updated February 15, 2005), **Appendix 34**.

I. EXTRACTION OF SAFE INCOME

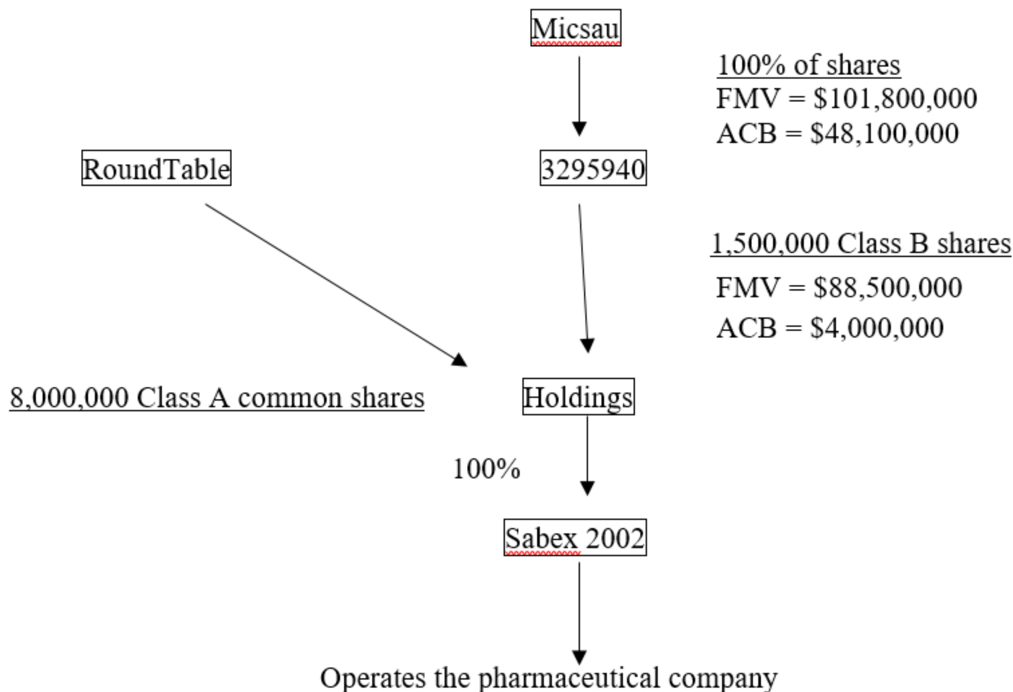
30. On June 29, 2004, Holdings increased the PUC in relation to its Class B shares by $4,000,000.

31. The safe income for those 1,500,000 Class B shares in Holdings still held by 3295940 was $4,000,000 within the meaning of subsection 55(5) of the ITA.

32. Holdings is deemed to have spent, and 3295940 is deemed to have received, a $4,000,000 dividend pursuant to subsection 84(1) of the ITA.

33. Given that this entire dividend came from safe income credited to 1,500,000 Class B shares, subsection 55(2) of the ITA did not apply in terms of deeming this dividend a capital gain.

34. Furthermore, the ACB for the 1,500,000 Class B shares in Holdings held by 3295940 increased by $4,000,000 pursuant to paragraph 53(1)(b) of the ITA:



II. REORGANIZATION OF CAPITAL FOR 3295940 AND INCORPORATION OF 4244

35. On June 29, 2004, 3295944 amended its governing documents to include Class D preferred shares without rights that are redeemable by the corporation or the shareholder at $1 per share.[34]

36. On June 30, 2004, 3295940 redeemed the shares of its capital stock held by Micsau in exchange for 31,500,000 Class D preferred shares and 100 common shares of its capital stock.[35]

37. This transaction was subject to a joint election under subsection 85(1) of the ITA.[36]

38. The amount agreed upon by the parties was established at $48,100,000.[37]

39. In accordance with paragraph 85(1)(g) of the ITA, the ACB of the 31,500,000 Class D preferred shares in 3295940 held by Micsau was established at $31,500,000. The FMV of the 31,500,000 Class D preferred shares in 3295444 held by Micsau was also $31,500,000.

40. Pursuant to paragraph 85(1)(h) of the ITA, the ACB of the 100 common shares in 3295940 held by Micsau was established at $16,600,000.

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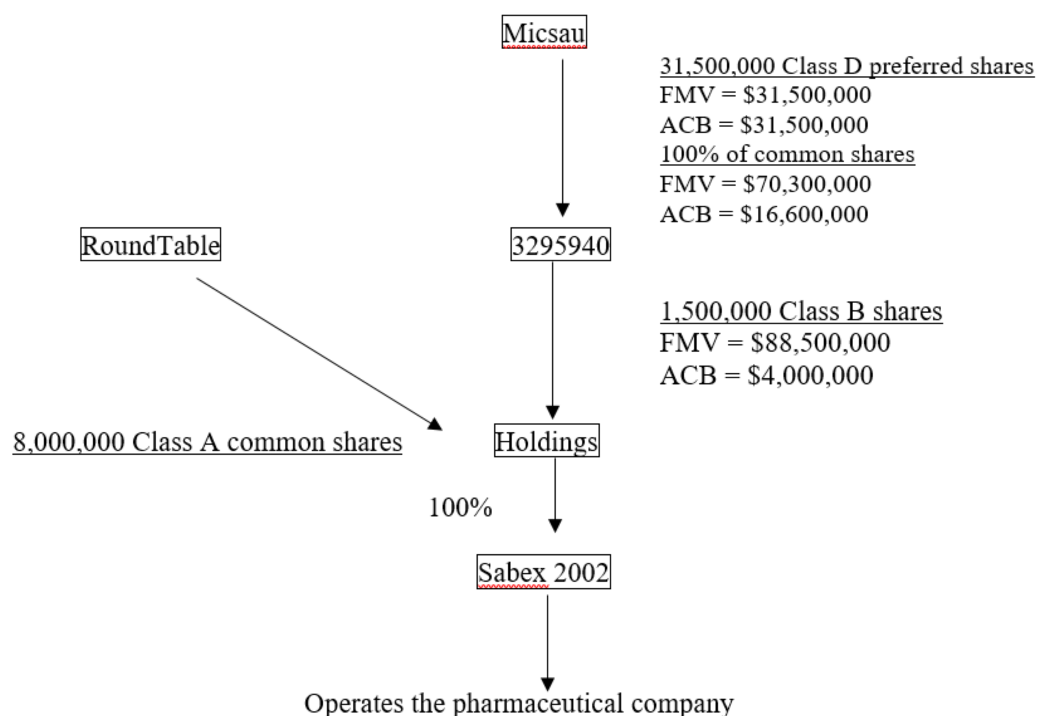
[34] See 3245440's amendment certificate dated June 29, 2004, **Appendix 6**.

[35] See written resolution by the sole director of 3295490 dated 10 a.m., June 30, 2004, **Appendix 35**.

[36] See T2057, **Appendix 36**.

[37] See T2057, **Appendix 36**.

41. The PUC of 3295940's 31,500,000 Class D preferred shares and 100 common shares was established at a nominal amount.



42. 4244851 Canada Inc. (**4244**) was incorporated on June 21, 2004,[38] and, until June 30, 2004, its only share issued and outstanding was a common share purchased by Micsau for a nominal amount at the time of its incorporation.

[38] See 4244's certificate of incorporation dated June 21, 2004, **Appendix 37.**

43. One June 30, 2004, Micsau transferred the 31,500,000 Class D shares in 3295440 that they had just acquired to 4244 in exchange for 31,500,000 Class D preferred shares in the capital stock of 4244.[39]

44. The Class D preferred shares in 4244 held by Micsau had no voting rights and were redeemable by the corporation or their shareholder for $1 per share.[40]

45. The PUC of the 31,500,000 Class D preferred shares in 4244 held by Micsau was nominal.

46. The ACB and FMV of the 31,500,000 Class D preferred shares in 4244 held by Micsau were $31,500,000.

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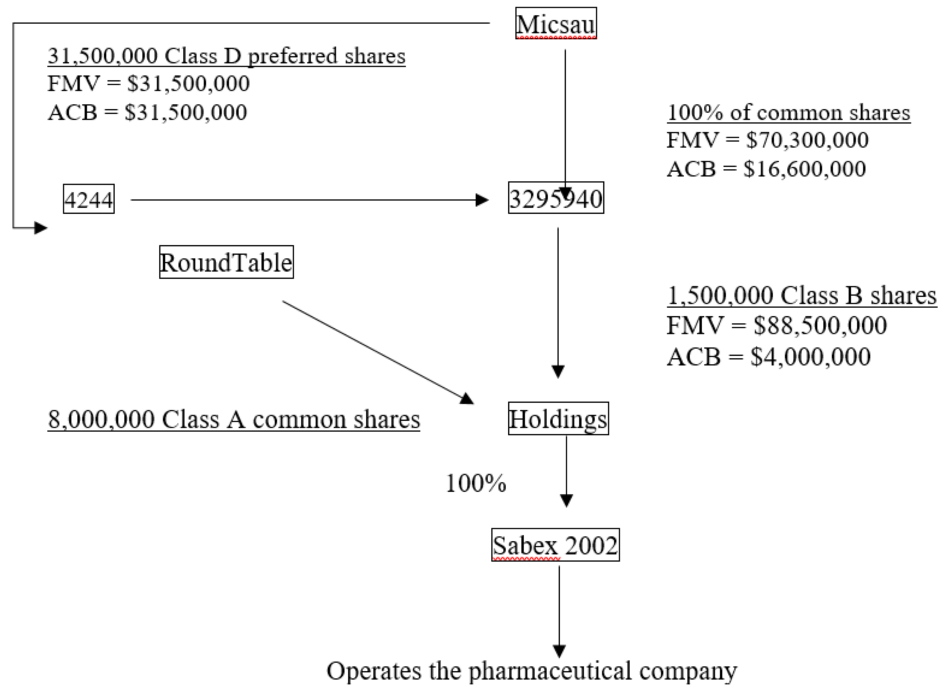
[39] See written resolution by the director of 3295490 dated 11 a.m., June 30, 2004, **Appendix 38**.

[40] See 4244's certificate of incorporation dated June 21, 2004, **Appendix 7.**

47. No gain resulted from this transaction since the FMV of the 31,500,000 Class D preferred shares in 3295940 held by Micsau was equal to their ACB:

<u>31,500,000 Class D preferred shares</u>
FMV = $31,500,000
ACB = $31,500,000
<u>1 common share</u>
FMV = $1
ACB = $1



III. THE SALE OF HOLDINGS SHARES TO 4244

48. On June 30, 2004, 3295940 disposed of the 1,500,000 Class B shares in Holdings (worth $88,500,000) that it held to 4244 in exchange for 57,000,000 Class D preferred shares and 31,500,000 common shares of the capital stock of 4244.[41]

49. This transaction was subject to a joint election under subsection 85(1) of the ITA.[42]

50. The amount agreed upon by the parties was established at $57,000,000.[53]

51. In accordance with paragraph 85(1)(g) of the ITA, the ACB of the 57,000,000 Class D preferred shares in 4244 held by 3295940 was established at $57,000,000.

52. Pursuant to paragraph 85(1)(h) of the ITA, the ACB of the 31,500,000 common shares in 4244 held by 3295940 was established at a nominal amount.

53. The PUC of the 57,000,000 Class D preferred shares and the 31,500,000 common shares in 4244 held by 3295940 was established at a nominal amount.

54. Given the $4,000,001 ACB for its 1,500,000 Class B shares in Holdings, 3295940 realized a capital gain of $52,999,999, $26,500,000 of which was taxable.

55. This transaction resulted in increasing 3295940's CDA amount by $26,500,000 within the meaning of subsection 89(1) of the ITA.

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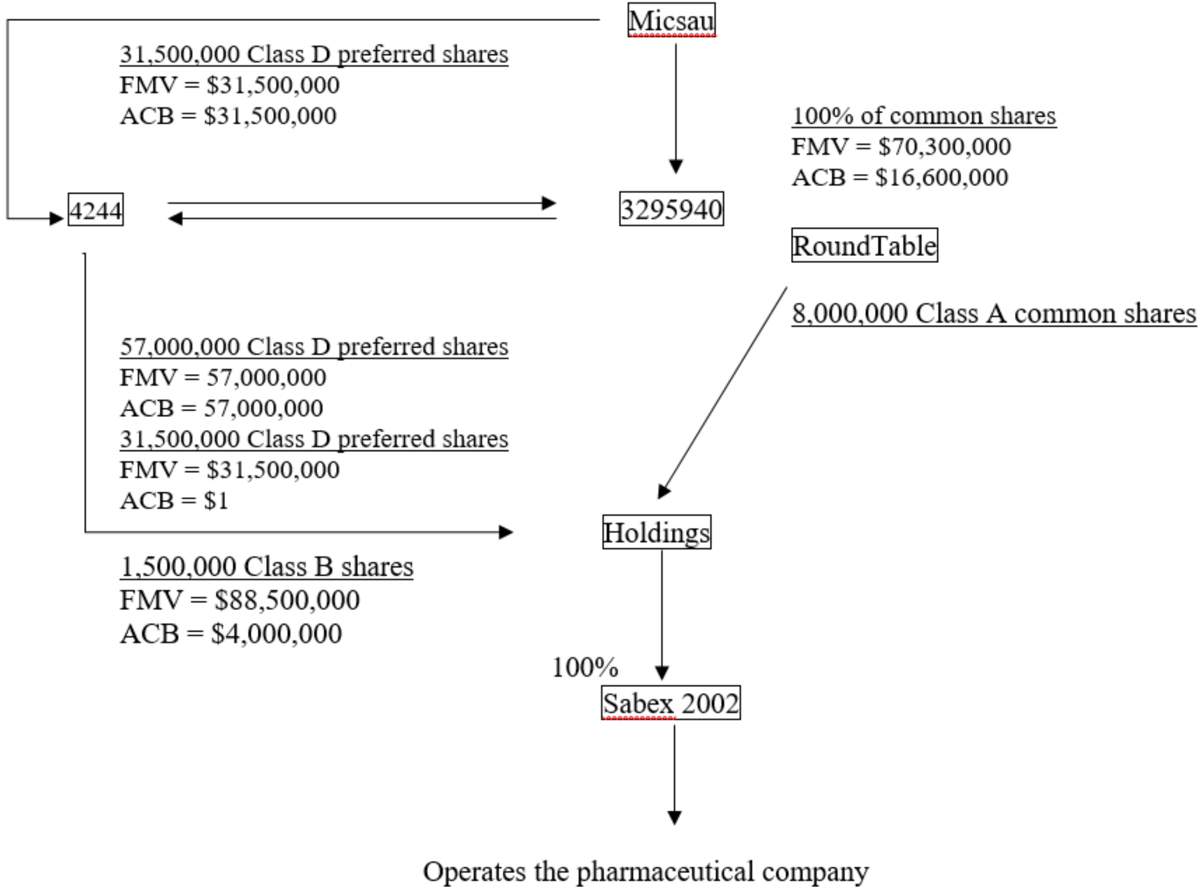
[41] See Share Purchase Agreement dated June 30, 2004, **Appendix 39**, as well as the written resolution prepared by the sole director of 3295444 at 12 p.m. on June 30, 2004, **Appendix 40.**

[42] See T2057, **Appendix 41.**

[43] See T2057, **Appendix 41.**

56. Following this transaction, 3295940's CDA amount increased to $32,280,000 within the meaning of subsection 89(1) of the ITA:



IV. CROSS REDEMPTION OF SHARES

57. On August 11, 2004, 3295940 redeemed the 31,500,000 Class D preferred shares in its capital stock held by 4244 in exchange for a $31,500,000 note payable.[44]

58. In accordance with subsection 84(3) of the ITA, 3295940 is deemed to have paid to 4244, and 4244 is deemed to have received, a $31,499,999 dividend.

59. 3295940 elected to have this dividend deemed a capital dividend pursuant to subsection 83(2) of the ITA.

60. Pursuant to paragraph 83(2)(b) of the ITA, this dividend is deemed a capital dividend and for this reason must not be included in calculating 4244's income.

61. Following this transaction, $31,499,999 was added to 4244's CDA, and an equivalent amount was removed from 3295944's CDA, in compliance with the definition of capital dividend account provided for in subsection 89(1) of the ITA.

62. On August 11, 2004, 4244 redeemed the 31,500,000 common shares and 110,000 of the 57,000,000 Class D preferred shares in its capital stock held by 3295940 in exchange for a $31,500,000 promissory note.

63. Pursuant to subsection 84(3) of the ITA, 4244 is deemed to have paid, and 3295940 is deemed to have received, a $31,389,999 dividend for the common shares and a $110,000 dividend for the Class D preferred shares.

64. 4244 elected to have these dividends deemed capital dividends pursuant to subsection 83(2) of the ITA.

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[44] See the Share Redemption Agreement dated August 11, 2004, as well as the written resolutions prepared by the sole director of 3295940 and 4244 at 9 a.m. on August 11, 2004, **Appendix 42.**

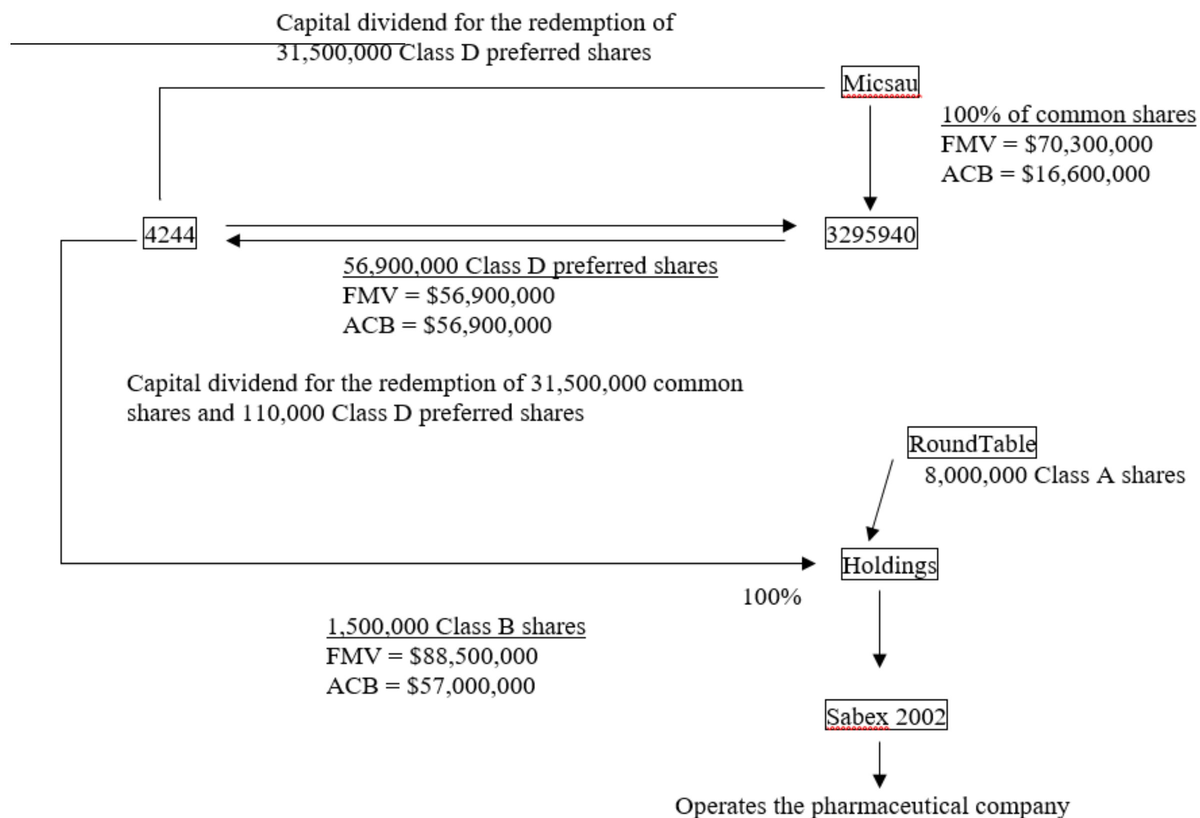
[45] See the Share Purchase Agreement dated August 11, 2004 as well as the written resolutions prepared by the sole director of 3295940 and 4244 at 10 a.m. on August 11, 2004, **Appendix 43.**

65. Pursuant to paragraph 83(2)(b) of the ITA, this dividend is deemed a capital dividend and for this reason must not be included in calculating 3295940's income.

66. Following this transaction, $31,499,999 was added to 3295940's CDA, and an equivalent amount was removed from 4244's CDA, in compliance with the definition of capital dividend account stipulated in subsection 89(1) of the ITA.

67. On August 11, 2004, the $31,500,000 notes payable that 3295940 and 4244 owed each other balanced out[46]:

31,500,000 Class D preferred shares
FMV = $31,500,000
ACB = $31,500,000
1 common share
FMV = $1
ACB = $1



[46] See written resolutions prepared by the sole director of 3295940 and 4244 at 11 a.m. on August 11, 2004, as well as the notes payable marked void, **Appendix 45**.

V. THE SALE OF SHARES IN 4244 TO 3295940

68. On August 12, 2004, Micsau transferred its common share and its 31,500,000 Class D preferred shares in 4244 to 3295940 in exchange for 31,500,000 Class D preferred shares of the capital stock of 4244.[47]

69. This transaction was subject to a joint election under subsection 85(1) of the ITA.

70. The amount agreed upon by the parties was established at $31,500,000.

71. In accordance with paragraph 85(1)(g) of the ITA, the ACB of the 31,500,000 Class D preferred shares in 3295940 held by Micsau was established at $31,500,000.

72. No gain resulted from this transaction since the FMV of the 31,500,000 Class D preferred shares in 4244 held by Micsau was equal to their ACB:

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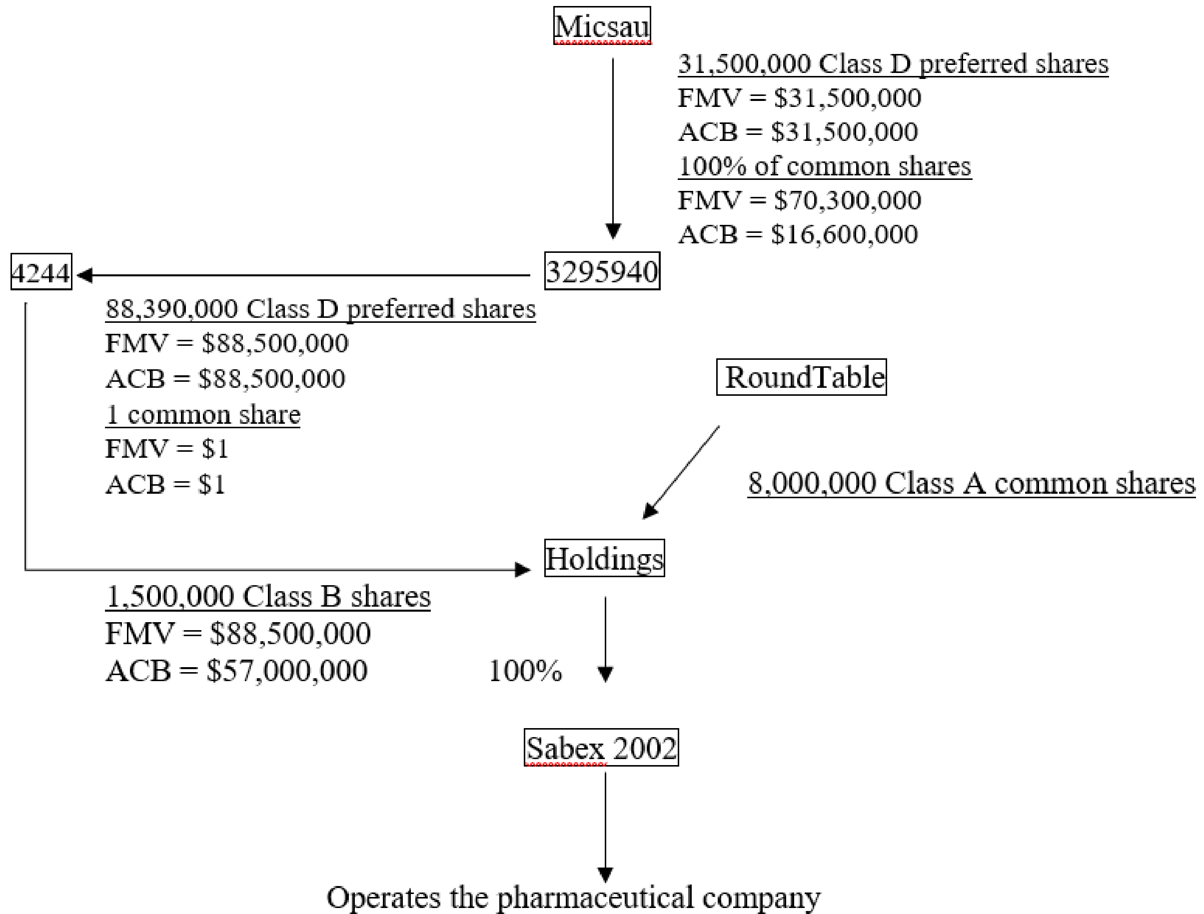
[47] See the Share Purchase Agreement dated August 12, 2004, as well as the written resolutions prepared by the sole director of 3295940, 4244 and Micsau at 12 p.m. on August 11, 2004, **Appendix 46**.

73. Following this transaction, 3295940 held a common shares and 88,390,000 Class D preferred shares in 4244 with an ACB of $88,390,000.



74. On August 13, 2004, 3295940 sold its common share and 88,390,000 Class D preferred shares in 4244 to Novartis in exchange for $88,390,000.[48]

75. The fees related to this transaction amounted to $170,000.

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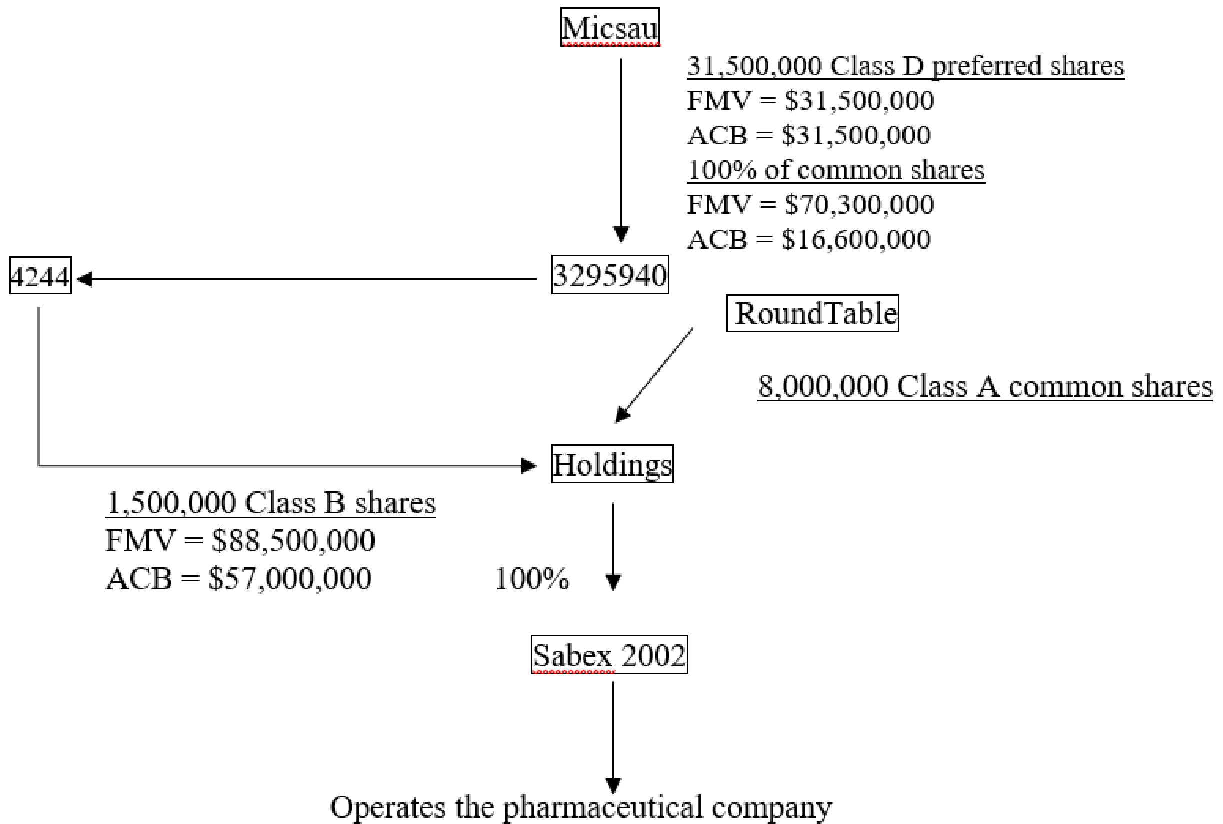
[48] See written resolutions prepared by the sole director of 3295940 and 4244 on August 13, 2004, **Appendix 47.**

76. Given the $88,390,000 ACB for the common share and 88,390,000 Class D preferred shares in 4244 and the $170,000 fees for the transaction, 3295940 incurred a $170,000 capital loss.



77. For the purposes of this appeal only, 3295940 concedes that the transactions put in place and described in paragraphs 30 to 74 above, which culminated in the sale of 3295940's indirect holdings in the pharmaceutical company known as Sabex 2002 through a sale of the shares it held in 4244 to Novartis, allowed 3295940 to reduce the capital gain amount by $31,500,000 that it would have otherwise realized if 3295940 had sold directly to Novartis, following 4244's redemption of its 500,000 Class B shares held by 3295 and its 1,500,000 Class B shares in Holdings. As a result, for the purposes of this appeal only, 3295940 concedes that this reduction constitutes a tax benefit within the meaning of this expression as provided for in subsection 245(1) of the ITA.

VI. THE REDEMPTION OF MICSAU'S SHARES IN 3295940

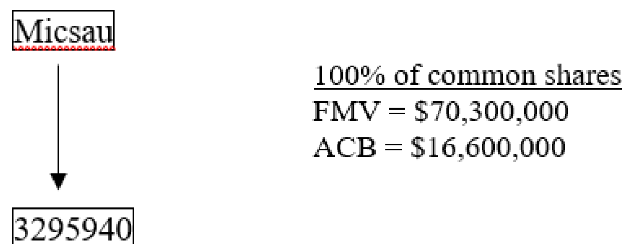
78. On August 16, 2004, 3295940 redeemed the 31,500,000 Class D preferred shares in its capital stock held by Micsau in exchange for $31,500,000.[49]

79. Pursuant to subsection 84(3) of the ITA, 3295940 is deemed to have paid, and Micsau is deemed to have received, a $31,500,000 dividend.

80. Pursuant to paragraph (j) of the definition of proceeds of disposition set out in section 54 of the Act, Micsau is deemed to have disposed of 31,500,000 Class D preferred shares in 3295940 for proceeds equal to nil and consequently incurred a capital loss of $31,500,000 since the ACB of these shares was $31,500,000.

81. This loss, however, was reported as nil pursuant to subsection 112(3) of the ITA.

82. Following these transactions, the ACB of the shares in 3295940 held by Micsau increased to $16,600,000.



[49] See written resolution prepared by the sole director of 3295490 dated 9 a.m., August 16, 2004, **Appendix 48.**

83. The capital gains and capital loss realized by 3295940 following the various transactions that were carried out are as follows:

Description	Capital gain (or loss)
Redemption of 500,000 Class B preferred shares in Holdings[1]	$11,550,000
Sale of 1,500,000 Class B preferred shares in Holdings[2]	$53,000,000
Sale of a common share and 88,390,000 Class B preferred shares in 4244[3]	($170,000)
	$64,380,000
[1] For further details, see paragraphs 23 to 27 [2] For further details, see paragraphs 48 to 56 [3] For further details, see paragraphs 74 to 76	

C – The assessment of 3295940 at issue

84. On November 21, 2008, the Minister of National Revenue (**Minister**) issued a reassessment to add a $31,500,000 capital gain in calculating 3295940's income for the tax year ending March 31, 2005.[50]

85. The addition of the $31,500,000 capital gain in calculating 3295940's income for the tax year ending March 31, 2005, was based on the application of the General Anti Avoidance Rule (**GAAR**) provided for in section 245 of the ITA and is supported by the following conclusions provided by the Minister:

(a) A series of transaction were carried out by 3295940 and Micsau, some of which were not carried out for *bona fide* purposes, except obtaining a tax benefit, including reducing the capital gain that 3295940 would have realized by $31,500,000 if it had directly sold the 1,500,000 Class B shares in Holdings that it held to Novartis.

(b) As a result of those transactions, subsection 55(2) of the ITA, the specific tax scheme for capital dividends and CDA provided for in subsection 83(2) and 80(1) of the ITA as well as the scheme governing the taxation of capital gains, including the key provisions found in paragraphs 3(b), 38(a), 39(1)(a) and 40(1)(a) were circumvented and abused, and these transactions directly or indirectly resulted in the abuse of the application of the provisions of the ITA as a whole.

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[50] See Notice of Reassessment, **Appendix 49** as well as Form T7W-C, **Appendix 50.**

86. On February 18, 2004, 3295940 objected against reassessment pursuant to subsection 165(1) of the ITA.[51] All the Minister's conclusions were contested by 3295940.

87. On August 31, 2017, the Minister confirmed the reassessment pursuant to subsection 165(3) of the ITA.[52]

88. On November 29, 2017, 3295940 filed a Notice of Appeal with the Tax Court of Canada in which 3295940 once again contested all the Minister's conclusions.

89. For the purposes of this appeal only, 3295940 concedes that the transactions carried out and described in paragraphs 30 to 74 above constitute a series of transactions for the purposes of subsection 245(3) of the ITA resulting in the tax benefit described in paragraph 77 above, and for that reason, constitute avoidance transactions within the meaning of subsection 245(3) of the ITA.

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[51] See Notice of Objection, **Appendix 51**.

[52] See Notice of Confirmation **Appendix 52.**

Montreal, August 10, 2020

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Montreal, August 7, 2020

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