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Highlights of Canada's Latest Legislative Tax Proposals

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The Department of Finance recently released a package of materials containing potential changes to the Canadian tax system (Tax Proposals). The materials, released on August 9, 2022, include draft amendments to the *Income Tax Act* (Tax Act) to implement certain measures from the 2022 Canadian federal budget (Budget 2022) and other outstanding proposals; a collection of technical amendments (which may significantly affect certain taxpayers); and other materials.

This bulletin highlights some of the main elements of the Tax Proposals:

- New rules for Canadian-controlled private corporations (CCPCs) and "substantive CCPCs"
- "Specified hedging transaction" rules for financial institutions
- Canada Recovery Dividend (i.e., tax)
- Updates to proposed new mandatory disclosure rules
- Technical changes involving
  - Withholding taxes
  - Foreign affiliates / foreign accrual property income (FAPI) regime
  - Partnership wind-ups
  - Shareholder loans
- GST/HST and other non-income tax measures
- New consultation paper (Consultation Paper) regarding potential changes to the general anti-avoidance rule (GAAR).

Certain measures discussed in Budget 2022, including further amendments regarding intergenerational share transfers and the implementation of the OECD's two-pillar framework, are not included in the Tax Proposals and remain outstanding. The Tax Proposals also do not include any further updates on the major outstanding proposals regarding the "excessive interest and financing expenses limitation" or hybrid-mismatch arrangements.

Prior Proposals

Substantive CCPCs

Canadian tax policy has historically imposed roughly the same level of tax on a Canadian individual earning investment income or realizing capital gain whether directly or through a CCPC. This policy of integration was primarily achieved (i) by an additional tax on investment income earned by CCPCs, which is potentially refundable to the corporation when it pays taxable dividends to its shareholders; and (ii) by the capital dividend account that permits the distribution of the tax-free half of capital gains realized by private corporations to its Canadian-resident shareholders. However, depending on the province of residence, the integration system may be flawed in its application to investment income of CCPCs, resulting in significantly more tax (non-refunded corporate tax and personal tax on the

dividend) being paid on investment income earned indirectly through a CCPC than would be paid in personal tax if the individual directly earned the investment income.

But strategies have been developed to defer the additional taxes paid and to reduce under-integration in respect of investment income earned through a CCPC, with the most prevalent strategy being to avoid CCPC status. This could be done, for example, by forming the corporation under foreign law (so that it could not qualify as a CCPC) and having it run from Canada (so that it was nonetheless resident in Canada). These strategies resulted in investment income earned by the holding company being taxed at the general corporate rate, which was often about one-half the tax rate imposed on investment income taxed under the special refundable tax rules applicable to CCPCs.

Budget 2022 included a new set of rules to counter these strategies by treating such corporations as "substantive CCPCs" that are taxed on investment income in the same manner as ordinary CCPCs. The Tax Proposals include legislation implementing the substantive CCPC rules consistent with the rules announced in Budget 2022.

The key similarities and differences in tax treatments between substantive CCPCs and actual CCPCs are summarized in the explanatory notes of the draft legislation as follows:

- Substantive CCPCs would generally be subject to the same anti-deferral and integration mechanisms that apply to CCPCs, including the additional 10⅔% tax (and denial of the 13% general rate reduction) on the corporation's "aggregate investment income"; and the addition of 30⅔% of the corporation's aggregate investment income to the corporation's "non-eligible refundable dividend tax on hand."
- Unlike CCPCs, substantive CCPCs would track their "low-rate income pool" (LRIP). However, the corporation's aggregate investment income would be added to its LRIP resulting in the same ultimate result as for CCPCs – that is, such income could not be distributed as eligible dividends.
- Substantive CCPCs would not be entitled to the special tax benefits provided to CCPCs, including the small business deduction; nor would they be entitled to the enhanced tax credit for scientific research and experimental development or be treated as CCPCs for any other purposes of the Tax Act.

Closely aligned to the substantive CCPC rules are changes to FAPI rules, which tax investment income earned by foreign resident corporations controlled by Canadian residents. But these changes will inappropriately also affect some business operations of such foreign subsidiaries of CCPCs, while providing some unexpected tax reductions for certain (but not all) capital gains realized by foreign subsidiaries through the extension of the capital dividend account to include amounts in respect of of foreign taxes paid by foreign subsidiaries on capital gains and also half of such gains less the foreign tax thereon.

As an example of the type of inappropriate result that could arise (relating to business operations), consider a CCPC that uses a local subsidiary to carry on business in a country with which Canada does not have certain tax treaty relations (or where such relations exist but the subsidiary is not considered under Canadian tax law to be resident in that country). If the subsidiary pays local tax of at least 25% on its profits, then under current law no Canadian tax will be paid on dividends paid by the subsidiary to the CCPC. That is appropriate because if the business were carried on directly by the CCPC, there would be no tax in Canada because the direct Canadian tax of 25% would offset by the local tax of 25%. But the proposed changes would, inappropriately, see Canada levy an immediate tax on dividends paid by the subsidiary of roughly 26.25% of the subsidiary's pre-tax profit that underlies the dividends.

Tax reductions under the proposed rules could apply, for example, if a directly held foreign subsidiary of a CCPC realized a capital gain on selling the shares of a lower-tier business subsidiary and paid local tax of at least 12.5% on the gain. The overall foreign and Canadian taxes on the gain and on a dividend of the net gain to the CCPC would be somewhat greater under the proposals than under current law (about 26% of the pre-tax gain (or 18% of the pre-tax gain after taking refundable tax into account) versus 12.5% of the pre-tax gain); however, the extension of the capital dividend account (to include amounts in respect of the foreign tax and half the gains less the tax thereon) would reduce the overall foreign and Canadian corporate and shareholder level tax once the gain was distributed to the CCPC's

shareholders by about 20% (of the pre-tax gain) compared with the current law. This extension of the capital dividend account announced in Budget 2022 was unexpected (but appropriate, having regard to Canadian integration principles discussed above).

It is not difficult to generally appreciate the main reason for the proposed tax increases – through the FAPI rules – on passive investment income earned by CCPCs through foreign resident subsidiaries (which is generally to ensure consistency with the integration system and the substantive CCPC rules noted above). But the proposals overlook the manner in which the changes will interact with particular fact situations and the full intricacies of the FAPI rules to produce inappropriate "outcomes" (as that term is being fashionably used by OECD and other tax policy makers).

The FAPI rules are extremely complex and apply to much more than "ordinary" investment income earned through a foreign holding corporation. FAPI can also apply to income generated by real estate and insurance businesses (among others) that have significant capital requirements but require a small number of employees (fewer than six) to operate. Given the breadth of the FAPI rules, the proposals may inappropriately impose additional taxes on income of privately owned multinational real estate businesses in a significantly more punitive manner than its public competitors.

Current law gives Canadian privately held and public company real estate businesses a level playing field with respect to their foreign investments. Canadian (FAPI) tax imposed on the foreign (say U.S.) rental income earned by a local (say U.S.) subsidiary (that does not have more than five full-time employees) of a CCPC real estate group will be no greater than that imposed on such foreign subsidiary that is owned by a publicly traded Canadian group. That seems appropriate.

But that essential equivalence (and lack of tax discrimination) between the private corporate and the public corporate real estate sectors will, arguably without justification, be upended by the proposed changes. The public corporation tax would remain unchanged while that of the private corporate competitor would increase – putting the latter at a competitive disadvantage.

The increased tax imposed on privately held Canadian businesses is clearly unacceptable, and the proposals should be modified accordingly, at minimum by grandfathering existing investments made prior to Budget 2022.

The foregoing policy changes and outcomes are provided for by, inter alia, the following specific proposed, amendments: (i) lowering the "relevant tax factor" for CCPCs (and substantive CCPCs) in respect of their share (as shareholders) of taxes paid by CFA's in respect of their investment income (FAPI) resulting in increased taxable net FAPI in the hands of such shareholders (ii) avoiding double tax on such attributed FAPI when distributed through to such shareholders by adding a grossed-up portion of the taxes paid by the CFA to the capital dividend accounts of such shareholders and conforming changes to other rules pertinent to such distributions and (3) extending those relevant tax factor, CDA and conforming notions to the active business income and capital gain matters discussed above.

Hedging by Canadian Financial Institutions

The Tax Proposals contain provisions previously announced in Budget 2022 that expand the "dividend rental arrangement" rules to deny the dividend received deduction in respect of "specified hedging transactions." In general terms, a specified hedging transaction arises where a registered security dealer that is part of a Canadian financial institution group (connected dealer) borrows a share of a Canadian corporation under a securities lending arrangement whereby another related corporation (the holder) holds the share so that the group's economic exposure with respect to the share is hedged. The purpose of the proposals is to treat the transaction as a dividend rental arrangement so that the corporate group is not entitled to a dividend received deduction in respect of the share when it is also entitled to deduction for a dividend compensation payment under the securities lending arrangement rules.

The Tax Proposals contain the following changes in the specified hedging transaction rules from what was first announced in Budget 2022:

1. They clarify that a synthetic equity arrangement that is also a specified hedging arrangement will be deemed to be a dividend rental arrangement because it is a specified hedging arrangement, not because it is a synthetic equity arrangement.

2. They clarify that a specified hedging arrangement will arise only where the connected dealer would otherwise be entitled to a deduction under the securities lending arrangement rules in respect of the transaction.

3. They confirm that in determining if a transaction would eliminate all or substantially all of the risk to the holder in respect of the share of the Canadian corporation for purposes of the definition of "specified hedging transaction," the transaction is considered without regard to other transactions undertaken with respect to the share. For example, a specified hedging arrangement will general occur where a holder owns a share and a connected dealer enters into a securities lending arrangement with respect to the share even if the holder or other members of the group enter into equity derivatives with respect to the same share.

Canada Recovery Dividend

The Tax Proposals contain the proposed Canada Recovery Dividend announced in Budget 2022 imposing a one-time 15% tax on income earned by Canadian banking and life insurance corporation groups in excess of $1 billion, as well as a permanent additional corporate tax increase of 1.5% on income in excess of $100,000,000 (Additional Tax on Banks and Life Insurers).

Budget 2022 had proposed that the Canada Recovery Dividend would be based on the 2021 taxation years of Canadian corporate groups. The Tax Proposals now provide that the tax is based on the average income of each corporation in the group for the 2020 and 2021 taxation years.

The Canada Recovery Dividend and Additional Tax on Banks and Life Insurers are determined without regard to losses within the corporate group. Accordingly, if a corporation has losses in one corporation in the group, those losses do not appear to be available to offset the income of another member of the group without undertaking a formal loss consolidation transaction to move those losses between the group members.

Mandatory Disclosure Rules

The Tax Proposals also include a revised draft of the new mandatory disclosure rules (relating to reportable and notifiable transactions, and reporting of uncertain tax positions) that were first announced in the 2021 federal budget and first released in draft form in February 2022.

The proposed mandatory disclosure rules – particularly the reportable transaction rules – are very broad, arguably requiring disclosure in respect of many normal commercial transactions. It was hoped that the rules would be narrowed in subsequent drafts. The reportable transaction rules provide that reporting will be required in respect of any avoidance transaction whereby one of any three of the following hallmarks is present: (i) a promoter or advisor is entitled to certain contingent fees with respect to the transaction; (ii) a promoter or advisor obtains "confidential protection" with respect to the transaction; and (iii) the taxpayer or certain other persons obtain "contractual protection" with respect to the transaction. Although the new draft legislation includes some targeted changes, it has not substantially narrowed these rules.

The changes that have been made include the following:

- **Effective Date.** The effective date of the new rules is deferred, so that they will apply only to transactions entered into in 2023 or later (or after royal assent in the case of penalty provisions). Previously, the new rules were to be effective from the start of 2022.
- **Confidential Protection.** The circumstances in which confidentiality requirements can cause a transaction to be reportable are limited to cases where there are confidentiality requirements regarding the tax treatment;
- **Contractual Protection.** The exclusion for "normal" contractual protection – that is, the types of contractual protection that will not result in a reportable transaction – is being both broadened and narrowed. On one hand, the exclusion will no longer require that the protections be of a type that is "offered to a broad class of persons," and therefore appears to more easily encompass normal contractual indemnity provisions. On the other hand, the exclusion will not apply where the protection extends to the tax treatment of an avoidance transaction, even where the avoidance transaction is covered only incidentally as part of a normal broad indemnity or insurance policy.
- **Financial Services.** Certain financial service providers are excluded from the requirement to report notifiable transactions if the service provider does not know that the transaction is notifiable.

Technical Amendments

Withholding Taxes

The technical proposals contain certain changes modifying the application of Canadian withholding tax where the payor is a partnership. Under current rules, a partnership is deemed to be a person resident in Canada in connection with payments made to non-residents if those payments are deductible in computing the partnership's Canadian source income. Under the proposals, a partnership would be deemed to be a person resident in Canada in respect of the portion of an amount paid by the partnership to a non-resident person to the extent that the amount is deductible in computing a partner's share of the partnership's income and that share is taxable under Part I of the Act. A partner's share would be taxable under Part I if the partner is resident in Canada or if the partner is a non-resident and the share is included in the partner's taxable income earned in Canada or in the partner's income that is subject to tax under section 216 of the Act. The proposals also contain look-through rules for tiered partnership structures. As a result of these proposed amendments, the deeming rule applies on the basis of whether an amount is deductible in computing the partner's rather than the partnership's income. This amendment has a potential to affect numerous investment fund partnerships that are managed by non-resident investment fund managers and have one or more Canadian resident partners. If this amendment comes into force in its current form, certain payments by the fund partnership, particularly management fees, which were not previously subject to Canadian taxation, may now be subject to Canadian withholding taxes unless an exemption under an applicable tax treaty is available.

A further change to the withholding tax rules for payments by non-residents may affect certain cross-border financing arrangements. Under current rules, a non-resident person is deemed to be a person resident in Canada in connection with payments made to a non-resident that are deductible in computing the payor's taxable income earned in Canada. This rule is now being extended to include amounts deductible in computing the payor's income under section 216 of the Act. As an example of the application of this change, assume a non-resident corporation owns Canadian commercial real estate that is subject to a triple net lease, and the non-resident corporation has filed an election under section 216 of the Act to pay tax on the rental income on a net rather than a gross basis. If the non-resident corporation is financed by its non-resident parent with debt, then, under current law, interest on that debt is not subject to Canadian withholding tax. Under the proposals, unless the non-resident corporation can rely on another exemption (e.g., under an applicable tax treaty), the interest would be subject to withholding.

Technical Changes in the Foreign Affiliate Area

Paragraph 95(2)(b) is a "base erosion" rule in the Tax Act that, among other things, treats as FAPI any income of a foreign affiliate of a particular taxpayer that is earned from providing services to a second foreign affiliate of the taxpayer, when the payment for the services is deductible in computing the second foreign affiliate's FAPI.

The technical proposals include amendments implementing comfort letters requested by fund managers and released in 2016 and 2017 that would limit this application of this rule in circumstances that were considered inappropriate:

1. The first change would prevent paragraph 95(2)(b) from applying in certain cases in which the second foreign affiliate is earning property income from shares of a third foreign affiliate of the taxpayer that mostly earns active business income (or the shares of the third foreign affiliate are otherwise "excluded property"), generally following the criteria of clause 95(2)(a)(ii)(D). This change would accommodate situations in which services could have been provided directly to the operating entity without the application of paragraph 95(2)(b) but have, for whatever reason, instead been provided to a holding entity higher in the structure.
2. The second change would limit paragraph 95(2)(b) so that it applies only to the extent of the total participating percentages of all taxpayers (whether or not they have any connection to the particular taxpayer) in the second foreign affiliate. Effectively, this change would limit the recharacterization under paragraph 95(2)(b) to the amount by which FAPI of taxpayers in respect of the second foreign affiliate is reduced as a result of the payment of the service fees. According to the comfort letter, this change appears to have been made mainly to accommodate foreign fund structures, where a manager earns fee income from a fund, structured as a partnership, mainly marketed to and held by third-party investors. If the fund was nonetheless a foreign affiliate of the manager's Canadian parent, due to some retained interest in the fund, then paragraph 95(2)(b) could otherwise apply to fully recharacterize the manager's service fees as FAPI.

These changes described in items 1 and 2 above will be retroactively effective for foreign affiliate taxation years beginning after 2015 and ending after 2016, respectively.

The technical amendments also include limitations on the "suppression election" available under subsection 88(3.3) of the Tax Act in connection with a "qualifying liquidation and dissolution" of a foreign affiliate of a taxpayer. Where it applies, the suppression election allows a taxpayer to defer the gain that would otherwise arise upon the disposition of the foreign affiliate's shares by instead suppressing the taxpayer's tax basis in the property received on liquidation.

The technical proposals would significantly limit the application of these rules, by allowing the suppression election to be made only for distributed property that is shares of another foreign affiliate. According to the Department of Finance, this restriction is made to more clearly align the rule with its original policy intent. The Department of Finance is apparently concerned that if the distributed property were, for example, shares or debt of a Canadian-resident corporation, under current rules the accrued gain could be eliminated through a subsequent reorganization of the Canadian-resident corporation following the dissolution of the foreign affiliate or deferred indefinitely while still allowing a Canadian-resident corporation use of the underlying property.

Finally, the technical amendments would also limit the ability of a taxpayer to transfer the shares of a foreign affiliate to another foreign affiliate on a tax-deferred basis under subsection 85.1(3). The availability of that deferral is limited by a special anti-avoidance rule in subsection 85.1(4). The relevant part of that anti-avoidance rule provides that the rollover will not apply to the transfer of shares of the foreign affiliate where all or substantially all of the affiliate's property is "excluded property" and the share is subsequently disposed of as part of the initial transaction, or a series that includes the initial transaction, to an arm's-length person or partnership (other than a foreign affiliate in which the taxpayer has a qualifying interest).

The technical amendments substantially expand the scope of the anti-avoidance rule in several ways. First, the anti-avoidance rule could now be triggered where the subsequent acquirer is a non-arm's-length non-resident or a partnership with any member that is an arm's-length person or a non-arm's-length non-resident. Second, the carve-out for foreign affiliate subsequent acquirers would be narrowed so that only foreign affiliates that are controlled foreign affiliates (for the purposes of section 17) are excepted from this anti-avoidance rule. Third, the rule would now expressly capture subsequent dispositions of one or more properties substituted for the shares of the first affiliate or that derive any of their fair market value from the first affiliate shares or any substituted property. Finally, the anti-avoidance rule may apply even if all or substantially all of the transferred foreign affiliate's property is not "excluded property," provided that the property transferred to the subsequent acquirer is excluded property at the time of the subsequent transfer. Corresponding changes are being made to the foreign merger rules to prevent the use of such merger transactions to effectively transfer foreign affiliate shares in a manner that is inconsistent with the amended version of subsection 85.1(4).

Partnership Wind-ups

Subsections 98(3) and 98(5) contain rules that permit a partnership with only Canadian members to wind up on a tax-deferred basis. Subsection 98(3) generally applies where a Canadian partnership distributes a co-ownership interest in each property to the partners. Subsection 98(5) applies where one of the members is going to carry on the business as a sole proprietor.

Paragraphs 98(3)(b) and 98(5)(b) provide a limited ability to "bump up" the adjusted cost base of non-depreciable capital property of the partnership distributed on the wind-up under subsection 98(3) or 98(5) to the extent that the applicable partner's adjusted cost base in the partnership interest (outside basis) exceeds the total of the cash distributed to the partner on the wind-up and the cost amount of the partnership property (or portion thereof) distributed to the partner immediately before the wind-up (inside basis). Paragraphs 98(3)(c) and 98(5)(c) include two limitations applicable to the bump-up rules. First, the new "bumped" adjusted cost base of the property cannot exceed the fair market value of the property at the time of the partnership wind-up (fair market value limitation). In addition, the total of the increases to the adjusted cost base of the property received by a partner cannot exceed the amount by which the partner's outside basis exceeds the inside basis.

The Tax Proposals contain a new rule for purposes of applying the fair market value limitation in tiered partnership situations, where a partnership interest in a lower-tier partnership is distributed on the winding up of an upper-tier partnership. Under this new rule, the fair market value of the partnership interest in the lower-tier partnership would be determined without regard to the increase in value of any

property that would not be eligible for the bump-up if distributed directly. For example, if a lower-tier partnership holds land and a building, the fair market value of the partnership interest would generally be determined only with respect to an increase in the fair market value of the land held by the lower-tier partnership and not any increases in the fair market value or recapture income associated with the building.

Shareholder Loan Rules

The Act contains rules (shareholder loan rules) that can cause a loan from a corporation to a non-corporate shareholder to be treated as taxable income. One exception to those rules applies to loans made by a corporation in the course of an ordinary business of lending money (lending business exception). The proposed technical amendments would narrow the lending business exception so that it would apply only where at least 90% of the corporation's lending was to arm's-length parties. A similar change is proposed to the "upstream loan" rules for loans from foreign affiliates.

Because of the broad drafting of the shareholder loan rules, those rules can apply in a wide range of cases beyond direct loans from a corporation to a shareholder. There are many instances in which the shareholder loan rules arguably apply inappropriately – for example, where the rules apply to an intragroup loan from a partnership in which a corporation merely holds a nominal interest.

In order to avoid such inappropriate application of the shareholder loan rules to internal funding transactions, taxpayers have sometimes relied on the lending business exception. For example, a business group might form an internal finance entity to be the borrower of all third-party financing. The finance entity would engage in an ordinary business of lending to group members and could therefore on-loan the third-party financing to the appropriate group members without triggering the shareholder loan rules. Such arrangements have been implicitly accepted by the CRA in several statements. However, under the proposed amendments, such arrangements would no longer be effective.

GST/HST and Other Measures

The Tax Proposals also contained a number of proposals relating to the GST/HST and other taxes, including cannabis duty and luxury tax. Of note, the GST/HST election for closely related parties in section 156 of the Part IX of the *Excise Tax Act* is proposed to be amended as applied to partnerships so as to allow groups that include partnerships with non-resident members to qualify as a "qualifying group" for purposes of the election, while maintaining the requirement an electing partnership must be a Canadian partnership (i.e., a partnership each member of which is a corporation or partnership and is resident in Canada). The definition of temporary member for purposes of the section 156 election is also proposed to be amended, which will be relevant in the context of reorganizations involving distributions of shares to transferee corporations.

Another interesting GST/HST change is the proposed inclusion of the following as a new prescribed activity for the joint-venture election: "the operation of a pipeline, rail terminal or truck terminal used for the transportation of oil, natural gas or related or ancillary products." While there has long been discussion of extending the list of qualifying activities for the joint-venture election to all commercial activities, this latest amendment suggests that expansion to all commercial activities is unlikely in the near term.

The Tax Proposals also contain amendments to enable authorized contract-for-service arrangements between licensed cannabis producers, as announced in the 2022 Budget, and draft *Select Luxury Items Tax Regulations* (effective September 1, 2022) to address certain exemptions (including aircraft for export and agreements entered before 2022) as previously announced.

GAAR Consultation Paper

The Consultation Paper follows up on a commitment made in the *2020 Fall Economic Statement* to seek public input on various proposals to "modernize and strengthen" the GAAR. The Consultation Paper surveys 24 reported court cases since 2005 in which the CRA attempted unsuccessfully to rely on the GAAR. It lists a variety of possible amendments to the Tax Act that would allow the GAAR to "better meet [ ] its objective of preventing abusive tax avoidance" presumably by allowing government victories in future similar cases. (The Consultation Paper ignores the possibility that, in any of those 24 cases, the CRA was raising the GAAR improperly and that the taxpayer had, in fact, done nothing untoward.)

The Consultation Paper groups the various options for reform into five broad categories:

- **Tax Benefits.** Expansion of the type of "tax benefits" subject to GAAR adjustments. The Tax Proposals include amendments to extend the GAAR to changes in tax attributes that do not produce any immediate tax consequences (such as the cost base of a property or paid-up capital of a share), and the Consultation Paper does not suggest any further changes in that context at this time.
- **Avoidance.** Limiting the circumstances in which a non-tax purpose will shield transactions from the application of the GAAR – for example, by specifying that certain types of purposes will not be considered bona fide non-tax purposes or by lowering the required purpose threshold.
- **Abuse.** Changing the nature of the "abuse" required to allow the GAAR to apply, and/or the means and burden of proving it.
- **Economic Substance.** Potentially adding some assessment of "economic substance" – a concept that Canadian courts have historically been reticent to invoke – as a component of the GAAR analysis.
- **Deterrence.** Whether the GAAR should be accompanied by additional consequences for taxpayers (such as penalties, enhanced interest or an extended reassessment periods) in order to increase its deterrent effect.

The section on adding an economic substance test to the GAAR takes up a particularly large portion of the Consultation Paper and is supplemented by an annex that illustrates how the test "might apply in certain fact patterns." One might reasonably infer that enacting some form of economic substance test is on the government's short list of preferred options – a course of action that could bring the GAAR more in line with the analogous regime in the United States (namely, the "economic substance doctrine" codified at section 7701(o) of the Internal Revenue Code).

The Consultation Paper does not discuss the application of the GAAR to tax treaties, explaining that in light of the recent SCC decision in *Canada v Alta Energy Luxembourg* SARL, 2021 SCC 49 (discussed in a previous bulletin), "[t]he government intends to announce more on its plans to curb tax treaty abuse at a later date."

Another conspicuous omission in the Consultation Paper is a discussion of the notion of "series" and, in particular, the SCC's endorsement, in *Copthorne Holdings Ltd. v Canada*, 2011 SCC 63, of the theory that a "series of transactions" can extend back to include completely separate transactions undertaken in years past that enable a tax benefit to be realized from a current transaction. Since any avoidance transaction in a "series" can potentially support the application of the GAAR, *Copthorne* represented a major expansion of the circumstances in which the GAAR might apply, at the cost of considerable uncertainty for taxpayers. Presumably, the government does not find this result at all troubling.

The various policy options set out in the Consultation Paper vary greatly in their fairness, feasibility, potential impact and likelihood of implementation. While some of the options are sensible and may even be welcomed by tax practitioners – such as inclusion of preambles and purpose statements in income tax legislation – others would impose amorphous and onerous (if not impossible) burdens on taxpayers – such as requiring a taxpayer who embarks on a lawful transaction to affirmatively prove that its tax consequences do not constitute "an abuse of the provisions of the Act read as a whole."

More fundamentally, however, the Consultation Paper does not discuss how the Tax Act may promote tax planning through its ever-increasing length and complexity, which has left the statute virtually incomprehensible to all but the most highly trained tax professionals. The extreme complexity of the Tax Act makes careful, and often complex, tax planning essential simply to avoid pitfalls and traps that can lead to double taxation or other manifestly unfair tax consequences. To distinguish an "abusive" tax plan from a non-abusive one under the GAAR can require ascertaining the "purpose" of one or several potentially inscrutable and sometimes contradictory provisions within the context of a virtually incomprehensible piece of legislation. The Consultation Paper acknowledges the complexity of the Tax Act, but unfortunately seems to take that complexity as a given rather than part of the problem to be addressed.

Members of the public are invited to review the Consultation Paper and forward any comments to the Department of Finance before September 30, 2022, at: GAAR-RGAE@fin.gc.ca.

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