2024 ■ VOLUME 72, Nº 3

CANADIAN TAX JOURNAL
REVUE FISCALE CANADIENNE

PEER-REVIEWED ARTICLES

How Do Fitness Tax Credits Affect Children's Physical Activity Levels? Evidence from Canada — *Aaron M. Gamino*

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Since its inception in 1945, the Foundation has published many books and articles on a wide range of subjects within its areas of interest. The Foundation seeks proposals for research projects that will

- result in a book on a single topic of interest in the area of taxation or public finance;
- be undertaken by an experienced researcher who has expertise in an area of taxation or public finance; and
- be carried out within a time frame that is reasonable, given the nature of the project.

Projects selected by the Foundation may qualify for its full or partial financial support of the research and for its underwriting of the publication costs. The Foundation retains the absolute right at its sole discretion to choose whether to support a given proposal or to publish a project.

Interested parties should send a brief written outline of a proposal, for initial consideration by the Foundation, to:

Heather Evans
Executive Director and Chief Executive Officer
Canadian Tax Foundation / Fondation canadienne de fiscalité
145 Wellington Street West, Suite 1400
Toronto, Ontario M5J 1H8

hevans@ctf.ca

For further information, please contact the director, as indicated above, or the co-chairs of the Canadian Tax Foundation Research Committee:

Mark Woltersdorf
c/o Canadian Tax Foundation / Fondation canadienne de fiscalité

Kim Brooks
c/o Canadian Tax Foundation / Fondation canadienne de fiscalité

Appel de propositions de livres

La Fondation canadienne de fiscalité (FCF) / Canadian Tax Foundation, un organisme sans but lucratif indépendant de recherche et à caractère éducatif, souhaite recevoir des propositions de livres dans les domaines de la fiscalité et des finances publiques.

Depuis sa fondation en 1945, la FCF a publié de nombreux livres et articles sur divers sujets dans ses champs d'intérêt. La FCF souhaite obtenir des propositions de projets de recherche qui :

- mèneront à la rédaction d'un livresur un sujet unique d'intérêt en fiscalité ou en finances publiques;
- seront dirigés par un chercheur chevronné ayant une expertise dans un domaine de la fiscalité ou des finances publiques;
- seront effectués dans un délai raisonnable, compte tenu de la nature du projet.

Les projets qui seront sélectionnés par la FCF pourront être partiellement ou totalement admissibles à une aide financière pour la recherche et les frais de publication. La FCF se réserve le droit absolu, et à sa seule discrétion, d'appuyer une proposition particulière ou de publier un projet.

Toute personne intéressée doit faire parvenir un bref sommaire de la proposition pour examen initial par la FCF à :

Heather Evans
Directrice exécutive et chef de la direction
Canadian Tax Foundation / Fondation canadienne de fiscalité
145 Wellington Street West, Suite 1400
Toronto, Ontario M5J 1H8

hevans@ctf.ca

Pour plus d'information, veuillez communiquer avec le directeur, tel qu'il est mentionné plus haut, ou avec les co-présidentes du comité de recherche de la Fondation canadienne de fiscalité :

Mark Woltersdorf
a/s Canadian Tax Foundation / Fondation canadienne de fiscalité

Kim Brooks
a/s Canadian Tax Foundation / Fondation canadienne de fiscalité

■ Recent and Upcoming Events*
■ Activités récentes et à venir*

PRAIRIE PROVINCES TAX CONFERENCE AND LIVE WEBCAST
Saskatoon and via Webcast, June 3-4, 2024

WOMEN IN TAX—WORK-LIFE BALANCE
Montreal, October 24, 2024

BRITISH COLUMBIA TAX CONFERENCE AND LIVE WEBCAST
Vancouver and via Webcast, September 16-17, 2024

ONTARIO TAX CONFERENCE AND LIVE WEBCAST
Toronto and via Webcast, October 21-22, 2024

ATLANTIC PROVINCES TAX CONFERENCE
Halifax, November 1-2, 2024

76TH ANNUAL TAX CONFERENCE
Vancouver, December 1-3, 2024

* For further details on upcoming events, please visit the Canadian Tax Foundation website at www.ctf.ca. / Pour plus de renseignements, veuillez consulter le site Web de la Fondation à www.fcf-ctf.ca.

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■ Canadian Tax Journal

INVITATION TO SUBMIT

The *Canadian Tax Journal* publishes research in, and informed comment on, taxation and public finance, with particular relevance to Canada. To this end, the journal invites interested parties to submit manuscripts for possible publication as peer-reviewed articles, and it especially welcomes work that contributes to the analysis, design, and implementation of tax policies.

Articles may be written in English or French and should present an original analysis of the topic. Submitted work, or any substantial part or version thereof, must not have been previously published, either in print or online, and it must not be submitted or scheduled for publication elsewhere. The journal welcomes shorter submissions (from 4,000 to 8,000 words) focused on specific topics as well as longer submissions that analyze issues in depth.

PEER REVIEW

Submitted articles are subject to a double-blind peer review; authors' identities are not known to reviewers, and reviewers' identities are not known to authors. (Non-peer-reviewed contributions may appear elsewhere in the journal.) Final decisions on the publication of articles are made by the editors—Kim Brooks, Kevin Milligan, and Daniel Sandler—on the advice of reviewers. Reviewers are experts in the area who are chosen by the editors to provide an opinion on the publishability of the submission and to make suggestions for improvement. Submissions may be (1) accepted outright; (2) accepted if recommended revisions are made; (3) revised by the authors, as requested by the editors on the advice of reviewers, and resubmitted for further review; or (4) rejected with reasons. The time from submission to the first editorial decision is usually two months or less.

SUBMISSION DETAILS

Prospective contributors should submit a copy of the manuscript to the journal's editorial department. The preferred method of submission is by e-mail with an attached Word document. E-mail inquiries are welcome: write to CTFeditorial@ctf.ca. Contributors are responsible for providing complete and accurate citations to sources, a detailed abstract (200 to 400 words), and up to six keywords for indexing purposes.

Manuscripts accepted for publication are to be prepared in the prescribed format. For details, see the Foundation's Style and Format Guide.

Because all articles are subject to double-blind review, a separate cover page should accompany each submission. The cover page should include the author's name, e-mail and postal addresses, telephone number, and fax number. Authors should take care not to identify themselves directly or indirectly in their articles.

POLICY FORUM CONTRIBUTIONS

The Policy Forum section includes both articles commissioned by the journal editors and articles proposed by prospective authors. All articles should aim for short and rigorous analysis (3,000 to 5,000 words) and be written for an audience of policy makers, tax practitioners, and students of fiscal and tax policy. Articles may be based on original research, or they may synthesize and apply established research findings to a particular policy context.

Calls for proposals for upcoming Policy Forum sections appear on the Foundation's website and Twitter feed and are circulated by e-mail. To receive these e-mails, please contact CTFeditorial@ctf.ca and ask to have your name added to the mailing list. Proposals will be reviewed by the journal editors, and authors whose proposals are selected will be invited to prepare articles.

All Policy Forum articles are reviewed by the journal's editors prior to publication.

ACCESSING THE JOURNAL

The full text of all articles that have appeared in the *Canadian Tax Journal* since its first issue in 1953 can be found in the Canadian Tax Foundation's TaxFind database and, with a minimum one-year delay, in HeinOnline, ProQuest, and EBSCO's Business Source Ultimate database. Also, peer-reviewed articles since 1991 are publicly available on the *Canadian Tax Journal*'s Issues Index web page.

The *Canadian Tax Journal* is also indexed in Scopus, LegalTrac, EconLit, Wolters Kluwer Canada's Canadian Income Tax Research Index, Carswell's Income Tax References, Canadian Periodicals Index, and Scott's Index to Canadian Legal Periodical Literature.

■ Revue fiscale canadienne

Invitation à soumettre

La *Revue fiscale canadienne* publie des articles de recherches et des commentaires éclairés sur la fiscalité et les finances publiques, qui sont particulièrement pertinents pour le Canada. À cette fin, la Revue invite les personnes intéressées à soumettre des articles, qui seront évalués par des pairs, pour une éventuelle publication et elle accueille plus particulièrement les écrits qui contribuent à l'analyse, à la conception et à la mise en œuvre des politiques fiscales.

Les articles peuvent être rédigés en anglais ou en français et doivent présenter une analyse inédite du sujet. L'article soumis, ou toute partie ou version substantielle de celui-ci, ne doit pas avoir été publié antérieurement, que ce soit sous forme papier ou numérique, et il ne doit pas avoir été soumis ou prévu d'être publié ailleurs. La Revue accueille les soumissions plus courtes (de 4 000 à 8 000 mots) axées sur des sujets précis et également les soumissions plus longues qui analysent des problèmes en profondeur.

Révision par les pairs

Les articles soumis font l'objet d'une révision anonyme par les pairs; l'identité des auteurs n'est pas connue des réviseurs, et l'identité des réviseurs n'est pas connue des auteurs. (Les propositions non évaluées par des pairs peuvent être publiées ailleurs dans la Revue.) Les décisions concernant la publication des articles sont prises par les rédacteurs — Kim Brooks, Kevin Milligan et Daniel Sandler — à partir des conseils des réviseurs. Ces derniers sont des experts établis en la matière, ils sont choisis par les rédacteurs pour donner leur avis en ce qui concerne le bien-fondé de publier la soumission et formuler des suggestions d'amélioration. Les soumissions peuvent être 1) acceptées sans réserve; 2) acceptées sous réserve des changements recommandés; 3) révisées par les auteurs, en fonction des exigences des rédacteurs qui suivent les conseils des réviseurs, et soumises à nouveau pour une révision supplémentaire; ou 4) rejetées avec motifs. Le délai entre la soumission et la première décision de la rédaction est généralement de deux mois ou moins.

Préparation de la soumission

Les contributeurs potentiels doivent soumettre une copie de leur article à la rédaction de la Revue. La méthode de transmission privilégiée est le courriel avec un document Word en pièce jointe. Toutes demandes de renseignements par courriel sont les bienvenues : vous pouvez contacter le CTFeditorial@ctf.ca. Les contributeurs ont l'entière responsabilité de fournir les références complètes et précises des documents qu'ils citent, un résumé détaillé (200 à 400 mots) et jusqu'à six mots-clés qui seront utilisés à des fins d'indexation.

Les articles acceptés pour publication doivent être préparés selon le format prescrit. Pour en savoir plus, se rapporter au Guide de rédaction et de présentation de la Fondation.

Puisque tous les articles font l'objet d'une révision anonyme par deux personnes, une page couverture séparée doit accompagner chaque article. Sur la page couverture, inclure le nom de l'auteur, l'adresse courriel et l'adresse postale, le numéro de téléphone et le numéro de télécopieur. Les auteurs doivent s'assurer qu'il est impossible de les identifier de manière directe ou indirecte dans leur article.

CONTRIBUTIONS AU FORUM DE POLITIQUES

La section Forum de politiques comprend à la fois des articles commandés par les rédacteurs en chef de la Revue et des articles proposés par des auteurs potentiels. Tous les articles doivent présenter une analyse courte et rigoureuse (3 000 à 5 000 mots) et être rédigés pour un auditoire de décideurs, de fiscalistes et d'étudiants en politique fiscale. Les articles peuvent être fondés sur des recherches originales, ou ils peuvent synthétiser et appliquer les résultats de recherche établis dans un contexte politique particulier.

Les invitations à soumettre des propositions pour les prochaines sections du Forum de politiques sont publiées sur le site Web de la Fondation, sur le fil Twitter, et elles sont également envoyées par courriel. Pour recevoir ces courriels, veuillez communiquer avec CTFeditorial@ctf.ca et demander que votre nom soit ajouté à la liste de diffusion. Les propositions seront examinées par les rédacteurs en chef de la Revue, et les auteurs des propositions retenues seront invités à rédiger des articles.

Tous les articles du Forum de politiques sont révisés par les rédacteurs en chef de la Revue avant leur publication.

ACCÈS À LA REVUE

L'intégralité de tous les articles parus dans la *Revue fiscale canadienne* depuis son premier numéro en 1953 se trouve dans la base de données TaxFind de la Fondation canadienne de fiscalité et, après un délai minimal d'un an, dans HeinOnline, ProQuest et dans la base de données Business Source Ultimate d'EBSCO. De plus, les articles révisés par les pairs depuis 1991 sont accessibles au public sur la page Web de l'Index des numéros de la *Revue fiscale canadienne*.

La *Revue fiscale canadienne* est également indexée dans Scopus, LegalTrac, EconLit, dans la section de recherche en fiscalité canadienne de Wolters Kluwer Canada, dans la section de références de Carswell, dans le Canadian Periodicals Index et dans le Scott's Index to Canadian Legal Periodical Literature.

■ Canadian Tax Foundation

The Canadian Tax Foundation is Canada's leading source of insight on tax issues. The Foundation promotes understanding of the Canadian tax system through analysis, research, and debate, and provides perspective and impartial recommendations concerning its equity, efficiency, and application.

The Canadian Tax Foundation is an independent tax research organization and a registered charity with over 12,000 individual and corporate members in Canada and abroad. For more than 70 years, it has fostered a better understanding of the Canadian tax system and assisted in the development of that system through its research projects, conferences, publications, and representations to government.

Members find the Foundation to be a valuable resource both for the scope and depth of the tax information it provides and for its services, which support their everyday work in the taxation field.

Government policy makers and administrators have long respected the Foundation for its objectivity, its focus on current tax issues, its concern for improvement of the Canadian tax system, and its significant contribution to tax and fiscal policy.

MEMBERSHIP

Membership in the Foundation is open to all who are interested in its work. Membership fees are $446.00 a year, except that special member rates apply as follows: (a) $222.00 for members of the accounting and legal professions in the first three years following date of qualification to practise; (b) $222.00 for persons on full-time teaching staff of colleges, universities, or other educational institutions; (c) complimentary for students in full-time attendance at a recognized educational institution; and (d) $191.00 for persons who have reached the age of 65 and are no longer actively working in tax. Memberships are for a period of 12 months dating from the receipt of application with the appropriate payment.

Applications for membership are available from the membership administrator for the Canadian Tax Foundation: facsimile: 416-599-9283; Internet: www.ctf.ca; e-mail: ctfmembership@ctf.ca.

■ Fondation canadienne de fiscalité

La Fondation canadienne de fiscalité est un organisme indépendant de recherche sur la fiscalité inscrit sous le régime des œuvres de charité. Elle compte environ 12 000 membres au Canada et à l'étranger. Depuis plus de 70 ans, la FCF favorise une meilleure compréhension du système fiscal canadien et aide au développement de ce système par le biais de ses projets de recherche, conférences, publications et représentations auprès des gouvernements.

Les membres considèrent l'étendue et le détail de l'information offerte par la FCF comme une importante ressource. Ils apprécient également les autres services de la FCF qui facilitent leur travail quotidien dans le domaine de la fiscalité.

Les décideurs et administrateurs gouvernementaux respectent depuis longtemps l'objectivité de la FCF, son attention aux questions fiscales de l'heure, sa préoccupation envers l'amélioration du système fiscal canadien et son importante contribution au développement des politiques fiscales.

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Toute personne intéressée aux travaux de la FCF peut en devenir membre. Les droits d'adhésion sont de 446,00 $ par année, à l'exception des tarifs spéciaux suivants : a) 222,00 $ pour les personnes faisant carrière en comptabilité ou en droit pendant les trois premières années suivant leur admission à la profession; b) 222,00 $ pour le personnel enseignant à temps plein dans un collège, une université ou une autre maison d'enseignement; c) gratuite pour les étudiants fréquentant à temps plein une maison d'enseignement reconnue; et d) 191,00 $ pour les personnes qui ont 65 ans et plus et qui ne travaillent plus activement en fiscalité. La période d'adhésion est de 12 mois, à compter de la réception de la demande accompagnée du paiement approprié.

Il est possible de se procurer les demandes d'adhésion auprès de l'administratice responsible de l'adhésion à la FCF : télécopieur : 514-939-7353; Internet : www.fcf-ctf.ca; courriel : adminmtl@ctf.ca.

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The Foundation's publications comprise a range of forms and delivery formats. A number of the regularly issued publications are distributed without charge to Foundation members: the *Canadian Tax Journal* (4 issues), *Perspectives on Tax Law & Policy* (4 issues, delivered electronically), *Tax for the Owner-Manager* (4 issues, delivered electronically), *Canadian Tax Focus* (4 issues, delivered electronically), *International Tax Highlights* (4 issues, delivered electronically), and the annual conference report. Monographs and books may be purchased on the Foundation's website at www.ctf.ca.

Canadian Tax Journal — issued quarterly to members via www.ctf.ca (Non-Members $75 per copy, $343.75 per year).

Newsletters

International Tax Highlights — issued quarterly to members via www.ctf.ca.

Perspectives on Tax Law & Policy — issued quarterly; available to members and non-members via www.ctf.ca.

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Conference Reports — Reports of the proceedings of annual tax conferences (Members $40; Non-Members $95). Latest issue: 2022 (Members $40; Non-Members $350).

— *Tax Dispute Resolution, Compliance, and Administration in Canada: Proceedings of the June 2012 Conference* (Members $30; Non-Members $195)

— Collections of papers delivered at regional and special tax conferences (British Columbia, Prairie Provinces, Ontario, and Atlantic Provinces) are available in USB format (Members $445; Non-Members $495).

Finances of the Nation — Review of expenditures and revenues and some budgets of the federal, provincial, and local governments of Canada. PDFs for the years 2002-2012 are available on the CTF website at no cost. In 2014, "Finances of the Nation" began to appear as a feature in issues of the *Canadian Tax Journal*.

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How Do Fitness Tax Credits Affect Children's Physical Activity Levels? Evidence from Canada

Aaron M. Gamino*

PRÉCIS

Dans cet article, l'auteur analyse les données sur les crédits d'impôt pour la condition physique des enfants et les taux d'imposition dans les provinces canadiennes afin d'évaluer si les réductions de l'obligation fiscale des contribuables qui demandent ces crédits ont un effet positif sur les niveaux d'activité physique des enfants. En s'appuyant sur les données d'enquêtes canadiennes menées entre 2001 et 2014, l'auteur ne trouve aucune preuve que les crédits d'impôt pour la condition physique stimulent une augmentation globale des niveaux d'activité physique ou améliorent l'état de santé autodéclaré. Toutefois, il a trouvé des preuves que les crédits d'impôt pour la condition physique des enfants augmentent l'activité des enfants des ménages qui se situent dans les 40 pour cent ayant les revenus les plus élevés. Malgré le coût substantiel que représente pour le gouvernement le manque à gagner en recettes fiscales, les crédits d'impôt pour la condition physique des enfants ne semblent pas réussir à améliorer les niveaux moyens d'activité physique des enfants.

ABSTRACT

In this article, the author analyzes data on children's fitness tax credits and tax rates across Canadian provinces to assess whether tax liability reductions for taxpayers claiming these credits have a positive impact on children's physical activity levels. Using Canadian survey data from 2001 to 2014, the author finds no evidence that fitness tax credits spur an aggregate increase in physical activity levels or improve self-reported health. However, he finds some evidence that children's fitness tax credits increase activity among children in the top 40 percent of households based on income. Despite the substantial costs in forgone government tax revenue, children's fitness tax credits appear to be ineffective in improving children's average physical activity levels.

KEYWORDS: CANADA ■ CHILDREN ■ HEALTH ■ TAX CREDITS

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INTRODUCTION

In 2017, 30 percent of children in Canada aged 5 to 17 years were overweight or obese.[1] Childhood obesity is associated with an increased prevalence of various physical maladies, reduced mental health, and obesity in adulthood.[2] Given the high share of children who are overweight or obese, and the associated costs, identifying ways to encourage children to achieve and maintain a healthy weight has become an essential topic of research.

One strategy that has been explored is to increase the number of children who meet recommended levels of physical activity and thereby improve the body mass index (BMI) of children who are overweight or obese.[3] Between 2007 and 2015, an average of only 33 percent of Canadian children aged 6 to 17 met the recommended 60 minutes of moderate to vigorous physical activity per day.[4] In response to growing concern about children's fitness and health, several provincial and territorial governments and the federal government have adopted tax credits for qualifying registration or enrolment costs incurred for children's participation in physical activities.

1 Public Health Agency of Canada, "Tackling Obesity in Canada: Childhood Obesity and Excess Weight Rates in Canada" (www.canada.ca/en/public-health/services/publications/healthy-living/obesity-excess-weight-rates-canadian-children.html), data reported for 2017.

2 Stephen R. Daniels, Marc S. Jacobson, Brian W. McCrindle, Robert H. Eckel, and Brigid McHugh Sanner, "American Heart Association Childhood Obesity Research Summit: Executive Summary" (2009) 119:15 *Circulation* 2114-23 (https://doi.org/10.1161/CIRCULATIONAHA.109.192215).

3 Peter T. Katzmarzyk, Jean-Philippe Chaput, Mikael Fogelholm, Gang Hu, Carol Maher, Jose Maia, Timothy Olds, Olga L. Sarmiento, Martyn Standage, Mark S. Tremblay, and Catrine Tudor-Locke, "International Study of Childhood Obesity, Lifestyle and the Environment (ISCOLE): Contributions to Understanding the Global Obesity Epidemic" (2019) 11:4 *Nutrients* 848-72 (https://doi.org/10.3390/nu11040848).

4 Rachel C. Colley, Valerie Carson, Didier Garriguet, Ian Janssen, Karen C. Roberts, and Mark S. Tremblay, "Physical Activity of Canadian Children and Youth, 2007 to 2015" (2017) 28:10 *Health Reports* 8-16.

The first tax credit that aimed to encourage activity among Canadian youth was adopted in 2005 by Nova Scotia. The province's healthy living tax credit allowed a tax credit for up to $500[5] of expenses incurred in enrolling a child in an eligible physical activity. The value of the tax credit does not translate to household savings at a one-to-one ratio. Instead, the tax credit reduces a claimant's tax liability on the basis of the rate for the lowest personal tax bracket, resulting in a maximum tax liability reduction of $44.00 for a Nova Scotian household. Since 2005, nearly half of the provinces or territories have followed suit and adopted similar forms of income support for children's physical activities. In 2007, the federal government introduced the children's fitness tax credit (CFTC). The combined federal and provincial/territorial tax credits could amount to as much as $2,000 in the most generous jurisdiction.

In this article, I provide the first causal estimates of the impact of tax credits on children's participation in leisure physical activities. I determine the amount of tax liability reduction available each year in each province or territory, using data on fitness tax credits and tax rates at the provincial, territorial, and federal levels. By combining the listed value of the available tax credits and data from the Canadian Community Health Survey (CCHS) covering the period 2001-2014, I assess the relationship between fitness tax credits and children's physical activity levels. I find no evidence that a reduction in tax liability has a positive impact on the overall likelihood that a child will participate in leisure physical activities or improves self-reported health status. However, I find evidence of an increase in the frequency of leisure physical activities among children in higher-income households.

This article contributes to the literature exploring the relationship between offered incentives and exercise outcomes. Prior research has examined the effects of providing incentives (either monetary or non-monetary) on college students,[6] workers,[7] gym members,[8] overweight or obese adults,[9] and older adults.[10] Studies examining

5 All dollar amounts referred to in this article are in Canadian dollars.

6 Bhagyashree Katare, "Do Low-Cost Economic Incentives Motivate Healthy Behavior?" (May 2021) 41 *Economics & Human Biology* (https://doi.org/10.1016/j.ehb.2021.100982); Lizzy Pope and Jean Harvey-Berino, "Burn and Earn: A Randomized Controlled Trial Incentivizing Exercise During Fall Semester for College First-Year Students" (2013) 56:3-4 *Preventive Medicine* 197-201; and Timothy K.M. Beatty and Bhagyashree Katare, "Low-Cost Approaches to Increasing Gym Attendance" (September 2018) 61 *Journal of Health Economics* 63-76 (https://doi.org/10.1016/j.jhealeco.2018.05.006).

7 Heather Royer, Mark Stehr, and Justin Sydnor, "Incentives, Commitments, and Habit Formation in Exercise: Evidence from a Field Experiment with Workers at a Fortune-500 Company" (2015) 7:3 *American Economic Journal: Applied Economics* 51-84.

8 Gary Charness and Uri Gneezy, "Incentives To Exercise" (2009) 77:3 *Econometrica* 909-31; Kirsten I.M. Rohde and Willem Verbeke, "We Like To See You in the Gym—A Field Experiment on Financial Incentives for Short and Long Term Gym Attendance" (February 2017) 134 *Journal of Economic Behavior & Organization* 388-407 (https://doi.org/10.1016/j.jebo.2016.12.012); Mariana Carrera, Heather Royer, Mark Stehr, and Justin Sydnor, "Can

(Notes 8, 9, and 10 are continued on the next page.)

the impact on children have found that lottery prizes increase walking or biking to school among school-aged children,[11] monetary incentives increase exercise among American Indian adolescents,[12] and activity vouchers increase exercise among year nine students in the United Kingdom.[13]

So far, the literature has consisted primarily of experimental interventions providing incentives through lotteries or rewards. The findings from these studies may not be generalizable to the public, given that participants are aware of their participation in a study, and the experimental settings do not accurately approximate conditions encountered in an extensive national or subnational (provincial or territorial) policy. As a result, there is a need to analyze the data relating to these governmental interventions. The adoption of fitness credits in Canada at the national and subnational levels provides an opportunity to assess the impact of such tax credits on exercise in a quasi-experimental setting. The literature lacks an analysis of whether large-scale tax credits are a viable means of increasing exercise among youth. This study aims to fill these gaps in the literature by examining youth fitness tax credits implemented both subnationally and nationally in Canada.

Financial Incentives Help People Trying To Establish New Habits? Experimental Evidence with New Gym Members" (March 2015) 58 *Journal of Health Economics* 202-14; and Dan Acland and Matthew R. Levy, "Naiveté, Projection Bias, and Habit Formation in Gym Attendance" (2015) 61:1 *Management Science* 146-60.

9 Mitesh S. Patel, David A. Asch, Roy Rosin, Dylan S. Small, Scarlett L. Bellamy, Jack Heuer, Susan Sproat, Chris Hyson, Nancy Haff, Samantha M. Lee, Lisa Wesby, Karen Hoffer, David Shuttleworth, Devon H. Taylor, Victoria Hilbert, Jingsan Zhu, Lin Yang, Xingmei Wang, and Kevin G. Volpp, "Framing Financial Incentives To Increase Physical Activity Among Overweight and Obese Adults: A Randomized, Controlled Trial" (2016) 164:6 *Annals of Internal Medicine* 385-94.

10 Eric A. Finkelstein, Derek S. Brown, David R. Brown, and David M. Buchner, "A Randomized Study of Financial Incentives To Increase Physical Activity Among Sedentary Older Adults" (2008) 47:2 *Preventive Medicine* 182-87.

11 Harold E. Cuffe, William T. Harbaugh, Jason M. Lindo, Giancarlo Musto, and Glen R. Waddell, "Evidence on the Efficacy of School-Based Incentives for Healthy Living" (2012) 31:6 *Economics of Education Review* 1028-36 (https://doi.org/10.1016/j.econedurev.2012.07.001).

12 Lilian Golzarri-Arroyo, Xiwei Chen, Stephanie L. Dickinson, Kevin R. Short, David M. Thompson, and David B. Allison, "Corrected Analysis of 'Using Financial Incentives To Promote Physical Activity in American Indian Adolescents: A Randomized Controlled Trial' Confirms Conclusions" (2020) 15:6 *PLoS ONE* (https://doi.org/10.1371/journal.pone.0233273); and Kevin R. Short, Jennifer Q. Chadwick, Tamela K. Cannady, Dannielle E. Branam, David F. Wharton, Mary A. Tullier, David M. Thompson, and Kenneth C. Copeland, "Using Financial Incentives To Promote Physical Activity in American Indian Adolescents: A Randomized Controlled Trial" (2018) 13:6 *PLoS ONE* (https://doi.org/10.1371/journal.pone.0198390).

13 Danielle Christian, Charlotte Todd, Rebecca Hill, Jaynie Rance, Kelly Mackintosh, Gareth Stratton, and Sinead Brophy, "Active Children Through Incentive Vouchers—Evaluation (ACTIVE): A Mixed-Method Feasibility Study" (2016) 16:1 *BMC Public Health* 890-99 (https://doi.org/10.1186/s12889-016-3381-6).

In the sections of this article that follow, first, I provide background information on children's fitness tax credits in Canada; second, I discuss the data used in the study; third, I describe my methodology; fourth, I present the results of the analysis; and finally, I discuss the policy implications of the results. Two appendixes provide additional details about the tax credits (in appendix A at the end of this article) and about the statistical analysis and results (in appendix B, available online).

FITNESS TAX CREDITS

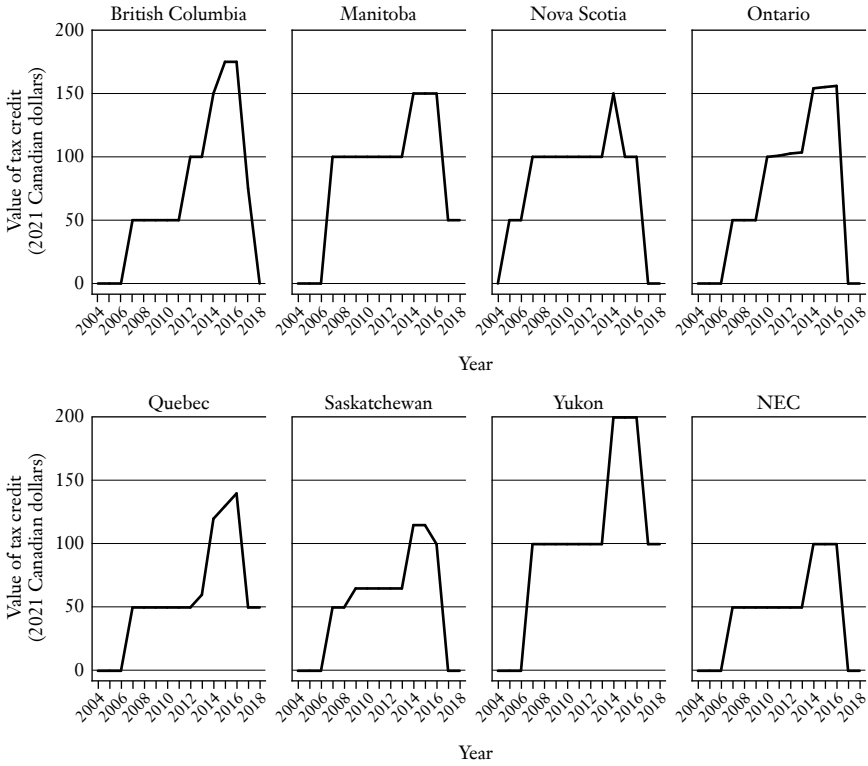
Seven of Canada's 13 provinces and territories implemented a fitness tax credit during the study period (2001-2014). As noted above, Nova Scotia adopted a fitness tax credit in 2005, followed by Manitoba and Yukon in 2007, Saskatchewan in 2009, Ontario in 2010, British Columbia in 2012, and Quebec in 2013. British Columbia, Manitoba, Quebec, Saskatchewan, and Yukon expanded the generosity of their tax credit program during the study period. Federally, the CFTC, adopted in 2007, was expanded in 2014. The costs to the government of providing the tax credits grew rapidly from $1 million in 2005 to $286 million in 2013.[14] Ultimately, most of these programs ended shortly after 2015.

Eligibility for the tax credit varied across jurisdictions. The maximum age for an eligible child varied from 14 to 18 years, with the most common age threshold being 16. In addition to having different age requirements, the size of the tax credits varied by program. Differences in personal income tax rates among jurisdictions also affected the amount of the tax liability reduction that households received from a fitness tax credit. Regardless of household income, the value of the tax liability reduction is based on the lowest provincial, territorial, or federal tax rate multiplied by the amount claimed. Appendix A provides details on the value of the tax credit, the age requirements, and the applicable personal income tax rates at the federal, provincial, and territorial levels.

To illustrate the role of income tax rates, consider the $500 tax credit offered in 2012 by British Columbia and Manitoba. The applicable tax rate in British Columbia was 5.06 percent, resulting in a maximum tax liability reduction of $25.30. Manitoba's applicable tax rate was 10.8 percent, resulting in a maximum tax liability reduction of $54.00. Although the value of the credit was the same in both provinces, the differences in provincial income tax rates resulted in Manitoba's credit having more than double the impact on tax liability compared to British Columbia's credit. For this reason, the analysis in this study focuses on the maximum reduction in tax liability available under each fitness tax credit program, rather than the listed value of a credit, which ignores differences in tax rates. In figure 1, I show the reduction in tax liability in 2021 Canadian dollars by province or territory from 2004 to 2018. Clearly, the differences in tax credits and relevant tax systems result in considerable variation across jurisdictions.

14 JoAnne Sauder, "Children's Fitness and Activity Tax Credits: Why They Were Created and What They Are Intended To Do" (2014) 21 *Health Law Journal* 75-96.

FIGURE 1 Reduction in Tax Liability by Province or Territory and Year, 2004-2018



NEC = not elsewhere classified.

Notes: Tax liability reduction is calculated as the maximum value of the fitness tax credit in the particular jurisdiction multiplied by the lowest applicable personal income tax rate. The plotted line represents the combination of federal and, where implemented, provincial or territorial tax credits. NEC includes the provinces and territories that did not adopt a tax credit in this period —namely, Alberta, New Brunswick, Newfoundland and Labrador, the Northwest Territories, Nunavut, and Prince Edward Island—and reflects only the federal children's fitness tax credit.

Despite the policy goal of promoting physical fitness and reducing obesity among children,[15] no prior research has thoroughly explored whether the tax credits actually contribute to the achievement of these objectives. The research that has examined exercise is limited to a single study that focused on a sample of Alberta students aged 10 to 11 years in 2012 and 2014,[16] and included no untreated years or ineligible ages.

15 Ibid.

16 Jodie A. Stearns, Paul J. Veugelers, Tara-Leigh McHugh, Chris Sprysak, and John C. Spence, "The Use of a Nonrefundable Tax Credit To Increase Children's Participation in Physical Activity in Alberta, Canada" (2021) 18:9 *Journal of Physical Activity and Health* 1067-73.

The authors found no association between federal tax credit claim status and physical activity or pedometer steps. Spence[17] surveyed a representative sample of Canadians and found that almost 16 percent of parents who claimed the CFTC believed that it increased their child's participation in physical activity programs.

Most of the work on the CFTC has focused on the characteristics of households that claim the credit. Higher-income households are more aware of and more likely to claim the CFTC than are lower-income households.[18] Higher tax literacy among higher-income Canadians may partially explain why higher-income households are more likely to claim the CFTC.[19] Households in an urban area or with at least one male child also are more likely to claim the CFTC.[20]

DATA

I use the CCHS to explore the impact of fitness tax credits on exercise. The CCHS interviews Canadians who are 12 years of age and older living across Canada. Individuals are excluded from the survey if they live on reserves or in Indigenous settlements, are institutionalized, are children in foster care, or live in Région du Nunavik or Région des Terres-Cries-de-la-Baie-James. With these restrictions, the CCHS covers approximately 97 percent of the age-eligible Canadian population. Interviews are conducted in English and French and cover Canada's provinces and territories. The survey is released in cycles every two years, providing a sample of approximately 65,000 individuals in each survey year.

In 2015, the CCHS underwent a significant redesign that included changes in survey questions and sampling methodology. To avoid issues that arise from the redesign, I use CCHS data from 2001 to 2014 for my analysis. The CCHS reports the geographical information for respondents, allowing me to match the respondent to the province- or territory-level tax credit policy. The CCHS contains basic demographic information on race, gender, the highest level of education in the household, and household income.

Importantly for this analysis, the CCHS contains information on participation in leisure physical activities. The list of activities expands in later cycles, notably adding

17 John C. Spence, Nicholas L. Holt, Julia K. Dutove, and Valerie Carson, "Uptake and Effectiveness of the Children's Fitness Tax Credit in Canada: The Rich Get Richer" (2010) 10:1 *BMC Public Health* 356-61.

18 Barbara von Tigerstrom, Tamara Larre, and JoAnne Sauder, "Using the Tax System To Promote Physical Activity: Critical Analysis of Canadian Initiatives" (2011) 101:8 *American Journal of Public Health* e10-e16; and Koren L. Fisher, Amin Mawani, Barbara von Tigerstrom, Tamara Larre, Christine Cameron, Karen E. Chad, Bruce Reeder, and Mark S. Tremblay, "Awareness and Use of Canada's Children's Fitness Tax Credit" (2013) 61:3 *Canadian Tax Journal* 599-632. See also Stearns et al., supra note 16, and Spence et al., supra note 17.

19 Antoine Genest-Grégoire, Luc Godbout, and Jean-Herman Guay, *The Knowledge Deficit About Taxes: Who It Affects and What To Do About It*, C.D. Howe Institute Commentary no. 484 (Toronto: C.D. Howe Institute, 2017).

20 Fisher et al., supra note 18.

questions pertaining to soccer. For consistency, I use the 21 leisure activities included in the 2001-2002 cycle. Activities added subsequently are included in the "other activities" category. Respondents report the number of times that they participated in the activity in the last three months and the average duration of each episode. Table B1 in appendix B[21] lists each of the 21 activities and reports the descriptive statistics for self-reported participation in each activity. Self-reported activity has been found to be in agreement, on average, with accelerometer-measured activity among 12- to 17-year-old Canadians between 2007 and 2011[22] and with accelerometer-measured or parent-reported activity levels among 10- to 12-year-old Australians.[23]

The CCHS uses responses to the activity questions to construct additional derived variables. A measure of the average monthly frequency of physical activity lasting more than 15 minutes is constructed by aggregating the reported participation habits of each respondent and dividing by 3 to obtain a monthly average. This average is then used to group the frequency of physical activity into three groups: infrequent (a monthly average less than 4), occasional (a monthly average greater than or equal to 4 but less than 12), and regular (a monthly average greater than or equal to 12). I create indicators for each of these three frequency measures. I create two additional indicators, "none" and "daily," which capture the subset of infrequent exercisers with a monthly average of 0 and the subset of regular exercisers with a monthly average greater than or equal to 30, respectively.

Additionally, the CCHS calculates respondents' energy expenditure using a measurement tool known as the metabolic equivalent of task (MET). METs are measured as a multiple of the metabolic energy expenditure relative to the resting metabolic rate. The CCHS calculates average daily energy expenditure with the following formula:

$$EE = (N \times D \times MET\ value)/365,$$

where *EE* is daily energy expenditure (in METs), *N* is the number of times that a respondent participated in the activity over a 12-month period, *D* is the average duration of the activity (in hours), and *MET value* is the energy cost of the activity (in kilocalories per kilogram per hour [kcal/kg/hr]). The *MET value* for each activity is listed in appendix table B2. For example, the *MET value* of participating in baseball or softball is 3 kcal/kg/hr. This means that an individual playing baseball uses triple the energy spent when at rest (0). The CCHS classifies respondents' level of energy

21 Appendix B is available from my personal website at www.aaronmgamino.com/wp-content/uploads/2024/07/CTJ-Appendix-B-1.pdf.

22 Didier Garriguet and Rachel C. Colley, "A Comparison of Self-Reported Leisure-Time Physical Activity and Measured Moderate-to-Vigorous Physical Activity in Adolescents and Adults" (2014) 25:7 *Health Reports* 3-11.

23 Amanda Telford, Jo Salmon, Damien Jolley, and David Crawford, "Reliability and Validity of Physical Activity Questionnaires for Children: The Children's Leisure Activities Study Survey (CLASS)" (2004) 16:1 *Pediatric Exercise Science* 64-78 (https://doi.org/10.1123/pes.16.1.64).

expenditure as "active" (*EE* greater than or equal to 3), "moderate" (*EE* greater than or equal to 1.5 and less than 3), or "inactive" (*EE* less than 1.5). I create a set of indicators for each level of energy expenditure as an alternative measure of activity level.

The CCHS also contains information on self-reported health status. Respondents report having poor, fair, good, very good, or excellent health. I create an indicator for each of the five responses to explore potential secondary benefits from the tax credits.

The CCHS reports age in bins. I limit my sample to respondents aged 12 to 14 years, to ensure that the age group is eligible for a tax credit, where available. Children under 12 are not part of the survey. The next youngest age bin is 15 to 19 years, which includes ages that would not be eligible for a tax credit in some jurisdictions. Unfortunately, the age bins preclude the use of BMI-for-age percentiles as an outcome of interest. I further limit the sample by excluding residents of Yukon, the Northwest Territories, or Nunavut, because the CCHS combines the responses for the three territories, making it impossible to identify the tax credit environment faced by each of these respondents.

Using the tax credits and income tax levels outlined in appendix A, I calculate the reductions in tax liability for each jurisdiction and each year. Because the CCHS waves cover two calendar years, I use the average tax liability reduction over each wave's interview period. The average tax liability reduction is then matched to the jurisdiction and the interview period. One concern may be that this measure can introduce considerable measurement error if the tax credit was adopted in the second year of the interview period. In the study period, the first subsidy in each jurisdiction started in an odd-numbered year. Fortunately, because the CCHS waves also start in odd-numbered years, it will not be the case that a jurisdiction goes from no tax liability reduction in the first interview year to a tax liability reduction in the second interview year.

After these restrictions, the analyzed sample consists of 31,835 individuals. In table 1, I report the sample's descriptive statistics. Almost half of the sample self-identifies as female and almost three-quarters as racially white. Relatively few respondents are in households with a low level of education: only 3.9 percent have less than a secondary school education, and 9.7 percent have a secondary school education. The average tax liability reduction is $69.50; and, conditional on the availability of a tax credit, the average is $113.59. (Unless otherwise indicated, all dollar amounts reported in the study results are in 2021 Canadian dollars.) Nearly 99 percent of the sample reported participation in leisure physical activity. The likelihood of infrequent, occasional, or regular participation in leisure physical activity is 6.9 percent, 15 percent, and 78.1 percent, respectively. Almost half of the sample reported daily participation in leisure physical activity. Respondents in the sample tend to have good or better self-reported health status: only 3 percent reported fair or poor health.

METHODOLOGY

My identification strategy relies on the heterogeneity in tax liability reduction caused by changes in provincial, territorial, and federal differences in tax credit policies and personal income tax rates. I employ a weighted least squares regression at the

TABLE 1 Descriptive Statistics for the Study Sample (N = 31,835)

	Mean	Standard deviation
Demographic		
Female	0.489	0.500
White	0.734	0.442
Household's highest level of education		
Less than secondary school	0.039	0.193
Secondary school	0.097	0.296
Post-secondary	0.783	0.412
Tax liability reduction	69.50	61.01
Tax liability reduction conditional on value > 0	113.59	32.79
Frequency of leisure physical activity		
None	0.013	0.112
Infrequent	0.069	0.254
Occasional	0.150	0.357
Regular	0.781	0.414
Daily	0.488	0.500
Self-reported health status		
Excellent	0.228	0.420
Very good	0.387	0.487
Good	0.233	0.422
Fair	0.028	0.164
Poor	0.002	0.039

Notes: Reported statistics are weighted by CCHS-provided sample weights. Tax liability reduction amounts are in 2021 Canadian dollars. "Infrequent," "occasional," and "regular" are exhaustive measures of leisure physical activity. "None" is the subset of infrequent exercisers who report a monthly average of 0 leisure physical activities of at least 15 minutes. "Daily" is the subset of regular exercisers who report a monthly average of at least 30 leisure physical activities of at least 15 minutes.

individual level to estimate the impact of tax credits on activity. This approach provides easily interpreted results, identifies the average effect of tax liability reductions, and handles fixed effects well.

I begin with the following equation:

$$Y_{igt} = \alpha + \beta TLR_{gt} + \gamma X_{it} + \tau_t + \sigma_g + \varepsilon_{igt},$$

where Y_{igt} is the outcome of interest for individual i in province or territory g in period t. Each period corresponds to the two years covered by each CCHS wave. X_{it} is a vector of individual controls for age, female gender, white race, household income, and highest household educational attainment. τ_t and σ_g are fixed effects for a period and for a province or territory, respectively. ε_{igt} is the error term. TLR_{gt} is the maximum tax liability reduction in 2021 Canadian dollars in province or territory g during period t. The tax liability reduction is an average for each survey wave

corresponding to a two-year period. All regressions use the CCHS-provided weights. To account for errors potentially being correlated within provinces or territories and periods, I estimate standard errors clustered by province or territory and period, using Cameron, Gelbach, and Miller's multi-way clustering procedure.[24]

I perform additional analyses that allow for effects to differ by demographic and household characteristics. Specifically, I conduct further analyses that interact TLR_{gt} with gender, race, household income quintiles, and household educational attainment indicators. These additional terms allow me to explore potential heterogeneous effects across different groups. Finally, I perform additional regressions to test the robustness of my primary results. I use energy expenditure outcomes as an alternative measure of physical activity. The energy expenditure variables are based on the METs expended in each activity, which may better account for differences in intensity across reported activities. I also look for an impact on each of the 21 CCHS-covered leisure physical activities.

The interpretation of the coefficient of interest, β, as capturing the causal impact of the tax credits on the outcomes of interest relies on several assumptions. To interpret the effect as causal, I must be able to compare what happens when treatment is received to what would have occurred in the absence of treatment. In this case, all units eventually receive treatment when a national policy is adopted. The identification instead comes from a measure of the differences in levels of treatment that individuals experience. The differences in provincial and territorial credits and tax rates provide a rich set of temporal and geographical variations, which in turn provide a wide variety of exposure to differing levels of treatment.

I also must assume that no provincial- or territorial-specific shocks are occurring that coincide with the adoption of tax credits and that persist for the duration of the tax credit programs. The policy discussion surrounding fitness tax credits did not allude to the simultaneous adoption of potentially confounding policies. Furthermore, making it less likely that a shock captures the identifying variation is the difference in the values of the tax credits in real terms over time. The changing purchasing power of the Canadian dollar provides an additional source of variation that aids in capturing the credit-induced effects.

RESULTS

Main Results

Table 2 presents the estimated effect of a tax liability reduction (TLR) of $100 on leisure physical activity. Each column shows the results from a regression on the indicated outcome of interest. I find no significant relationship between TLR and the frequency of leisure physical activity. For regular activity, which includes daily, the 95 percent confidence interval allows me to rule out effects from a TLR of $100 up to 4.4 percent of the analytic mean.

24 A. Colin Cameron, Jonah B. Gelbach, and Douglas L. Miller, "Robust Inference with Multiway Clustering" (2011) 29:2 *Journal of Business & Economic Statistics* 238-49.

TABLE 2 Effects of Fitness Tax Credits on Leisure Physical Activity

	Participant in leisure physical activity	Frequency of leisure physical activity				
		None	Infrequent	Occasional	Regular	Daily
TLR	0.002	−0.002	−0.006	0.006	0.001	0.014
	(0.004)	(0.004)	(0.009)	(0.005)	(0.014)	(0.013)
Mean	0.987	0.013	0.069	0.150	0.781	0.488
N	31,835	31,835	31,835	31,835	31,835	31,835

TLR = tax liability reduction.

Notes: Reported estimates are weighted by CCHS-provided weights. For convenience, the value of the tax credit is in hundreds of 2021 Canadian dollars. Standard errors clustered by survey and by province or territory are presented in parentheses. The sample consists of individual-level observations. The weighted analytic mean is reported. "Infrequent," "occasional," and "regular" are exhaustive measures of leisure physical activity. "None" is the subset of infrequent exercisers who report a monthly average of 0 leisure physical activities of at least 15 minutes. "Daily" is the subset of regular exercisers who report a monthly average of at least 30 leisure physical activities of at least 15 minutes.

I explore the sensitivity of the main results using three additional models. The results of these calculations are provided in appendix B. First, in table B3, I report the results with an additional indicator identifying whether a local tax credit is in place. Second, I use the nominal credit value rather than the tax liability reduction and report the results in table B4. Third, I estimate a model that includes an indicator for whether the local credit can be used for non-physical activities or is refundable. (Because the two policies are perfectly collinear, it is impossible to have a separate dummy for each.) I present the results in table B5. I do not find results that significantly differ from those reported in table 2 for each additional specification. The additional indicators for the presence of a local credit or the credit being refundable or applicable to non-physical activities are insignificant and do not significantly alter the estimated effect of the tax liability reduction.

Table B6 presents the estimated effects on self-reported health outcomes. I find no significant relationship between tax liability reduction and the likelihood that a respondent reported excellent, very good, good, fair, or poor health. The lack of significance should not be surprising since I found no overall significant effects on the frequency of leisure physical activity.

Next, I explore the potential heterogeneous effects of demographic and household characteristics. Table 3 explores differences by gender in panel A, by race in panel B, by household income in panel C, and by household educational attainment in panel D. I do not find compelling evidence of differences by gender, race, or household educational attainment. However, in panel C, I find some meaningful effects. A TLR of $100 is associated with an increase of roughly 13 percent in the likelihood of

TABLE 3 Heterogeneous Effects of Fitness Tax Credits on Leisure Physical Activity

	Frequency of leisure physical activity				
	None	Infrequent	Occasional	Regular	Daily
Panel A By gender					
TLR	−0.003	−0.004	0.003	0.001	0.013
	(0.005)	(0.007)	(0.002)	(0.014)	(0.014)
TLR × female	0.001	−0.003	0.005	−0.002	0.002
	(0.005)	(0.007)	(0.006)	(0.014)	(0.015)
Panel B By race					
TLR	0.000	−0.003	0.005**	−0.002	−0.001
	(0.002)	(0.014)	(0.001)	(0.015)	(0.016)
TLR × white	−0.003	−0.004	0.001	0.003	0.022
	(0.002)	(0.009)	(0.003)	(0.008)	(0.019)
Panel C By income					
TLR	0.010***	−0.009	0.017***	−0.008	−0.022
	(0.002)	(0.015)	(0.000)	(0.010)	(0.020)
TLR × quintile 2	−0.020***	0.013	−0.015	0.002	0.022
	(0.004)	(0.007)	(0.012)	(0.016)	(0.014)
TLR × quintile 3	−0.014***	0.004	−0.013	0.009	0.033
	(0.003)	(0.010)	(0.014)	(0.008)	(0.020)
TLR × quintile 4	−0.016***	−0.001	−0.011	0.012	0.059**
	(0.004)	(0.011)	(0.007)	(0.015)	(0.024)
TLR × quintile 5	−0.011***	0.001	−0.017**	0.016	0.062***
	(0.003)	(0.008)	(0.005)	(0.012)	(0.003)
Panel D By household education					
TLR	0.009**	0.007	−0.004	−0.002	−0.003
	(0.003)	(0.011)	(0.015)	(0.016)	(0.024)
TLR × secondary school	−0.013*	−0.002	0.014	−0.012	0.004
	(0.006)	(0.016)	(0.024)	(0.036)	(0.019)
TLR × post-secondary	−0.012***	−0.016***	0.011	0.005	0.023
	(0.003)	(0.004)	(0.013)	(0.013)	(0.018)

TLR = tax liability reduction.

*, **, and *** indicate statistical significance at the 10, 5, and 1 percent levels, respectively.

Notes: Reported estimates are weighted by CCHS-provided weights. For convenience, the value of the tax credit is in hundreds of 2021 Canadian dollars. Standard errors clustered by survey and by province or territory are presented in parentheses. The sample consists of individual-level observations. The weighted analytic mean is reported. "Infrequent," "occasional," and "regular" are exhaustive measures of leisure physical activity. "None" is the subset of infrequent exercisers who report a monthly average of 0 leisure physical activities of at least 15 minutes. "Daily" is the subset of regular exercisers who report a monthly average of at least 30 leisure physical activities of at least 15 minutes.

occasional leisure physical activity among individuals in the first income quintile (the 20 percent of households with the lowest income). The same TLR is associated with an increase of around 8 percent in the probability of daily leisure physical activity among children in the fourth and fifth quintiles.

Alternative Outcomes

In appendix table B7, I present the results for the total energy expenditure and the likelihood of energy expenditure levels being inactive, moderate, or active. I do not find a significant relationship between tax liability reduction and energy expenditure measures. In table B8, I conduct heterogeneity analyses analogous to those used in table 3. I observe an increase of around 10 percent in the likelihood that individuals in the fourth and fifth income quintiles will be active. This result is consistent with the finding that children in these quintiles are more likely to participate in daily leisure physical activity.

Along with the energy expenditure outcomes, I explore the specific activities covered by the survey. In figure 2, I present the point estimate and 95 percent confidence interval corresponding to a tax liability reduction of $100 for each activity. There are few activities with discernable increases or decreases. Tax liability reduction is associated with a reduction in the likelihood of golfing, an increase in the likelihood of skating, and an increase in the likelihood of swimming.

CONCLUSION AND POLICY DISCUSSION

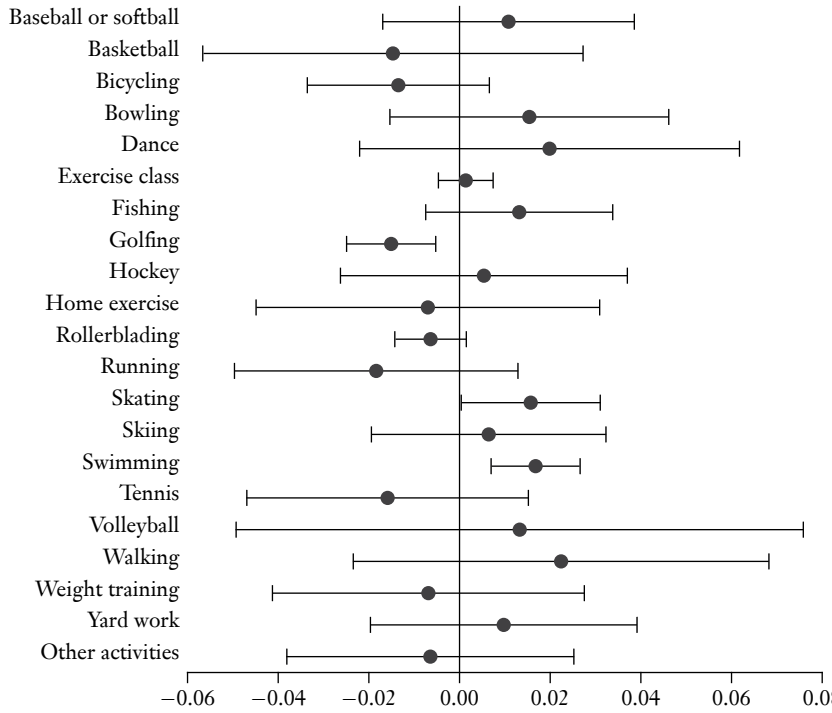
In this article, I study the relationship between tax liability reduction and leisure physical activity among Canadian youth. I use provincial, territorial, and federal children's fitness tax credits and tax rates as a source of variation in tax liability reduction between 2001 and 2014. I use CCHS data to examine the frequency of leisure physical activity, self-reported health status, and energy expenditure.

I find no significant effects of tax liability reduction on the frequency of leisure physical activity, health status, or energy expenditure. At the upper end of the 95 percent confidence interval, the estimated effect of a $100 tax liability reduction on leisure physical activity participation is less than 1 percent, and the estimated effect on the likelihood of regular physical activity participation is less than 5 percent. I find some evidence that the tax liability reduction resulted in an increase in the frequency of leisure physical activity and active energy expenditure among children in households in the upper 40 percent of households based on income.

Requiring registration in physical activity to take advantage of the tax liability reduction may be a barrier to families with considerable time, transportation, financial (equipment is not necessarily covered), or other constraints. Prior research has found that higher-income families are more aware of and more likely to claim the tax credits.[25] The finding that a tax liability reduction of $100 resulted in an increase

25 Fisher et al., supra note 18. See also Stearns et al., supra note 16, and Spence et al., supra note 17.

FIGURE 2 Effects of Fitness Tax Credits on Specific Leisure Physical Activities



Notes: The estimated coefficient and 95 percent confidence intervals corresponding to a tax liability reduction of $100 are shown for each indicated exercise. Reported estimates are weighted by CCHS-provided weights.

in daily or active energy expenditure among the highest two quintiles of household income shows that the limited exercise benefits were concentrated among better-off households. The increase is relatively small compared to the tax revenue lost; that is, the tax liability reduction likely served as a rebate for many families that would have enrolled their child in physical activity with or without the fitness tax credit.

As of 2021, five provinces and territories have kept, readopted, or newly adopted children's fitness tax credits. The use of tax credits to increase children's physical activity levels appears to be an expensive policy—$286 million of forgone tax revenue in 2013[26]—particularly in light of the limited progress achieved toward meeting its goal. It would be beneficial to explore whether the increased levels of activity among children in higher-income families result in improved BMI or healthier habits persisting into adulthood. One opportunity for potential improvement is relaxation of the

26 See Sauder, supra note 14.

barriers imposed by the tax credits' conditional requirements. Allowing reimbursement for any sporting equipment, rather than registration costs, may help to alleviate some of the obstacles faced by less advantaged families. However, it is possible that potential delays in receiving the credit or other existing barriers could dampen the effects of relaxed policies.

APPENDIX A FITNESS TAX CREDITS IN CANADA: FEDERAL, PROVINCIAL, AND TERRITORIAL, 2001-2021

Canada

In 2007, Canada implemented the national children's fitness tax credit (CFTC). The CFTC allowed a claim of up to $500 (non-refundable) for costs incurred in registering a child aged 16 years or younger in an eligible physical activity program. In 2014, the value of the credit was increased to $1,000. The credit became refundable in 2015. The credit was reduced to $500 in 2016 and eliminated in 2017. The applicable income tax rate was 15 percent.

Alberta

Alberta did not have a fitness tax credit in this period (2001-2021).

British Columbia

British Columbia introduced its child fitness credit in 2012. The value of the non-refundable credit was up to $500 for expenses incurred in registering a child aged 16 years or younger in an eligible physical activity program. In 2015, the child fitness equipment tax credit was introduced, providing a non-refundable credit for up to half of the amount claimed under the BC child fitness credit. Both credits ended in 2018. The applicable tax rate was 5.06 percent.

Manitoba

Manitoba introduced its children's fitness tax credit in 2007. The value of the non-refundable credit was up to $500 for costs of registering a child aged 16 years or younger in an eligible physical activity program. The credit was renamed the fitness tax credit in 2011 and expanded to include young adults up to the age of 24. The applicable tax rate was 10.9 percent in 2007-8 and 10.8 percent in 2009 onward.

New Brunswick

New Brunswick did not have a fitness tax credit in this period.

Newfoundland and Labrador

Newfoundland and Labrador implemented its physical activity tax credit in 2021. The value of the refundable credit is up to $2,000 per family. Eligible expenses are those incurred in registering for a physical activity program. The applicable tax rate is 8.7 percent.

Northwest Territories

The Northwest Territories did not have a fitness tax credit in this period.

Nova Scotia

Nova Scotia implemented its healthy living tax credit in 2005. The value of the non-refundable credit was up to $500 for children up to the age of 18 years. The credit was available for registration in a physical activity. The credit ended in 2015. The applicable tax rate was 8.79 percent.

Nunavut

Nunavut did not have a fitness tax credit in this period.

Ontario

Ontario implemented its children's activity tax credit in 2010. The value of the refundable credit was up to $500 for costs incurred in registering a child aged 16 years or younger in a physical activity program. The credit could also be used for certain non-physical activities. The credit was indexed for inflation. In chronological order, the value of the credit for 2011-2016 was $509, $526, $535, $541, $551, and $560. The credit ended in 2017. The applicable tax rate was 5.05 percent.

Prince Edward Island

Prince Edward Island implemented its children's wellness tax credit in 2021. The non-refundable credit covers registration costs for eligible activities (physical and non-physical) for children under 18 years of age. The applicable tax rate is 9.8 percent.

Quebec

Quebec implemented its tax credit for children's activity in 2013. Costs incurred in registering children aged 5 to 16 years can be claimed. The refundable tax credit is worth up to 20 percent of the expenses incurred, with a maximum of $100 of eligible fees in 2013. The credit can be used for qualifying physical and non-physical activities. The maximum amount of eligible fees increased by $100 per year until it reached $500 in 2017. The personal income tax rate is not applicable; instead, the value of the refundable credit is 20 percent of the eligible costs.

Saskatchewan

Saskatchewan implemented its active families benefit in 2009. The refundable benefit covers children aged 6 to 14 years during the tax year. The amount of the benefit is up to $150 per child. The eligible age limit was extended to children under 18 in 2012. In 2016, the benefit ended. The benefit was reinstated for children aged 18 or younger whose families had adjusted income less than or equal to $60,000 in 2021. The personal income tax rate is not applicable in calculating the amount of the benefit.

Yukon

Yukon implemented its child fitness credit in 2007. Initially, the non-refundable credit was for up to $500 of expenses incurred in registering a child under 16 years of age in eligible activities. The credit became refundable and increased to $1,000 in 2014. The applicable tax rate was 7.04 percent from 2007 to 2014 and 6.4 percent starting in 2015.

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https://doi.org/10.32721/ctj.2024.72.3.pf.editors

Policy Forum: Editors' Introduction—Recent Amendments to the General Anti-Avoidance Rule

Canada's general anti-avoidance rule (GAAR), in section 245 of the Income Tax Act,[1] was introduced in 1988. Over the next 35 years, the legislation was amended only twice: in 2004, subsection 245(4) was amended, with retroactive effect, to include references to other legislation, regulations, and tax treaties; and in 2022, the definitions of "tax benefit" and "tax consequences" in subsection 245(1) were amended to include possible future tax savings. During the same period, a substantial body of jurisprudence developed regarding the interpretation and application of GAAR, including several decisions of the Supreme Court of Canada. The framework for the GAAR analysis that is currently undertaken by the courts was originally established by the Supreme Court of Canada in its first GAAR decision in 2005, *Canada Trustco Mortgage Co. v. Canada*.[2]

The new amendments that are the subject of this Policy Forum follow from the Department of Finance's 2022 consultation paper.[3] Elements of the amendments stem directly from the consultation paper, including almost verbatim the portion of the preamble of paragraph 245(0.1)(b). According to the consultation paper, "[t]he GAAR was intended to strike a balance between taxpayers' need for certainty in planning their affairs and the government's responsibility to protect the tax base and the fairness of the tax system."[4]

Bill C-59,[5] enacted in June 2024, includes several significant amendments to GAAR, including the introduction of the aforementioned preamble; the change in the threshold for "avoidance transaction" in subsection 245(3) from "primarily" to "one of the main purposes"; the introduction of an "economic substance" test in subsections 245(4.1)

1 RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as "the Act"). Unless otherwise stated, statutory references in this introduction are to the Act.

2 2005 SCC 54.

3 Canada, Department of Finance, *Modernizing and Strengthening the General Anti-Avoidance Rule: Consultation Paper* (Ottawa: Department of Finance, 2022).

4 Ibid., at 4.

5 Bill C-59, An Act To Implement Certain Provisions of the Fall Economic Statement Tabled in Parliament on November 21, 2023 and Certain Provisions of the Budget Tabled in Parliament on March 28, 2023, enacted by SC 2024, c. 15; royal assent June 20, 2024.

and (4.2), applicable in determining whether there has been abusive tax avoidance under subsection 245(4); and the introduction of a penalty in subsection 245(5.1).

The three articles in this Policy Forum examine aspects of these amendments, focusing in particular on the impact that they may have on future GAAR jurisprudence.

In the first article, Pooja Mihailovich provides a comprehensive overview of the amendments, including the history behind their introduction. In her view, while the amendments will introduce new interpretive issues to be dealt with in the jurisprudence, "courts should continue to exercise restraint in applying this provision, lest the basis for [GAAR's] application devolve into a social fairness analysis that is neither rigorous nor principled."[6]

In the second article, Richard Krever compares and contrasts the Canadian GAAR jurisprudence with jurisprudence under the Australian GAAR, highlighting the role that purpose plays as a threshold in these two Anglo GAARs. He expresses skepticism about whether the recent Canadian changes will be successful in enabling the Canada Revenue Agency (CRA) to successfully challenge arrangements involving "legitimate commercial transactions," unless the economic substance test broadens the concept of abuse. An exploration of the evolution of Australian GAAR jurisprudence does not suggest that the changes to section 245 will have much consequence.

The final article, by David Ross, focuses on the interaction between GAAR and statutory bright-line rules. Ross explores the notion of a "purpose error," which occurs when a court overemphasizes an abstract purpose in applying GAAR. He considers how the Supreme Court's 2023 decision in *Deans Knight Income Corp. v. Canada*,[7] and the new preamble to GAAR, in which "certainty" is confined to a desire of taxpayers and not necessarily a desire of the CRA in administering the Act, might affect a GAAR analysis where other statutory provisions containing artificial bright lines are involved. These bright lines include the specific time periods applicable under the superficial loss rules[8] and the property-flipping rules,[9] and the specific share ownership thresholds applicable for foreign affiliate status (and the deductions available under subsection 113(1) flowing therefrom), as well as for part IV tax purposes. Ultimately, Ross identifies several questions that courts might pose in adjudicating whether GAAR should apply to transactions that rely on a bright-line provision.

It will likely be many years before a case involving the amendments is decided by the Supreme Court of Canada.[10] Until then, it will be unclear to what extent these

6 Pooja Mihailovich, "Policy Forum: GAAR Revisited—A Road Map for Continued Analytical Rigour," elsewhere in this feature, at 615.

7 2023 SCC 16.

8 Including subparagraph 40(2)(g)(i) and the definition of "superficial loss" in section 54, subsections 40(3.4) to (3.6), and subsections 13(21.2) and 18(13) to (15).

9 Subsections 12(12) to (14).

10 *Canada Trustco*, supra note 2, was decided approximately 17 years after the introduction of GAAR.

amendments may affect the framework for a GAAR analysis as articulated by the Supreme Court in *Canada Trustco*. This collection of articles provides food for thought on the impact that the amendments may have on that analytical framework.

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Policy Forum: GAAR Revisited—A Road Map for Continued Analytical Rigour

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PRÉCIS

De nouveaux problèmes d'interprétation émergent des modifications de la règle générale anti-évitement (RGAE), notamment l'inclusion d'un nouveau préambule et d'un critère de substance économique, ainsi que la possibilité d'une pénalité s'appliquant aux cas d'évitement fiscal abusif. Dans cet article, l'auteure présente son point de vue d'avocate plaidante sur la manière dont les tribunaux sont susceptibles d'aborder ces problèmes. Bien que les modifications étaient justifiées étant donné qu'elles visaient à « moderniser » la RGAE, elles servent en grande partie à codifier les principes existants, qui ont été soigneusement établis à la suite de nombreuses années de jurisprudence. L'auteure souligne que les tribunaux devraient se fier à ces principes pour s'assurer que l'analyse de la RGAE est réalisée avec la même rigueur analytique que celle dont ont fait preuve les tribunaux jusqu'à maintenant. De plus, compte tenu de la pénalité importante qui pourrait être imposée lorsque la RGAE s'applique, les tribunaux devraient insister sur un renforcement du fondement probatoire et un rehaussement de la norme de ce qui constitue un abus.

ABSTRACT

New interpretive issues arise from the amendments to the general anti-avoidance rule (GAAR), including the introduction of a novel preamble and an economic substance test, as well as the potential for a penalty to apply where abusive tax avoidance is found. In this article, the author provides a litigator's perspective on how these issues might be addressed by the courts. Although the amendments have been justified on the basis that they were intended to "modernize" GAAR, they serve in large part to codify existing principles that have been carefully developed through years of jurisprudence. The author emphasizes that the courts should rely on those principles to ensure that the GAAR analysis is undertaken with the same analytical rigour as has been judicially developed to date. Moreover, given the potential for a substantial

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penalty to be imposed where GAAR is found to apply, courts should insist on a stronger evidentiary foundation and a higher standard for a finding of misuse or abuse.

KEYWORDS: GAAR ■ TAX AVOIDANCE ■ ANTI-AVOIDANCE ■ STATUTORY INTERPRETATION ■ COURTS ■ TAX LITIGATION

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Plus ça change, plus c'est la même chose.
Jean-Baptiste Alphonse Karr, *Les Guêpes* [The Wasps] (January 1849)

INTRODUCTION

Canada's general anti-avoidance rule[1] (GAAR) is at a critical point in its evolution. Since its enactment more than 35 years ago, it has served as an effective tool for preventing abusive tax avoidance. The courts have developed a rigorous analytical framework to determine whether GAAR should apply and have continually sought to balance the need for certainty in tax planning against the desire to combat abuse.[2]

The record to date shows that the existing GAAR framework has largely achieved this objective. When legislative amendments to GAAR were first proposed in 2022, the minister of national revenue had lost approximately 24 cases, despite having assessed taxpayers under GAAR in more than 1,300 instances.[3] Despite this enviable track record, the amendments were aimed at "modernizing" GAAR.[4]

1 Section 245 of the Income Tax Act, RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as "the Act"). Unless otherwise stated, statutory references in this article are to the Act.

2 The decision of the Supreme Court of Canada in *Copthorne Holdings Ltd. v. Canada*, 2011 SCC 63, could be considered the high-water mark in this regard.

3 Canada, Department of Finance, *Modernizing and Strengthening the General Anti-Avoidance Rule*, *Consultation Paper* (Ottawa: Department of Finance, 2022) (herein referred to as "the consultation paper"), at 7 and 37, annex A. The irony of this statistic is manifest given the observations of the Supreme Court of Canada in *Deans Knight Income Corp. v. Canada*, 2023 SCC 16, at paragraph 49 (emphasis added): "By virtue of the rigorous analysis required by s. 245, *the GAAR only affects a small subset of transactions*, largely conducted by sophisticated parties with the ability to properly evaluate the risks inherent in a GAAR reassessment."

4 The amendments are contained in Bill C-59, An Act To Implement Certain Provisions of the Fall Economic Statement Tabled in Parliament on November 21, 2023 and Certain Provisions of the Budget Tabled in Parliament on March 28, 2023, enacted by SC 2024, c. 15; royal assent June 20, 2024.

The genesis of these changes can be traced in part to a politically motivated mandate letter issued by the prime minister to the minister of finance,[5] directing that "all Canadians and businesses contribute their fair share to a stronger economic recovery"[6] and that various legislative amendments be considered to give effect to that directive.

The mandate letter was issued a mere month after a majority of the Supreme Court of Canada decided *Alta Energy* in favour of the taxpayer—the first decision of that court to consider the application of GAAR to a tax treaty.[7] In that case, for the first time, the dissenting judges spoke of the need to strike a "balance between the uncertainty inherent in the GAAR and *the fairness of the Canadian tax system as a whole*."[8]

Although it is difficult to attribute these observations and the change in political and judicial temperament to any one cause, it is obvious that the public profile of tax avoidance has changed radically in the last decade, and that there is heightened sensitivity toward tax planning in general.

Even before the amendments were proposed, GAAR was perceived as a source of uncertainty in a relatively structured tax system. The amendments have only enhanced that perception. Additional interpretive issues have arisen in considering the scope of the amendments, marking a new era in the evolution of GAAR. Such issues surround the introduction of a novel preamble, the inclusion of an "economic substance" test, and the potential for a substantial penalty to be levied where GAAR is found to apply.[9]

Although it is debatable whether GAAR needed fine-tuning, the question arises: To what extent will the amendments affect the way that GAAR operates? To maintain consistency in the application of GAAR, the goal should be to ensure that the analysis remains both principled and rooted in the framework that has been judicially developed to date. None of the amendments should be viewed by the courts as a

5 Mandate letters typically outline the objectives that each minister will work to accomplish, as well as the pressing challenges that they will address in their role. See Canada, Office of the Prime Minister, Deputy Prime Minister and Minister of Finance Mandate Letter, December 16, 2021 (www.pm.gc.ca/en/mandate-letters/2021/12/16/deputy-prime-minister-and-minister-finance-mandate-letter) (herein referred to as "the mandate letter"). See also Brian R. Carr, Brittany D. Rossler, and Molly Martin, "What Is a Tax Planner To Do After Deans Knight?" Corporate Tax Planning feature (2024) 72:1 *Canadian Tax Journal* 231-80, at 269 (citing Jinyan Li, Marshall Rothstein, Steve Suarez, and Jeffrey Trossman, "Deeper into the Knight: Exploring Deans Knight and Its Effects on the Canadian GAAR" (2023) 111:13 *Tax Notes International* 1639-59, at 1655): "We agree with Li et al., who state that the amendments appear more politically motivated than tax-policy-oriented."

6 The mandate letter, supra note 5.

7 *Canada v. Alta Energy Luxembourg SARL*, 2021 SCC 49.

8 Ibid., at paragraph 101 (emphasis added).

9 The amendments also include a change to the definition of "avoidance transaction." As amended, an avoidance transaction is a transaction "one of the main purposes" of which is to obtain a tax benefit. This article does not address this amendment in any detail.

reason to deviate from the analytical rigour that is mandated by GAAR and that remains its defining feature.[10]

THE GAAR FRAMEWORK: A SNAPSHOT OF THE GOVERNING PRINCIPLES

GAAR inevitably introduces a degree of unpredictability into tax planning.[11] Recognizing this reality, the courts have developed a comprehensive framework to determine whether GAAR should apply in a particular case. This framework and the principles that underlie it reflect the courts' effort to respect Parliament's intention that GAAR be invoked with caution.[12]

Despite the recent changes, the more significant principles that informed the GAAR analysis of the past should continue to inform the application of GAAR in future cases.[13] These principles are briefly reviewed below.

A necessary part of the governing GAAR framework is to determine whether there is a tax benefit and, if one is found, to ascertain whether there has been an avoidance transaction. To the extent that an avoidance transaction is found, a central element of the misuse and abuse analysis is to first identify the object, spirit, and purpose, or the "underlying rationale," behind the provisions that are relied on, and then determine whether that rationale has been defeated or frustrated by the avoidance transaction(s) in issue.[14]

The onus on the Crown is both to establish the underlying rationale and to show that it was not fully captured by the text of the relevant provisions.[15] The rationale must be grounded in the provisions themselves, the scheme of the Act, and permissible extrinsic aids,[16] and *not* on the broader policy objectives underlying the Act.[17]

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10 *Deans Knight*, supra note 3, at paragraph 50, citing Pooja Samtani and Justin Kutyan, "GAAR Revisited: From Instinctive Reaction to Intellectual Rigour" (2014) 62:2 *Canadian Tax Journal* 401-28, at 403.

11 *Husky Energy Inc. v. The King*, 2023 TCC 167, at paragraph 298.

12 *Copthorne*, supra note 2, at paragraph 67: "A court must be mindful that a decision supporting a GAAR assessment in a particular case may have implications for innumerable 'everyday' transactions of taxpayers. . . . Because of the potential to affect so many transactions, the court must approach a GAAR decision cautiously."

13 "Except in so far as they are clearly and unambiguously intended to do so, statutes should not be construed so as to make any alteration in the common law or to change *any established principle of law*." Ruth Sullivan, *Sullivan on the Construction of Statutes*, 6th ed. (Markham, ON: LexisNexis Canada, 2014), at 538 (emphasis added), citing *Halsbury's Laws of England*, 3d ed., vol. 36 (London, UK: Butterworths, 1961), at 412, paragraph 625. The various principles developed over time governing the interpretation and application of GAAR are now firmly established in the law.

14 *Deans Knight*, supra note 3, at paragraph 56.

15 *Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54, at paragraphs 64 and 65.

16 Ibid., at paragraphs 41 and 42.

17 *Alta Energy*, supra note 7, at paragraph 49.

In applying GAAR, courts have been cautioned against conflating a transaction that is primarily (or even solely) tax-motivated with a transaction that is abusive.[18] The role of the court is to conduct an objective, thorough, and step-by-step review of the provisions in issue.[19] The court must then anchor its search for the underlying rationale in a textual, contextual, and purposive analysis of those provisions.[20] This is what gives GAAR its legitimacy, since taxpayers can hardly be required to comply with unwritten rules unless they are rationally discernible.

The Act is dominated by express provisions dictating specific results. Where Parliament has expressed its intention and specified precisely the conditions that must be satisfied to achieve a particular result, a taxpayer is entitled to rely on those conditions.[21] There may accordingly be cases where the underlying rationale of a provision is found to be no broader than its text.[22] In other cases, the means selected by drafters and endorsed by Parliament to give effect to the rationale behind a provision may not provide a full answer as to why the provision was adopted.[23] In such cases, a court must go further in ascertaining legislative intent.[24]

In conducting the GAAR analysis, it is important to consider the existence and interplay of relevant specific anti-avoidance provisions. GAAR was intended to catch unforeseen abusive tax strategies, but if Parliament drafts specific anti-avoidance provisions in a way that leaves open a clearly foreseeable gap, this may be an indication that the gap is intentional, in which case relying on it should not be considered abusive.[25] That said, there is no bar to the application of GAAR in situations where the Act specifies precise qualifying conditions.[26]

Finally, the Act is replete with diverse and at times competing policy choices. Determining whether an avoidance transaction (undertaken in reliance on a specific policy choice) has resulted in abusive tax avoidance is an exercise in statutory interpretation. It should not be driven by value judgments or theories about how the Act ought to operate. In other words, the analysis cannot be results-oriented.[27]

18 Ibid., at paragraph 47.

19 *Copthorne*, supra note 2, at paragraph 68.

20 Ibid., at paragraph 70.

21 *Canada Trustco*, supra note 15, at paragraph 11.

22 *Copthorne*, supra note 2, at paragraph 110. In such cases, the Crown will not discharge its burden by asserting that the avoidance transaction exploits the specificity of the relevant text. See *Lehigh Cement Limited v. Canada*, 2010 FCA 124, at paragraph 37; and *McClarty Family Trust v. The Queen*, 2012 TCC 80, at paragraph 55.

23 *Deans Knight*, supra note 3, at paragraph 59.

24 Ibid., at paragraph 68.

25 Ibid., at paragraphs 153 and 154. See also *Canada v. Landrus*, 2009 FCA 113, at paragraph 47.

26 *Deans Knight*, supra note 3, at paragraph 72.

27 *Copthorne*, supra note 2, at paragraph 70.

PLACING THE PREAMBLE: A PRECURSOR TO THE MISUSE AND ABUSE ANALYSIS

Over decades of jurisprudence, the GAAR framework has been refined to the point where the principles for its application are reasonably well settled. Nevertheless, the amendments include a preamble that explicitly describes the intended role of GAAR.[28]

In essence, the preamble declares that (1) GAAR applies to deny tax benefits resulting from abusive tax avoidance while allowing taxpayers to obtain tax benefits contemplated by the relevant provisions; and (2) GAAR strikes a balance between the need for taxpayer certainty and the responsibility of the government to protect the tax base and the fairness of the tax system.

A generic introductory statement of this nature is a departure from legislative drafting norms in the Canadian tax context.[29] Such a statement has a limited role to play in the interpretive analysis of a provision, particularly where (as here) competing interests are in play. The explanatory notes confirm that the preamble is not part of the GAAR framework, but is intended to emphasize "key considerations" relating to the purpose and operation of GAAR.[30] On this basis, the preamble should at most be viewed as a "largely political statement" regarding the "social context in which" GAAR was enacted and amended.[31]

The preamble to the amended GAAR introduces a distinct concept of fairness that is divorced from the principles of predictability and certainty, which are often cited concurrently with the principle of fairness. Instead of presenting the three principles as necessarily linked, the preamble alludes to balancing taxpayer certainty with "fairness of the tax system"—an undefined concept that is seemingly tied to protecting the tax base.[32] According to the Department of Finance, "fairness" in this sense is used broadly, "reflecting the unfair distributional effects of tax avoidance as it shifts the tax burden from those willing and able to avoid taxes to those who are not."[33]

The goal, as it relates to the concept of fairness, should be to ensure that taxpayers know what the law is and how they can follow it. This conception of fairness—in

28 Bill C-59, supra note 4, section 66(1).

29 In contrast, for example, the Australian Income Tax Assessment Act 1997, No. 38 of 1997, which is generally divided into chapters, divisions, and subdivisions, contains object statements at the beginning of most divisions and subdivisions.

30 Canada, Department of Finance, *Explanatory Notes Relating to the Income Tax Act and Regulations* (Ottawa: Department of Finance, November 2023) (herein referred to as "the 2023 explanatory notes"). See also the Interpretation Act, RSC 1985, c. I-23, section 13, which provides that the "preamble of an enactment shall be read as a part of the enactment intended to assist in explaining its purport and object."

31 J. Paul Salembier, *Legal and Legislative Drafting*, 2d ed. (Markham, ON: LexisNexis Canada, 2018), at 435.

32 Bill C-59, supra note 4, section 66(1). One of the objectives of the mandate letter, supra note 5, was to ensure that all Canadians and businesses "contribute their fair share."

33 Canada, Department of Finance, 2023 Budget, Tax Measures: Supplementary Information, March 28, 2023, at 38.

its most basic form—is an expression of the rule-of-law principle. In other words, there should be fairness for the taxpayer who is subject to the exercise of state power as reflected in tax legislation, not fairness in, or for, the tax system itself.

Legislators are (presumably) equipped to assess "the distributional effects of tax avoidance," but courts are simply not.[34] The inclusion of a distributional concept of fairness in the preamble may be unsurprising given the context of the amendments to GAAR generally.[35] However, even if one accepts the general presumption that the addition of this statutory text is not superfluous, judges will continue to focus (as they must) on the operative provisions of the Act.

The application of GAAR centres on the provisions allegedly misused or abused, and the expression of legislative intent, as anchored in those provisions. An objectively rigorous examination of the specific provisions in issue must triumph over vague notions of what Parliament might have intended or what might be perceived by either the minister or a court to be "fair" from a systemic perspective. As the Supreme Court of Canada has emphasized, "the principles of certainty, predictability and fairness do not play an independent role; rather, they are reflected in the carefully calibrated test that Parliament crafted in s. 245 of the Act and in its interpretation by [the] Court."[36]

Finally, the Supreme Court of Canada has explained that, when interpreting a complex legislative scheme, it is necessary to avoid fixating on one objective to the exclusion of others. Primary legislative purposes, however important, "are not pursued at all costs and are clearly intended to be balanced with other important interests within the context of a carefully calibrated scheme."[37] Stated differently, the overarching purpose of one particular legislative scheme (such as the kind purportedly expressed by the new preamble to GAAR) cannot be the decisive factor in the analysis.[38] Rather, the analysis must be grounded in other indicators of legislative purpose that are specific to the provisions in issue.

SITUATING ECONOMIC SUBSTANCE: THE NEED TO ANCHOR THE ALLEGED ABUSE IN THE ACT

GAAR, as it has been interpreted to date, respects the foundational principle in Canadian tax law that transactions are to be tested according to their legal substance—

34 *Canada Trustco*, supra note 15, at paragraph 41; and *Alta Energy*, supra note 7, at paragraph 96.

35 As acknowledged in the consultation paper, supra note 3, at 6, the need for change was justified in the context of "other efforts to improve the integrity of the Canadian income tax system," including the enhancement of Canada's mandatory disclosure rules, proposed changes to the transfer-pricing rules, and the prospect of Canada's participation in a two-pillar plan for international tax reform, as part of the Inclusive Framework on Base Erosion and Profit Shifting established by the Organisation for Economic Co-operation and Development together with the Group of Twenty.

36 *Deans Knight*, supra note 3, at paragraph 50.

37 *Sun Indalex Finance, LLC v. United Steelworkers*, 2013 SCC 6, at paragraph 174.

38 *R v. Rafilovich*, 2019 SCC 51, at paragraph 30.

that is, the substantive rights and obligations created between parties. The 1988 explanatory notes accompanying the original enactment of GAAR stated that the Act is intended to apply to transactions with "real economic substance."[39] The Supreme Court of Canada has explained that this principle operates in the GAAR analysis to recognize that "the provisions of the Act were intended to apply to transactions that were executed within the object, spirit and purpose" of the relevant provisions giving rise to the disputed tax benefit.[40]

In jurisdictions that give priority to economic substance over legal form, the focus is generally not on the purpose of a transaction or whether it is tax-driven, but on whether a series of transactions, taken as a whole, gives rise to an economic result that is different from the results of the legal character of the individual transactions.[41] That is not the case in Canada, and the amendments to GAAR do not create a new alternate reality within the current system. However, these amendments do incorporate a new test at the misuse or abuse stage of the analysis, to assess whether the disputed transactions "significantly" lack "economic substance."[42]

The concept of economic substance is itself capable of various interpretations. Accordingly, the amended GAAR includes three factors that establish that a transaction is significantly lacking in economic substance.[43] Each factor in this non-exhaustive list focuses on the weighting of tax considerations relative to the economic benefit(s) of the transaction(s) in issue. In this regard, the new economic substance test manifestly overlaps with the factors that are necessarily considered at the avoidance transaction stage of the analysis.[44]

39 Canada, Department of Finance, *Explanatory Notes to Proposed Tax Legislation (Bill C-139)* (Ottawa: Department of Finance, June 1988), at 326 (herein referred to as "the 1988 explanatory notes").

40 *Canada Trustco*, supra note 15, at paragraph 56.

41 One such example would be the characterization of rights and obligations arising from a series of transactions as resulting economically in a loan transaction even though the relevant agreements purport to create an equity investment.

42 Bill C-59, supra note 4, section 66(3). The directive to explicitly introduce the concept of economic substance into GAAR originated in the prime minister's office rather than the Department of Finance. In the mandate letter, supra note 5, the minister of finance was instructed by the prime minister to ensure that changes be made to ensure that all taxpayers pay their "fair share" of tax, including by "[m]odernizing the general anti-avoidance rule regime to focus on economic substance."

43 It is not required that all three factors be satisfied for a transaction to be viewed as significantly lacking in economic substance. The test will be met if any enumerated factor is present or, since the list is non-exhaustive, if another undefined factor is present. In addition, the 2023 explanatory notes, supra note 30, clarify that economic substance is "generally" assessed by examining the series, but note that there may be situations where a transaction, or a subset of transactions within the series, should be used to assess economic substance instead.

44 See the definition of "avoidance transaction" in subsection 245(1), and *Copthorne*, supra note 2, at paragraphs 120 to 121. See also the consultation paper, supra note 3, at 22, which concedes that "the avoidance transaction test is, in a sense, a form of economic substance test."

Under the amended GAAR, if a transaction is found to significantly lack economic substance, this will be "an important consideration" that "tends to indicate" that the transaction results in abusive tax avoidance.[45]

It remains to be seen how language such as "significantly lacking," "important consideration," "tends to indicate," and "almost entire" will be interpreted by the courts.[46] However, the 2023 explanatory notes suggest, without legislative support, that if the transaction or series of transactions in issue is found to significantly lack economic substance "the starting point would be that there is a misuse or abuse."[47] This language is troubling, since many related-party transactions may be considered significantly lacking in economic substance, on the basis of the three factors, but would not otherwise be considered to result in a misuse or abuse.

The amended GAAR contemplates that a transaction, or a series of transactions, may be significantly lacking in economic substance without being abusive. However, it is unclear how the economic substance test should interact with the underlying rationale of the relevant provisions, so that courts might determine whether there has been a misuse or abuse in a manner that adheres to, and is consistent with, that rationale. The answer lies in the GAAR analysis itself.

The political desire to incorporate an explicit economic substance test was justified on the basis that courts do not regularly or expressly apply such a test when determining whether an avoidance transaction is subject to GAAR.[48] This concern was evidently animated, in part, by comments made by the Supreme Court in *Canada Trustco*.[49]

When those comments are considered in context, the concern appears unfounded. *In the specific factual context of that case*, the court rejected the Crown's argument that the transactions suffered from a "lack of substance" because that argument amounted

45 Bill C-59, supra note 4, section 66(3).

46 Ibid. One of the factors for establishing a significant lack of economic substance is whether it is reasonable to conclude that the entire, "or almost entire," purpose of the transaction was to obtain the tax benefit.

47 The 2023 explanatory notes, supra note 30, at 329. The prior draft of the proposed amendments to GAAR imposed a rebuttable "presumption" such that if an avoidance transaction was found to significantly lack economic substance, the transaction would be presumed to result in a misuse or abuse. It can be inferred that a deliberate choice was made not to proceed with this approach, suggesting a clear intention that the Crown is to retain the onus of establishing a misuse or abuse.

48 The consultation paper, supra note 3, at 22 (footnotes omitted): "Some cases may suggest that economic substance is a factor that is given weight in GAAR decisions. However, other cases tend to minimize the role and weight accorded economic substance. Moreover, those cases that show some deference to economic substance usually involve some type of attribute duplication, preservation or manipulation and are found to be abusive on that basis. In any event, this limited or *ad hoc* role for economic substance is unsatisfying from a policy perspective." This was also confirmed by the Department of Finance at the 2023 International Fiscal Association round table.

49 In fact, the 2023 explanatory notes, supra note 30, at 332, expressly acknowledge that one of the factors for establishing that a transaction significantly lacks economic substance "is intended to capture situations like that described in the *Canada Trustco* (2005 SCC 54) decision."

to "a narrow consideration of the 'economic substance' of the transaction, viewed in isolation from a textual, contextual and purposive interpretation of the . . . provisions."[50] As to the relationship between "lack of substance" and abuse, the court concluded that a transaction may be considered artificial or to lack substance "with respect to specific provisions of [the Act], if allowing a tax benefit would not be consistent with the object, spirit or purpose of those provisions."[51]

These observations were predicated on the court's careful—and predominantly textual—analysis of how to approach GAAR to "achieve *balance* between the need to address abusive tax avoidance while preserving certainty, predictability and fairness in tax law."[52] The decision in *Copthorne*[53] offered a more sophisticated framework for conducting and emphasizing contextual and purposive interpretation, but it remains the case that considering economic substance "in isolation from the proper interpretation of specific provisions of the Act"[54] would risk disturbing this carefully struck balance.

Despite what is suggested in the consultation paper, the Supreme Court did not ignore economic substance, but instead insisted that it be considered in a manner that aligns with the underlying rationale of the relevant provisions. The same applies to lower courts. For example, in a trilogy of cases involving transactions that "shifted value" from one class of shares to another and resulted in "paper losses,"[55] the Federal Court of Appeal accepted the Crown's argument that the underlying rationale of the relevant loss provisions required the taxpayer to suffer a real economic loss. Since the taxpayer did not, GAAR was held to apply.[56]

Given that the new economic substance test must be applied at the misuse and abuse stage of the GAAR analysis, it cannot be divorced from the otherwise rigorous examination of legislative rationale that is required at this stage. As the Supreme Court has repeatedly cautioned, the analysis must be founded on the provisions involved, lest it turn into "a value judgment of what is right or wrong [or] . . . what tax law ought to be or ought to do."[57]

50 *Canada Trustco*, supra note 15, at paragraph 76.

51 Ibid., at paragraph 60 (emphasis omitted).

52 Ibid., at paragraph 61 (emphasis added).

53 *Copthorne*, supra note 2.

54 *Canada Trustco*, supra note 15, at paragraph 76.

55 *Triad Gestco Ltd. v. Canada*, 2012 FCA 258; *1207192 Ontario Limited v. Canada*, 2012 FCA 259; and *Global Equity*, infra note 81 (FCA).

56 More recently, see *DEML Investments Limited v. The King*, 2024 TCC 27, at paragraphs 42 et seq. More particularly, see *DEML*, ibid., at paragraph 47 (emphasis added), per Russell J: "GAAR, where the applicable OSP has been abused, should prevent a taxpayer from doing indirectly what cannot be done directly. *Applying the GAAR turns on viewing what has actually happened*. Here the substantial Capital Loss was claimed where there was no economic loss or impoverishment."

57 *Copthorne*, supra note 2, at paragraph 70; and *Deans Knight*, supra note 3, at paragraph 63, citing *Copthorne*, ibid.

Leaving aside the non-binding commentary in the 2023 explanatory notes,[58] the new economic substance test cannot distract from the principles articulated in *Canada Trustco* and refined in *Copthorne*.[59] A lack of economic substance is merely a factor in the analysis (as it always was) and should be given weight as determined by the court (as it would in any event). In this way, abusive tax avoidance should be found only where a transaction that is significantly lacking in economic substance is determined to be abusive on the basis that it defeats the underlying rationale of the provisions that confer the tax benefit.[60]

This approach is consistent with the interpretation of GAARs in other countries—for example, the United Kingdom, India, South Africa, New Zealand, and Australia. All of these jurisdictions recognize the relevance of economic reality as a factor in identifying abuse, and do so by referring in either the applicable legislation or the jurisprudence to an economic result, business profits, pre-tax profit, or commercial substance. None of these GAARs automatically equates an absence of economic substance with abuse.[61]

Under the UK GAAR, for instance, the question of whether a tax arrangement is abusive is tested against the "relevant tax provisions": an arrangement is abusive if it cannot be reasonably regarded as a reasonable course of action *in relation to* the relevant tax provisions.[62] Similarly, the New Zealand Supreme Court has held that ascertaining when an arrangement crosses the line from a "permissible arrangement into a tax avoidance arrangement . . . should be firmly grounded in the statutory language of the provisions themselves."[63]

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58 Although permissible, extrinsic aids may contain "self-serving" language that is of little assistance in the interpretive process: *Canada v. Oxford Properties Group Inc.*, 2018 FCA 30, at paragraph 93; rev'g 2016 TCC 204.

59 Helpfully, the Canada Revenue Agency (CRA) has also confirmed in CRA document no. 2024-1008251I7, February 28, 2024, that its "general view is that the conclusions reached in the examples provided in IC 88-2 and IC 88-2 Supplement 1 should remain the same under the amended section 245."

60 *Canada Trustco*, supra note 15, at paragraph 60.

61 For a detailed review of the role played by economic substance in the GAARs of other jurisdictions, see Jinyan Li, "Hallmarks of Abusive Transactions and the Role of Economic Substance: Comments on Modernizing and Strengthening the General Anti-Avoidance Rule Consultation Paper" (2022) (https://digitalcommons.osgoode.yorku.ca/all_papers/345).

62 Finance Act 2013 (UK), 2013, c. 29, part 5, subsection 207. The relevant legislation does not contain an explicit reference to "economic substance." However, in determining whether the tax arrangement in question is abusive, consideration must be given to the means of achieving the tax result sought, and reference must also be made to a non-exhaustive list of examples, all of which are focused on economic substance.

63 *Ben Nevis Forestry Ventures Ltd v. Commissioner of Inland Revenue*, [2008] NZSC 115, at paragraph 104 (footnotes omitted). The court (ibid., at paragraph 109) went on to state that the "ultimate question" in determining the applicability of New Zealand's GAAR "is whether the impugned arrangement, viewed in a commercially and economically realistic way, makes use of the specific provision in a manner that is consistent with Parliament's purpose." Like the UK legislation, the NZ legislation also does not contain an explicit reference to "economic

Considering economic substance as a free-standing requirement, by reference to a non-exhaustive list of hallmarks, and in isolation from the specific provisions at issue, does little to advance the GAAR analysis and risks turning it into a test of fiscal morality, which the Supreme Court of Canada has repeatedly warned against.[64] Economic substance cannot serve as a starting point in every analysis of misuse and abuse, without regard to whether the provisions in issue (for example, tax incentive provisions) contemplate that the disputed transactions would have any meaningful economic effect.

Taking such an approach would "impair the proper interpretation of the relevant provisions in a manner that makes substantive economic connections or the presence of a *bona fide* non-tax purpose a condition precedent to every tax benefit."[65] Instead, the goal should be to ensure that the relevant provisions are properly interpreted on the basis of their text, context, and purpose; and if the provisions themselves reveal the requisite level or amount of substance, the Crown should be required to identify precisely how the lack of economic substance frustrates the underlying rationale of those provisions.

PROVING THE ALLEGED MISUSE OR ABUSE: IMPLICATIONS FOR THE BURDEN OF PERSUASION

In theory at least, the Crown bears the burden in GAAR cases of establishing a clear misuse or abuse.[66] This position has been stated without qualification and repeatedly affirmed.[67] However, in practice, the "burden" has effectively been borne equally by the parties.[68]

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substance." However, on February 3, 2023, the NZ Inland Revenue issued an interpretation statement that included a section on the relevance of the "commercial and economic reality of an arrangement." See New Zealand, Inland Revenue, *Interpretation Statement* IS23/01, "Tax Avoidance and the Interpretation of the General Anti-Avoidance Provisions Sections BG 1 and GA 1 of the Income Tax Act 2007," February 3, 2023 (www.taxtechnical.ird.govt.nz/interpretation-statements/2023/is-23-01).

64 On the role that fiscal morality may play in GAAR cases, see Hon. Donald G.H. Bowman, Deen Olsen, Wayne Adams, Al Meghji, and Wilfrid Lefebvre, "GAAR: Its Evolution and Application," in *Report of Proceedings of the Sixty-First Tax Conference*, 2009 Conference Report (Toronto: Canadian Tax Foundation, 2010), 2:1-23.

65 *Alta Energy*, supra note 7, at paragraph 47.

66 As part of the consultation paper, supra note 3, at 20, the government considered whether to reverse the onus and require taxpayers to both establish the relevant policy and demonstrate affirmatively that there was no misuse or abuse. In response to submissions made by the tax community, the decision was made not to proceed with this reform.

67 See, for example, *Alta Energy*, supra note 7, at paragraph 32; and *Oxford Properties*, supra note 58, at paragraph 113.

68 For example, in *Madison Pacific Properties Inc. v. The King*, 2023 TCC 180, at paragraph 141, the court, in finding that GAAR applied, noted that the appellant should have focused on "explaining why there was no abuse."

In *OSFC*,[69] the Federal Court of Appeal characterized the burden in terms of its practicality. As a legal matter, neither party bore the burden, since it was up to the court to answer a "question of interpretation."[70] But, from a practical perspective, the Crown was obliged to set out the relevant "policy with reference to the provisions of the Act or extrinsic aids upon which [it] relies."[71]

In *Canada Trustco*, the Supreme Court took a slightly different approach. Rather than referring to a practical burden, the court held that the Crown must identify the underlying rationale of the provisions and demonstrate that the provisions were misused or abused by reference to that rationale.[72] The court also confirmed that, for GAAR to apply, the misuse or abuse must be clear.[73]

This standard reflects the understanding that GAAR is a provision of last resort, to be applied only when the Crown can clearly demonstrate the abusive nature of the disputed transactions. In practice, however, each party is called upon to make its own affirmative case:

> As a result, it is not clear how the concept of burden would apply to a question of law. *It is simply a question of how any particular party satisfies the court regarding what the law is in a particular case*—that is, regarding the object, spirit, and purpose of the relevant provision.[74]

The proposition that the misuse and abuse analysis is an entirely legal matter, and that the Crown merely carries a burden of persuasion—as either party would in a non-GAAR case—is conceptually problematic. If a taxpayer is to be taxed by reference to an unwritten rule or some rationale left unexpressed in legislative text, the Crown should be required to express and substantiate the basis for its position and to do so well in advance of trial.[75] If the Crown particularizes its assertions of abuse

69 *OSFC Holdings Ltd. v. Canada*, 2001 FCA 260.

70 Ibid., at paragraph 68.

71 Ibid.

72 *Canada Trustco*, supra note 15, at paragraph 69. Lower courts have also characterized the burden on the Crown as a "burden of persuasion." See *Evans v. The Queen*, 2005 TCC 684, at paragraph 35.

73 *Canada Trustco*, supra note 15, at paragraphs 50 and 69; *Copthorne*, supra note 2, at paragraph 72; *Alta Energy*, supra note 7, at paragraph 33; and *Deans Knight*, supra note 3, at paragraph 69.

74 Hon. Wyman Webb, Hon. Lucie Lamarre, Hon. David Graham, Pooja Mihailovich, Michelle Moriartey, and Matthew Turnell, "Judges' Panel," in *Report of Proceedings of the Seventieth Tax Conference*, 2018 Conference Report (Toronto: Canadian Tax Foundation, 2019), 2:1-25, at 2:20 (emphasis added), per Webb JA.

75 See, for example, *Lark Investments Inc. v. The King*, 2024 TCC 30, at paragraph 57, per St-Hilaire J: "At the risk of repeating myself, I would say that the interested reader should not have to trace their own path between the factual underpinnings and [other portions of the reply] to know exactly what the Respondent's position is as to why there is abuse or misuse in this case." In disposing of the motion in issue, the court struck a portion of the reply, with leave to amend, on the basis that it could prejudice the fair hearing of the appeal and was an abuse

for the first time in oral argument, the taxpayer is left with a limited opportunity in advance of trial to truly appreciate the case against it, and insufficient time at trial to marshal a sufficiently robust response. The difficulty with this approach is also compounded by the fact that, as discussed further below, a taxpayer may now be penalized if GAAR is found to apply.

As the Supreme Court has observed, *evidence* concerning the purpose of a provision (that is, Parliament's intent at the time of enactment) is necessary to enable the court to determine what Parliament was trying to achieve.[76] In a GAAR case, it is the Crown, forming part of the corpus of the state, that has comparatively more knowledge of the relevant statutory scheme and should be in a better position to establish, as an evidentiary matter, what is intended.

Taxpayers are tasked with familiarizing themselves with the detailed rules in the Act and filing a return on a basis that complies with those rules. In a GAAR case, the Crown's task is to explain why, and how, strict compliance with the rules is insufficient to allow the consequences mandated by them. To effectively put the taxpayer to the task of both making the Crown's case and defending against it is antithetical to the rule of law, the self-reporting nature of the tax regime, and the adversarial system.

Given the serious reputational consequences that flow from litigating a GAAR assessment, and the potential monetary implications of both the assessment itself and the associated penalty, the Crown should be held to its burden in real terms, and the courts should be reluctant to make any finding of abuse without a sound evidentiary foundation for doing so.[77]

MAKING IT CLEAR: IMPACT OF A PENALTY ON THE THRESHOLD FOR A FINDING OF MISUSE OR ABUSE

Under the amended GAAR, a substantial monetary penalty may be assessed where GAAR is held to apply.[78] The introduction of a penalty is a significant shift in the

of process. The court emphasized that the Crown "must state the reasons they intend to rely on as required by paragraph 49(1)(h) of the [Tax Court] Rules. They did not, at least certainly not clearly and without the Appellant having to forge its own path to get there." Ibid., at paragraph 60.

76 *Canada v. Loblaw Financial Holdings Inc.*, 2021 SCC 51, at paragraph 54.

77 On this point, it has also been suggested that the government should improve the communication of its legislative and regulatory objectives so that courts can better understand the circumstances that led to the enactment of particular tax provisions. See, for example, Steve Suarez, "GAAR Two Years Later" (2024) 5:1 *Perspectives on Tax Law & Policy* 4-6; and Pooja Mihailovich, "Words Matter: The Limits of Purposive Interpretation," in Pooja Mihailovich and John Sorensen, eds., *Tax Disputes in Canada: The Path Forward* (Toronto: Canadian Tax Foundation, 2022), 1:1-32, at 1:28-29.

78 Bill C-59, supra note 4, section 66(4). The penalty is 25 percent of the tax benefit denied. It can be avoided if the taxpayer voluntarily discloses the transactions in advance. A taxpayer may also be able to avoid the new penalty under a token "due diligence" exception if it can demonstrate

operation of GAAR. It was previously well understood that GAAR was not a penal provision and that taxpayers could not self-assess under GAAR. Given the potential for a penalty, the question arises: What impact will this have on the threshold for finding that there has been a misuse or abuse?

In applying GAAR, it is taken for granted that both the underlying rationale of the provisions in issue and the alleged abuse must be clear. In practice, however, there remain vastly different approaches to determining whether these tests have been met in any given case.

In determining whether the alleged rationale exists, courts have relied on various extrinsic aids, but without any measurable degree of consistency or clear direction as to the weight that should be given to the different aids. Materials offered in evidence have included judicial statements, Hansard, ministerial or departmental statements, explanatory notes, texts, and periodicals.[79] In some cases, courts have found clear abuse primarily by relying on academic literature and an analysis of the provision itself.[80] In other cases, the Crown has failed to meet this burden without offering the court more.[81]

The current diversity in approach has led to uncertainty in the degree to which courts at various levels have required the Crown to discharge its burden. This uncertainty is particularly noticeable where trial decisions finding no clear abuse have been overturned on appeal or where there is a dissenting opinion from an appellate court on whether there has been misuse or abuse. If the abuse must be clear, any decision in which abuse has been found should rarely be overturned on appeal or result in a dissent.

Also, in considering whether the Crown has met its burden, a court should be guided by a consistent standard. One such standard is followed, for example, by the Department of Finance in proposing retroactive clarifying changes, namely, where

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that the transaction was, at the time it was undertaken, "identical or almost identical" to a transaction that was the subject of administrative guidance, government statements, or court decisions. The purpose and utility of this exception are questionable, since it is highly unlikely that GAAR, and thus the penalty, would have applied to such transactions in any event. The 2023 explanatory notes, supra note 30, at 340, also state that this exception is not meant to replace any other defences that may be available. This position is consistent with jurisprudence that establishes that taxpayers are entitled to assert a due diligence defence, whether or not there is language permitting such a defence: *Corporation de l'École Polytechnique v. Canada*, 2004 FCA 127, at paragraphs 27 and 28; and *Home Depot of Canada Inc. v. The Queen*, 2009 TCC 281, at paragraphs 12 and 13.

79 *Canada Trustco*, supra note 15, at paragraph 55. See also, for example, *Lehigh Cement*, supra note 22, at paragraph 32; and *Deans Knight*, supra note 3, at paragraph 104, where the majority relied on the observations of a politician to ground its conclusion regarding abuse.

80 See, for example, *Loblaw Financial*, supra note 76.

81 See, for example, *Global Equity Fund Ltd. v. The Queen*, 2011 TCC 507; rev'd 2012 FCA 272 (because the Crown alleged on appeal that different provisions had been abused and raised new arguments).

the existing policy can be "easily deduced" from the provision or is "well-known and understood" by taxpayers:

> Retroactive clarifying changes may also be appropriate to counteract a literal interpretation of a legislative provision that would produce a result that is clearly contrary to the underlying policy. *This should only be the case, however, to the extent that the policy can be easily deduced from the relevant provisions or where it may reasonably be considered that the policy is well-known and understood by the taxpayers.* Where this is the case, the taxpayers should not legitimately expect to obtain the benefits of an interpretation that would run contrary to the policy.[82]

Given the judicial experience to date, this may be viewed as a lofty goal in the GAAR context. But, just as a provision may be amended retroactively to give effect to its existing policy only if the amendment is intended to clarify rather than alter that policy, it is arguable that GAAR should be invoked to override the tax consequences of a provision only if the underlying rationale of that provision is palpably evident. This is particularly the case following the enactment of the amendments, given the potential for a substantial penalty if GAAR is held to apply.

The situations in which penalties are applied typically involve objective facts and actions that are within the taxpayer's control. By contrast, at the heart of any GAAR case is a debate about the underlying rationale of complex statutory schemes. As the consultation paper recognizes, the Crown itself has struggled to clearly establish the underlying rationale of relevant provisions in many instances.[83] This struggle is borne out in the jurisprudence: in some cases, the Tax Court has found there to be no clear underlying rationale or abuse, while the Federal Court of Appeal has come to the opposite conclusion on both points.[84]

The application of GAAR can often amount to an exercise in which reasonable minds may differ with respect to the outcome. It is questionable whether there is any place for a penalty in such cases—although, admittedly, the penalty provision is likely animated by the hope that it will realign taxpayer risks and incentives. Be that as it may, the very potential for a penalty should cause courts to apply greater consistency in the approach to the determination of misuse or abuse, and to insist on a high standard for finding clear abuse.

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82 Canada, Department of Finance, *Comprehensive Response of the Government of Canada to the Seventh Report of the Standing Committee on Public Accounts* (Ottawa: Department of Finance, September 1995), at 16 (emphasis added).

83 The consultation paper, supra note 3, at 15.

84 For example, in *Oxford Properties*, supra note 58, the Tax Court found that none of the three provisions at issue had been misused or abused, and the Federal Court of Appeal found that all three provisions had been abused. This was the first GAAR case in which the Tax Court concluded that the Crown had not provided clear support for its assertions of unexpressed legislative policy and the Federal Court of Appeal found otherwise.

For instance, in *Lehigh Cement*, the Federal Court of Appeal chastised the Crown for advancing a position that was not grounded in the Act or the jurisprudence, but was "an echo of a sentence in the budget paper released by the Department of Finance."[85] In that case, the Crown cited numerous articles that discussed the scope of the provision, but the court found that those publications said nothing about the policy underlying the enactment of the provision, except to repeat what the budget paper had said. In the court's view, this evidence was a "shaky foundation" for a GAAR assessment.[86]

It is evident that perceptions of legislative intent can differ markedly from person to person and from court to court. It follows that the question should not be what a tax official or, for that matter, a judge ascertains the underlying rationale to be years after the fact. The proper perspective is that of the time when the relevant transactions were undertaken. Moreover, the underlying rationale must have been objectively ascertainable at that time and sufficiently clear for the taxpayer to appreciate.

CONCLUDING OBSERVATIONS

The Supreme Court of Canada has consistently recognized that, absent a clear framework for the principled application of GAAR and a high threshold for demonstrating misuse or abuse, GAAR could devolve into a discretionary provision, undermining the certainty that must underpin the proper functioning of the tax system.

Taxpayers need to understand at the time of undertaking transactions whether, and in what circumstances, the minister may deny the associated tax benefits. This is not an unrealistic expectation, particularly given that a GAAR assessment can now result in a substantial penalty. Moreover, if taxpayers may now be penalized for failing to land on the right side of a debate that routinely confounds the courts,[87] it behooves the minister to detail in precise terms both the underlying rationale in issue and the basis for alleging misuse and abuse. The courts, in turn, must conduct a thoroughly objective and analytically robust examination, and apply a consistent and clearly defined standard against which any alleged misuse or abuse must be measured.

GAAR is intended to be a backstop for the minister where Parliament has failed to legislate explicitly or to be sufficiently precise in formulating legislative text. With the addition of a penalty and the lowering of various thresholds in the different steps of the GAAR analysis, GAAR will continue to serve as a deterrent to taxpayers who may otherwise undertake planning that is viewed as aggressive. Nevertheless, courts should continue to exercise restraint in applying this provision, lest the basis for its application devolve into a social fairness analysis that is neither rigorous nor principled.

85 *Lehigh Cement*, supra note 22, at paragraph 32.

86 Ibid., at paragraph 35.

87 As the consultation paper, supra note 3, at 17, acknowledges, "the interpretive process is a difficult one for taxpayers, advisors, the CRA and the courts."

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Policy Forum: Rethinking GAAR—Back to Basics

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PRÉCIS

À première vue, les récentes modifications de la règle générale anti-évitement (RGAE) du Canada ont pour effet d'élargir la portée de cette dernière afin de la rendre applicable à un plus grand nombre de stratégies d'atténuation fiscale. Toutefois, des développements survenus en Australie, où est née la RGAE moderne, et la jurisprudence canadienne donnent à penser que l'incidence des modifications pourrait être limitée. Plus particulièrement, l'extension de la RGAE aux conventions dont l'atténuation fiscale n'est pas nécessairement l'objectif premier de l'opération, mais seulement l'un des principaux objets, pourrait s'avérer impraticable. En définitive, l'objet d'une opération est un facteur subjectif, peu importe les indicateurs objectifs considérés, et le contribuable est la seule personne capable d'évaluer l'objet véritable d'une convention. Il va également de soi que l'atténuation fiscale n'est l'objectif que de certaines étapes d'une convention commerciale, et si le contribuable peut remplacer l'investigation des opérations en litige par la convention commerciale élargie — vente d'un actif, emprunt, etc. — le principal objet sera presque toujours un objectif commercial légitime.

Surtout, un examen de la jurisprudence australienne et canadienne montre que les tribunaux font invariablement une distinction entre les conventions qui sont implicitement approuvées par le législateur et celles qui s'écartent clairement des possibilités envisagées par le Parlement, ne permettant l'application de la RGAE qu'à ces dernières. Par exemple, si le législateur et les autorités fiscales permettent aux contribuables de traiter des contrats de location-financement comme des contrats de location-exploitation, les tribunaux n'autorisent pas les autorités fiscales à utiliser la RGAE pour arrêter une exploitation déraisonnable du mythe légal. Si le législateur offre des crédits d'imputation sur les dividendes et que des contribuables structurent leur financement pour profiter de cet avantage, les tribunaux n'interviennent pas pour y restreindre l'accès lorsque le législateur n'a pas imposé de limites prescrites par la loi. À l'inverse, si le législateur a établi des règles claires et sans équivoque sur le transfert de pertes, les tribunaux autorisent les autorités fiscales à utiliser la RGAE pour rejeter les conventions qui cherchent à contourner ces règles.

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L'expérience montre que les tribunaux sont fortement disposés à autoriser l'utilisation de la RGAE comme rempart contre les cas où des contribuables élaborent des structures qui abusent, par l'intermédiaire de conventions sophistiquées, de concessions de la loi dans le but d'étendre ces concessions bien au-delà des conventions auxquelles elles étaient destinées. Toutefois, les tribunaux n'autorisent pas le gouvernement à utiliser la RGAE comme une arme pour étendre, grâce à des failles ou des erreurs de la loi, une obligation fiscale aux conventions qui sont clairement exclues. Le message des tribunaux est sans équivoque : si la loi ou un traité contient une erreur, celle-ci doit être corrigée au moyen d'une modification et non grâce à la RGAE.

En résumé, l'apparente refonte de la RGAE canadienne pourrait ne s'avérer qu'une tempête dans un verre d'eau et avoir une incidence faible, voire inexistante, sur l'issue des litiges.

ABSTRACT

Recent changes to Canada's general anti-avoidance rule (GAAR) on their face broaden the scope of GAAR, making it applicable to more tax-minimization schemes. However, developments in Australia, home of the modern GAAR, and case law in Canada suggest that the impact of the changes may be limited. In particular, the extension of GAAR to arrangements where tax minimization is not necessarily the primary objective of the transaction but merely one of the main purposes may prove to be unworkable. The purpose of a transaction is ultimately a subjective factor, whatever objective indicators are considered, and the only person able to assert the true purpose of an arrangement is the taxpayer. Equally obvious is the reality that tax minimization is the goal of only some steps in a commercial arrangement, and if the taxpayer can replace the investigation of the impugned transactions with the broader commercial arrangement—sell an asset, borrow money, and so forth—the main purpose will almost always be a legitimate commercial goal.

More significantly, an examination of Australian and Canadian case law reveals that the courts consistently make a distinction between arrangements that are implicitly endorsed by the legislature and those that clearly fall outside possibilities contemplated by Parliament, allowing GAAR to apply only in the latter cases. For example, if the legislature and tax authorities allow taxpayers to treat finance leases as operating leases, the courts will not permit tax authorities to use GAAR to stop an egregious exploitation of the legal myth. If the legislature provides imputation credits for dividends and taxpayers structure financing to enjoy the benefit, the courts will not step in to restrict access where the legislature has not imposed statutory limits. Conversely, if the legislature has set out clear and unambiguous rules on when losses can be transferred, courts will allow tax authorities to use GAAR to strike down arrangements seeking to bypass those rules.

Experience shows the courts are quite willing to allow the use of GAAR as a shield where taxpayers devise schemes that abuse concessions in the law through contrived arrangements that seek to extend the concessions to arrangements far from those for which the concessions were intended. The courts will not, however, allow the government to use GAAR as a sword to extend tax liability to arrangements that are clearly excluded through gaps or errors in the law. The message from the courts is unambiguous: if a mistake was made in the law or a treaty, it should be fixed by way of amendment, not GAAR.

In short, the apparent overhaul of the Canadian GAAR may prove to be little more than a tempest in a teacup with little and perhaps no impact on dispute outcomes.

KEYWORDS: GAAR ■ STATUTORY INTERPRETATION ■ PURPOSE ■ AVOIDANCE

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INTRODUCTION

More often than not, speed is of the essence as the government of the day tables tax legislation in Parliament to quickly close an exposed loophole, grant a politically opportune concession, or pursue economic or social-planning objectives with what it hopes are sufficiently targeted tax expenditures. The generous consultation and discussion period provided for proposals for reform of Canada's general anti-avoidance rule (GAAR) has offered a useful and rare opportunity to consider the fundamental elements of the rule and what the amendments can accomplish.

While GAARs have a history dating back to the 19th century,[1] modern "Anglo" GAARs are relatively recent phenomena, beginning with New Zealand's GAAR in 1974 and the modern Australian GAAR in 1980 (replacing one that had been in place since the adoption of income taxation at the federal level in 1915), which in turn influenced the design of the subsequent Canadian GAAR in 1988, the replacement South African GAAR in 2006, and finally the United Kingdom's GAAR in 2013.[2] Tax authorities in all jurisdictions generally welcomed the adoption of a new and seemingly more rigorous GAAR that could be, and no doubt is, invoked in almost all disputes as a threat and a negotiating tool. However, the various measures have generated relatively little case law, considering their potential reach. Only seven disputes considering the GAAR's application to avoidance arrangements have reached the highest court in Australia since the adoption more than 40 years ago of the world's most comprehensive and detailed general anti-avoidance provision that influenced the design of almost all subsequently enacted GAARs.[3]

1 Craig Elliffe, "New Zealand's General Anti-Avoidance Rule—A Triumph of Flexibility over Certainty" (2014) 62:1 *Canadian Tax Journal* 147-64.

2 The Australian, NZ, Canadian, and UK GAARs are compared in John Gaetano Tretola, "Trending Towards Convergence" (2020) 15:1 *Journal of the Australasian Tax Teachers Association* 40-66.

3 An eighth case, *Deputy Commissioner of Taxation v. Richard Walter Pty Ltd* (1995), 183 CLR 168, considered the interaction of GAAR assessments and other procedural rules, but not the substantive reach of Australia's GAAR.

The concerns of taxpayers, tax practitioners, and tax scholars over the role of a GAAR are well documented.[4] A GAAR applies in an arbitrary and unfair manner, affecting only those taxpayers that are identified in an audit, while all others that have engaged previously in similar arrangements escape the application of the rule. A GAAR encourages further tax-avoidance arrangements by providing signposts for the factors that will bring a particular arrangement within the scope of the measure or help it to escape the application of the rule. Finally, and most significantly, the crucial trigger for the application of a GAAR to a tax-effective transaction is a wholly subjective factor ultimately known only to the taxpayer—the taxpayer's subjective purpose for engaging in the transaction. Until the recent enactment of Canada's GAAR amendments,[5] the Canada Revenue Agency (CRA)—like its counterparts in other jurisdictions—could replace the tax liability from the arrangement that was used with the tax liability that would have followed from a hypothetical transaction that was not used only if tax avoidance accounted for more than 50 percent of the purposes for adopting the transaction that was used. The amendments change this test to apply GAAR if tax avoidance was "one of the main purposes" of an arrangement. The possible implications of this change are discussed further below.

GAARs are not new, and there is a wealth of case law in common-law jurisdictions that can provide some clues as to how courts draw the line between acceptable and unacceptable tax planning. An examination of key decisions in Canada and Australia suggests that taxpayers and their advisers may be looking in the wrong direction for the purpose that matters when determining whether GAAR may deny a tax benefit resulting from a tax-effective transaction. Instead of focusing on the subjective intention of the taxpayer engaging in the transaction, they should perhaps consider the legislature's intention in providing alternative tax outcomes for complex arrangements undertaken for legitimate commercial reasons.

In every case of tax avoidance, as opposed to tax evasion, the taxpayer followed a legal path that the legislature intended to be available in some circumstances and not others. The real question considered by the courts might be whether Parliament intended to make the option used by the taxpayer available in the circumstances of the taxpayer's arrangements. None of the amendments to Canada's GAAR will affect this process, nor are they likely to have more than an insignificant impact on the potential application of the provision.

4 These are summarized in Richard Krever, "General Report: GAARs," in Michael Lang, Jeffrey Owens, Pasquale Pistone, Alexander Rust, Josef Schuch, and Claus Staringer, eds., *GAARs—A Key Element of Tax Systems in the Post-BEPS World* (Amsterdam: International Bureau of Fiscal Documentation, 2016), 1-20.

5 The GAAR amendments were incorporated into the Income Tax Act (RSC 1985, c. 1 (5th Supp.), as amended) by the passage of Bill C-59, An Act To Implement Certain Provisions of the Fall Economic Statement Tabled in Parliament on November 21, 2023 and Certain Provisions of the Budget Tabled in Parliament on March 28, 2023, enacted by SC 2024, c. 15; royal assent June 20, 2024.

TAX LIABILITIES BASED ON SUBJECTIVE INTENT?

A general *anti-avoidance* rule, as the name signifies, is intended to counter tax avoidance. It does so by substituting for the tax liability imposed on a taxpayer as a consequence of an arrangement subject to GAAR a (higher) tax liability based on a hypothetical transaction (or series of transactions) that the taxpayer could have undertaken instead of the arrangement actually used. Whether GAAR will apply or not turns, as noted, on the taxpayer's purpose in adopting the path disputed by the tax authority.

In many tax systems, it would strike observers as odd that tax liability should depend on the purpose of a taxpayer when entering into a transaction. Observers in jurisdictions that equate the rule of law with objective rules and clearly established legal boundaries might balk at a system where liability could be based on a taxpayer's subjective intent, but this odd approach to defining the tax base is a fundamental feature of the Canadian tax system and, for that matter, almost all Anglo tax regimes apart from that of the United States.[6] For example, in the early days of income tax jurisprudence, American courts concluded that the term "income" had a simple objective meaning—a realized increase in wealth—thus catching gains of all sorts, from true happenstance windfalls to ordinary returns for investment, business, or labour. In contrast, Anglo courts outside the United States adopted the UK interpretation of "income" in tax law, concluding that the legislature intended the term to have the same meaning that it had in pre-income-tax trust law, describing the gains that would be distributed to life or income beneficiaries as opposed to those to which remainder or capital beneficiaries were entitled.

The interpretive technique of borrowing the meanings of terms in tax law from their meanings in other, and older, fields of law (famously labelled the "fallacy of the transplanted doctrine" by Neil Brooks)[7] is, of course, not limited to the definition of income. For example, the common-law test for determining whether the provider of labour services is an "employee" for income tax purposes is lifted directly from much earlier vicarious liability law. But unique to the judicial concept of "income" is the role of the taxpayer's subjective state of mind in determining the character of gains. The trust-law tests used to identify income gains transposed to the income tax are based on both features of amounts received (anticipated and

6 While all Anglo jurisdictions have adopted the UK common-law system, there is a distinction between the United States, which developed its own interpretation techniques and definitions of tax-law concepts, and other Anglo jurisdictions that followed UK interpretation doctrines and definitions developed by UK courts based on the UK tax-law statutes because of both deference toward UK courts and the fact that the Privy Council was the final court of appeal for former colonies, apart from the United States, long after independence. (The final Privy Council decision on Canadian law was rendered in 1959.)

7 Neil Brooks, "The Responsibility of Judges in Interpreting Tax Legislation," in Graeme S. Cooper, ed., *Tax Avoidance and the Rule of Law* (Amsterdam and Sydney: International Bureau of Fiscal Documentation and Australian Tax Research Foundation, 1997), 93-129, at 122.

periodic) and the taxpayer's purpose in acquiring property or entering into an arrangement. Under Canada's tax system, if property were acquired as an investment to generate current income, the gain realized on its disposal would be a capital gain, completely free of income tax prior to 1972 and partially exempt since that time. If, on the other hand, property were acquired as inventory or for the purpose of resale at a profit or for use in an adventure in the nature of trade, the same gain on disposition of the property would be an income gain.

A tax-avoidance *purpose* threshold is common to all Anglo GAARs. The UK and Scottish GAARs characterize an arrangement as an unacceptable tax-avoidance transaction if one of the "main" purposes of the transaction is to reduce a tax liability.[8] The South African GAAR uses a "sole or main purpose" test.[9] The previous version of the Canadian GAAR had a similar threshold, characterizing an arrangement as a prohibited tax-avoidance transaction if it was not done "primarily" for reasons other than to reduce a tax liability.[10] Similarly, the Australian legislation refers to the "dominant" purpose of the arrangement.[11] New Zealand's GAAR appears to have a lower threshold: a tax-avoidance purpose that is greater than "merely incidental" to the purposes of the transaction.[12] Also, it refers to either the purpose or the "effect" of the transaction. An alternative "effect" test is also found in the GAAR included in Australia's goods and services tax (GST) statute.[13]

The new Canadian test to identify transactions subject to GAAR—transactions in which tax avoidance is "one of the main purposes"[14]—is unique and, on its face, unworkable. In all constructions creating a tax-avoidance purpose cutoff for the operation of GAAR, the implied threshold for terms such as "main," "dominant," or "primary" is a purpose greater than 50 percent of all the purposes. By definition, a collection of purposes can at best have only one main purpose. There is, however, precedent for an alternative interpretation for the phrase in tax law, one that equates "main" with "more important than some others," as is the case in phrases such as "a main road." According to this interpretation, "one of the main purposes" is understood to mean one of a number of purposes that are more important than other (perhaps many other) purposes.[15]

8 Finance Act 2013 (UK), 2013, c. 29, section 207; Revenue Scotland and Tax Powers Act 2014, section 63.

9 South Africa, Income Tax Act 1962, section 80A.

10 Subsection 245(3) of the Income Tax Act, supra note 5, as it read prior to the enactment of the amendments.

11 Australia, Income Tax Assessment Act 1936, No. 27, 1936, section 177A(5).

12 New Zealand, Income Tax Act 2007, 2007 No. 97, section YA1, definition of "tax avoidance arrangement."

13 Australia, A New Tax System (Goods and Services Tax) Act 1999, section 165-5.

14 Subsection 245(3) of the Income Tax Act as amended by Bill C-59, supra note 5.

15 *Groupe Honco Inc. v. Canada*, 2013 FCA 128.

This interpretation will validate the technical construction of the new measure but does not address a broader conceptual issue: How narrow can an arrangement be considered to be when evaluating the main purposes of the transaction? The same issue arises in respect of a tax-avoidance effect test. On its face, an objective effect threshold appears to offer advantages over a less certain subjective purpose threshold ultimately based on aims known only to the taxpayer, even if the legislators indicate what sort of factors can be considered when evaluating the taxpayer's purpose.[16] Tax administrators, at least, should appreciate the certainty of an objective tax, though taxpayers may see advantages in a game in which they hold all the subjective cards.

In practice, however, the desired certainty of an objective tax-avoidance effect test can prove to be little more than a chimera in the mind of the legislative drafter. Taxpayers enter into tax-avoidance arrangements to minimize the tax liability resulting from a commercial transaction. In terms of the broader arrangement, the effect (and main purpose) of any tax-avoidance arrangement is attainment of a legitimate commercial objective, not a tax objective. The tax aspect of the arrangement is limited to the secondary goal of maximizing after-tax returns or minimizing after-tax expenses in the commercial transaction.

Thus, taking examples from Canadian case law, the ultimate purpose of the taxpayer in *Canada Trustco*[17] was to borrow money from a lender and pay the lowest interest rate available. The taxpayer in *Copthorne Holdings*[18] wished to consolidate lower-tier companies and recover funds that could be better invested elsewhere. The respective taxpayers in *Deans Knight*[19] and *MacKay*[20] wanted to sell loss-making subsidiaries for the highest price possible. The taxpayer in *Lipson*[21] wanted to borrow money from a bank to buy a house. If GAAR were triggered by a tax-minimization purpose, almost every GAAR case would fail the test provided that the taxpayer was allowed to present the impugned arrangement as the actual commercial transaction from beginning to end. The same is true of a main effect test. Like the purpose test, the effect test can be applied in favour of the tax authority only if the arrangement is dissected into its separate steps, and the test is applied to the intermediary steps that have no explanation other than the minimization of tax in the larger commercial transaction.

Will the shift to a "one of the main purposes" test be effective to overcome the overall purpose conundrum where the arrangement, taken as a whole, is intended to achieve an observable commercial objective? It may not. There is no doubt that

16 The Australian GAAR, for example, provides an extensive list of factors that can be considered when determining whether the provision applies to a transaction; see Income Tax Assessment Act 1936, supra note 10, section 177D.

17 *Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54.

18 *Copthorne Holdings Ltd. v. Canada*, 2011 SCC 63.

19 *Deans Knight Income Corp. v. Canada*, 2023 SCC 16.

20 *Canada v. MacKay*, 2008 FCA 105.

21 *Lipson v. Canada*, 2009 SCC 1.

the test eases the task of tax authorities in satisfying the GAAR requirements if the inquiry can be narrowed to the intermediary steps used to minimize tax en route to the larger commercial objective. The tax-minimization manoeuvres incorporated into the intermediary steps will not be considered, however, if the taxpayer is able to shift the focus to the purpose of the overall transaction. At the end of the day, whether a court chooses to consider intermediary or ultimate objectives may turn, not on the taxpayer's purpose, but rather on an unstated factor, the legislature's intention.

WHOSE PURPOSE MATTERS: THE TAXPAYER'S OR THE LEGISLATURE'S?

Crucial to an understanding of the judicial reasoning process is an appreciation of the tax-law feature that underlies all tax-minimization arrangements: tax legislation that offers taxpayers a number of options for different tax treatments of different legal arrangements that yield identical economic outcomes. Common to cases in which the courts approve arrangements as acceptable tax-planning exercises and cases in which the arrangements fall afoul of GAAR are different options in the tax legislation that attract different tax burdens. If both acceptable and non-acceptable arrangements reflect taxpayers' deliberate choices of lower-tax options, can it really be the taxpayer's purpose that triggers the application of GAAR?

Consideration of the key decisions in Canada and Australia (the home of the modern GAAR) suggests that taxpayers and their advisers may be looking in the wrong direction for the purpose that really matters when determining whether GAAR will permit a reconstruction of a tax-effective transaction for tax purposes. Rather than searching out the subjective intention of the person orchestrating the transaction (the nominal test set out in the law), they may be better advised to look to Parliament's purpose in providing alternative tax outcomes for complex multi-step arrangements that are intended to achieve legitimate commercial ends. Without exception, in cases involving tax avoidance (as opposed to tax evasion), the taxpayer chose a legal option that the legislators intended to be available in some circumstances and not others. The proper question to be considered by the courts might be whether Parliament intended to make the option used by the taxpayer one that could be available in the circumstances of the taxpayer's arrangements.

Parliamentary intent can be explicitly stated through boundaries set out in the law or implied through non-action in response to interpretations followed by the courts or the tax authority. The taxpayer in *Copthorne Holdings*[22] failed in its endeavour to avoid GAAR when it was shown that Parliament had adopted specific anti-avoidance measures to limit the circumstances in which funds could be withdrawn from a company free of tax. Unlike the corporate tax provisions in some jurisdictions, Canada's Income Tax Act[23] provides no ordering rules to characterize company distributions

22 Supra note 18.

23 Income Tax Act, supra note 5.

as taxable distributions of retained profits or tax-free returns of after-tax contributions to paid-up capital. The Act does, however, have rules that seek to establish strict boundaries to what can constitute paid-up capital, and it could be shown that the taxpayer's arrangements in *Copthorne Holdings* were intended to circumvent those rules and bypass parliamentary intent. The Supreme Court of Canada, not surprisingly, applied GAAR to cancel the taxpayer's attempt to make double use of the same paid-up capital.

The taxpayers in *Deans Knight*[24] and *MacKay*[25] were unsuccessful for similar reasons. Parliament has enacted measures to allow the use by profitable businesses of tax losses transferred by way of a sale of a loss company in limited and defined circumstances. The owners of loss companies and prospective purchasers, including the taxpayers in *Deans Knight* and *MacKay*, entered into a series of transactions intended to circumvent the bright lines set by the legislature and provide the taxpayers with an opportunity to utilize the transferred losses in a transaction that fell outside the scope of legislatively acceptable transfers. Unsurprisingly, the courts were sympathetic to the government's argument that the transfers fell afoul of GAAR.

There are a number of Australian cases that illustrate a similar approach to the application of GAAR outside Canada when courts face contrived and artificial arrangements adopted in an attempt by taxpayers to shift an arrangement that would be subject to less generous tax treatment to one that notionally appears to qualify for preferential treatment offered by the legislature through alternative tax rules.

One example is the decision of the Australian High Court (Australia's final court of appeal) in *Spotless*.[26] This case involved a taxpayer that had entered into a series of transactions to route a deposit into an Australian bank through a foreign tax haven to take advantage of an exemption then in place for foreign-source income. Long before the case reached the High Court (where the Australian Taxation Office [ATO] succeeded using GAAR), the government had realized that the foreign-source income system was not sustainable, and the exemption regime had been replaced with a conventional foreign tax credit system. However, at the time of the transaction in dispute, the legislation provided two clear alternatives: an investment in Australia would yield taxable income, and an investment abroad subject to the lowest foreign withholding tax would yield income exempt from Australian taxation. Indeed, it is likely that a better-planned arrangement would have been successful, but the blatant round-tripping in the case, as the funds quickly moved from the tax haven and were fully secured by a deposit by the scheme organizers in a large Australian bank in Sydney, ultimately proved fatal to the taxpayer. The audacity of the scheme alone likely triggered the decision in favour of the ATO.

24 Supra note 19.

25 Supra note 20.

26 *Federal Commissioner of Taxation v. Spotless Services Ltd.* (1996), 186 CLR 404.

The High Court applied a similar approach in its decision in *Peabody*,[27] a case in which the contrived nature of the arrangements would have torpedoed the tax scheme but for a fatal mistake by the ATO. The taxpayer in *Peabody* floated a very successful private company on the stock exchange. The taxpayer had acquired its initial tranche of shares long before the float, but most of the shares that it held had been acquired within a year of the float. At the time, short-term capital gains (realized on property acquired within a year of disposition) were fully taxed, and long-term capital gains were exempt from tax. Prior to the float, the taxpayer arranged for the company to alter the rights attached to the newly acquired shares so that all of their value was transferred to the shares that had been held for many years, shifting the taxable capital gains that would have been realized on the sale of the new shares to the tax-exempt gains realized on the sale of the old shares.

As it turned out, the taxpayer was successful in its bid to dispute the application of GAAR, not because it was able to show that the tax-avoidance scheme fell outside the reach of GAAR, but rather because the ATO was unable to show that it had assessed the correct person in its reconstruction. The shares were held through a discretionary trust, and the ATO attributed the gains to one of the potential beneficiaries under the trust deed. The court concluded that there was no certainty that the gain would go to that person if the transaction were unwound and reconstructed so that the sale by the discretionary trust generated taxable gains. But for the ATO's choice of taxpayer to assess, it seems clear that the court would have concluded that the arrangement had been defeated by GAAR, since the legislature had drawn a clear distinction between the tax treatment of short-term capital gains and the tax treatment of long-term capital gains, and the gains in this case were attributable solely to the increase in value of recently acquired assets. The decision prompted a change to the capital gains tax rules so that value shifts are now treated as a capital gains realization event.

A third Australian example of a case in which the artificial and contrived nature of the arrangements led the court to reject the taxpayer's attempt to achieve a preferential tax treatment seemingly permitted by the law is the High Court decision in *Hart*.[28] That case involved a taxpayer and his spouse who sought a mortgage loan to purchase a new house but wanted to retain their existing house as an investment property. They entered into an arrangement marketed by a bank as a "wealth optimizer" loan—essentially, two loans bundled together, with the equity in one property allowing for a much more leveraged loan on the other property. The arrangement provided for a loan on what became the investment property equal to much of its market value and a far less leveraged loan secured on the new family home. Under the wealth optimizer contract, the investment property loan was structured as an interest-only loan that provided for interest payments to be capitalized and added to the principal so long as the bank's security in the couple's new residential property

27 *Federal Commissioner of Taxation v. Peabody* (1994), 181 CLR 359.

28 *Federal Commissioner of Taxation v. Hart* (2004), 217 CLR 216.

grew through their gradual repayment of that loan. All payments to the bank were accordingly directed to the home loan.

The alternative to the impugned arrangement would have been for the taxpayer to take separate loans for the investment property and the family home, with the investment loan being extremely highly leveraged, with interest payments only and with interest being compoundable over an extremely long period. Crucial to the decisions of the first instance court, the appeal court, and the High Court was the finding that the taxpayer could not have found a loan with such favourable conditions outside the tied-loan arrangement marketed by the bank. In other words, but for the arrangement that shifted much of the interest on the borrowed funds to the investment loan, the taxpayer would have held an investment loan with much lower deductible interest payments and a home loan with much higher non-deductible interest payments. Had a commercially valid arrangement been available that offered similar tax benefits, all three courts would likely have found that GAAR had no application to the taxpayer's arrangement. GAAR applied because of the artificiality of the arrangement: apart from the tax benefit provided by the arrangement, there would have been no rationale for the tied loans, and no financial institution would have offered the investment loan on these terms without the security of the home loan.

The fact situation in *Hart* bears a resemblance to that in *Singleton*,[29] a decision of the Supreme Court of Canada, where a taxpayer withdrew capital from a partnership to purchase a residential home for personal use and borrowed to restore the partnership capital using the family home as security. The crucial difference was that the taxpayer in *Singleton* could show that the two separate loans were commercially available in an open market, not arrangements available only in the context of a tax-minimization scheme. The CRA made no attempt to dispute the arrangement using GAAR, and subsequent discussion appears to reinforce the conclusion that GAAR would not have applied had it been raised by the CRA.[30]

A final Australian GAAR case, *Unit Trend*,[31] provides an illustration of a further situation in which courts will apply GAAR: a scheme in which a taxpayer legitimately uses legislatively endorsed tax measures in a manner never contemplated by the legislature, to achieve tax savings made possible by the juxtaposition of measures that by themselves offer no tax savings. The taxpayer in the case was a member of a group that constructed residential apartment buildings. Australia's GST law, like that in some other jurisdictions, zero-rates intra-group transfers to avoid group companies having to remit and then claim offsetting input tax credits for GST on transfers within the organization. The first step of the tax-avoidance arrangement was an

29 *Singleton v. Canada*, 2001 SCC 61.

30 See comments of Chief Justice Marc Noël in Hon. Marc Noël, Hon. Randall Bocock, Hon. Bruce Russell, Sharon Lee, Florence Sauvé, and Douglas Wright, "Judges' Panel," in *Report of Proceedings of the Seventy-Fourth Tax Conference*, 2022 Conference Report (Toronto: Canadian Tax Foundation, 2023), 3:1-16.

31 *Federal Commissioner of Taxation v. Unit Trend Services Pty. Ltd.*, [2013] HCA 16.

intra-group transfer of almost-completed apartment buildings to another group company. At that point, the value of the buildings was very close to their retail value, and far above the combined cost of the land, construction materials, and labour.

The second step of the arrangement involved an election for the method of calculating GST on the sale of the premises to retail customers. Australia allows vendors of real property to elect to use a margin scheme for the sale of the property, which denies the vendor input tax credits for GST on the expenses incurred prior to the sale and imposes GST only on the margin between the sale price and the GST-inclusive cost of the property. In economic terms, the margin scheme in theory yields the same tax revenue as the conventional tax invoice system, with the vendor claiming input tax credits for GST on all acquisitions and charging GST on the market value of the goods sold.

The vendor in *Unit Trend* elected to use the margin scheme to calculate the tax due on the sale of apartments to retail buyers, but treated the cost of the property as the market value at which the property had been transferred in the intra-group sale. Together, the zero-rating rule for intra-group transfers and the margin scheme for the second sale to retail customers insulated the largest part of the market value, the improvement from empty land to completed apartments, from GST. Separately, the election either to zero-rate the first sale or to use the margin scheme on the second sale would have constituted a legitimate tax choice wholly endorsed by the legislature. It was inconceivable, however, that the legislature contemplated that the two rules could be used in conjunction to remove GST from the bulk of the value of the property sold. The use of both rules in a pre-arranged scheme to avoid GST could not escape the application of GAAR.

These cases in which taxpayers entered into convoluted arrangements to bypass legislative boundaries can be contrasted with instances in which taxpayers abided by the legislative rules constraining tax benefits but opted for arrangements that clearly fell outside rules without the need for contrived or convoluted planning. If the legislature has established boundaries restricting access to tax benefits, but has implicitly accepted arrangements outside those boundaries as tax-effective, tax authorities will not be able to apply GAAR to deny taxpayers' access to the benefits.

This phenomenon is illustrated in the *Canada Trustco* case.[32] The taxpayer in *Canada Trustco* went to a bank subsidiary for a loan and was told that the interest rate would be lower if the loan were structured as a sale-and-leaseback arrangement using a finance lease. A sale-and-leaseback contract is simply a set of three legal transactions (sale, lease, and repurchase) that together amount to a blended-payment loan. Not surprisingly, accounting principles, which classify commercial transactions by reference to their economic substance rather than their legal label, collapse the three elements into a single loan arrangement. In contrast, Anglo legal interpretation practice, apart from that of the United States, recognizes each of the

32 *Canada Trustco*, supra note 17.

combined steps as a separate transaction for tax purposes. Relying on traditional legal interpretation doctrines, taxpayers treat a sale-and-leaseback arrangement as if the resulting finance lease were an operating lease rather than a loan. This arrangement allows a taxpayer seeking reduced effective interest charges to enter into a finance lease that shifts to a bank depreciation entitlement that the taxpayer is unable to absorb through current profits. By adopting limitations to capital cost allowance entitlements, reinforced by the tax administration through complementary regulations, Parliament has established constraints on depreciation claims by lessors in finance leases, but has implicitly accepted the legal form-over-economic-substance approach for arrangements not included in the specified limitations.

There was no dispute regarding the tax motives behind the form of the transaction in *Canada Trustco*. The taxpayer deliberately structured a blended-payment loan in a way that allowed it to enjoy tax benefits in the form of capital cost allowance deductions, and it shared the tax savings with the borrower by way of reduced implicit interest charges incorporated into nominal lease payments. The key question, as the trial judge observed, is whether Parliament has tacitly accepted this shifting of tax benefits in some sale-and-leaseback arrangements as effective for tax purposes, on the basis that legal form takes precedence over economic substance.[33] The fact that Parliament had established limitations on the amount of capital cost allowance that could be claimed in certain circumstances and had excluded from those limitations assets and arrangements similar to those in *Canada Trustco* reinforced the conclusion that the taxpayers' arrangements were not obviously inconsistent with government policy. It is thus not surprising that the trial judge, the Federal Court of Appeal,[34] and the Supreme Court of Canada[35] all found that the legally effective arrangement was not an abuse of the legislative policy and subject to GAAR.

Similar considerations explain the Supreme Court of Canada's rejection of the government's attempt to apply GAAR in *Alta Energy*.[36] Canada has many tax treaties that include a provision based on article 13 of the Organisation for Economic Co-operation and Development's model income tax convention,[37] to protect its right to tax capital gains on the disposition of real property by non-residents where the property is owned through interposed entities. The treaty with Luxembourg,[38] which was central to the issue in this case, differs from those other treaties in this respect. The text of article 13 in that treaty opens a wide hole in the measure if the taxpayer

33 *Canada Trustco Mortgage Company v. The Queen*, 2003 TCC 215, at paragraph 89.

34 *Canada v. Canada Trustco Mortgage Co.*, 2004 FCA 67.

35 *Canada Trustco*, supra note 17.

36 *Canada v. Alta Energy Luxembourg SARL*, 2021 SCC 49.

37 Organisation for Economic Co-operation and Development, *Model Tax Convention on Income and on Capital: Full Version 2017* (Paris: OECD, 2019).

38 Convention Between the Government of Canada and the Government of the Grand Duchy of Luxembourg for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital, signed at Luxembourg on September 10, 1999.

can show that the owner of real property carried on a business on the property. The clear message in the court's decision was that GAAR could not be used to fix the obvious difficulty with the treaty.

A comparable message can be found in the decision of the Australian Full Federal Court in *Lamesa*:[39] If there is a problem with a treaty, the solution is to fix the treaty. The treaty in question in *Lamesa* was the Netherlands-Australia double taxation agreement,[40] which failed to include language found in other Australian tax treaties protecting Australia's right to tax capital gains on the indirect disposal of real property owned through a tier of enterprises. As in the case of the treaty in issue in *Alta Energy*, the government clearly was aware of the shortcomings of the treaty and left it in place while ensuring that other treaties did not suffer from the same shortcoming. The endorsement by the government of different tax outcomes for the same transaction depending on which treaty applied was accepted by courts in both the Canadian and Australian cases as an invitation by the government to treaty-shop.

Another example of a court declining to apply GAAR when a taxpayer has taken advantage of an implicit election in the tax law can be found in the decision of the Australian High Court in *Mills*.[41] Australia has one of the world's most comprehensive imputation systems. It returns all company tax to resident shareholders through refundable imputation credits attached to dividends. The system is complemented by a comprehensive "financial arrangements" regime that distinguishes between equity investments and debt instruments. Interest on stapled debt and convertible debt is treated as a "non-share" dividend for the purpose of the imputation system, and is entitled to imputation credits in the same manner as traditional dividends on shares. The taxpayer in *Mills* had issued stapled stock, and investors in the notes claimed imputation credits on the interest that they received on the advice of the taxpayer that the interest was treated as a dividend for tax purposes. The aspect of the arrangement that most troubled the ATO was its insertion in a cross-border arrangement involving a subsidiary in New Zealand.

The High Court accepted the ATO's argument that the purpose of the stapling arrangement was to provide imputation credits to investors, thus reducing the taxpayer's financing costs, but concluded that the purpose of the overall arrangement was to raise needed capital for a financial institution. There was no doubt that the arrangement was designed to be tax-effective, but viewed in terms of the larger objective, it could not be said that taking advantage of imputation rules offended GAAR. Importantly, there was nothing in the deeming rules that distinguished returns on debt and equity to indicate that the definitions of debt and equity, and interest and dividends, were to be limited in circumstances similar to the arrangement in the case.

39 *Lamesa Holding BV v. Federal Commissioner of Taxation*, [1997] FCA 134.

40 Agreement Between Australia and the Kingdom of the Netherlands for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, and Protocol, signed at Canberra on March 17, 1976.

41 *Mills v. Commissioner of Taxation*, [2012] HCA 51.

Had the legislature wished to constrain the application of the imputation system, it could have easily done so, and the High Court no doubt felt that it was not the court's role to draw lines that the legislature chose not to draw.

WHY AMEND?

The Canadian government's aim in extending GAAR, in particular adding an economic substance test to the measure, and in shifting the GAAR application threshold from "primary purpose" to "one of the main purposes," is presumably to enable the CRA to successfully apply GAAR to arrangements that have to date been shown to fall outside the reach of the anti-avoidance rule. There are sound reasons to conclude that the goal is unlikely to be achieved. Taxpayers devising clearly contrived arrangements to shoehorn a transaction into a preferable taxed arrangement—for example, funnelling the sale of a loss company through a series of complex transfers and arrangements wholly unnecessary to the sale of the business (*Deans Knight* and *MacKay*); creating tax-effective linked loans that would not be available in the market separately (*Hart*); altering a company's articles to shift value from one type of share to another (*Peabody*); looping a deposit guaranteed by a local bank through an offshore deposit (*Spotless*), and so on—already attract the application of a GAAR.

If there is room for an altered GAAR to have an impact as a result of the first change (the addition of an economic substance test), it is in respect of transactions that have been accepted at face value, consistent with their legal form, by courts but have been recognized, consistent with their economic substance, by accountants—for example, finance leases and repo transactions. US courts have generally deviated from their Anglo common-law counterparts in this respect by collapsing connected transactions into ones aligning with their economic substance.[42] For a brief period, UK courts did the same with selected arrangements under a judicially devised fiscal nullity doctrine, or *Ramsay* doctrine,[43] whereby a court would collapse preordained steps inserted into a commercial transaction to alter its tax consequences and uphold an assessment based on the substance of the overall commercial transaction. The UK doctrine has been explicitly rejected by courts in jurisdictions such as Canada[44] and Australia[45] with GAARs in place. Will the addition of an alternative economic substance test to Canada's GAAR broaden the concept of abuse to bring the *Ramsay* doctrine into Canadian law and capture arrangements currently outside the scope of the provision?

On its face, an economic substance test based solely on objective facts might appear to broaden the scope of Canada's GAAR. Subsection 245(2) of the Income Tax

42 For commentary on the US approach from a UK Anglo perspective, see M. Bernard Aidinoff, "Furniss v Dawson: The US Experience" (1985) 6:4 *Fiscal Studies* 66-76.

43 *W.T. Ramsay Ltd. v. Inland Revenue Commissioners*, [1982] AC 300.

44 *Stubart Investments Ltd. v. The Queen*, [1984] 1 SCR 536.

45 *John v. Federal Commissioner of Taxation* (1989), 166 CLR 417.

Act permits the CRA to reconstruct a transaction where there is an avoidance transaction (as defined in subsection 245(3)) and that transaction misuses a provision of the Act or would result in an abuse of the provisions of the Act (subsection 245(4)). Clearly, the addition of the economic substance test will have no impact on manipulative arrangements such as those in *Copthorne Holdings*, *Deans Knight*, and *MacKay* (and analogous Australian cases such as *Spotless*, *Hart*, and *Unit Trend*), which are already caught by the abuse and misuse tests in GAAR. Could the economic substance test change the results in arrangements that previously escaped the application of GAAR, such as those in *Canada Trustco* and *Alta Energy* (or the analogous *Lamesa* decision)?

It would, to be sure, create a dilemma for the CRA if it were to seek to use GAAR to unwind the arrangements in similar cases. If the CRA were successful, not only would impugned arrangements be brought under GAAR, but potentially so too would arrangements that have been long accepted by the legislature as legitimate tax-effective transactions. Most likely, when confronted with taxpayers taking advantage of clearly articulated boundaries in the law, such as the lender and borrower in *Canada Trustco*, the courts would acknowledge the economic substance of the arrangement—a sale and leaseback amounting to a blended-payments loan—and find that GAAR has no application to an arrangement explicitly or implicitly endorsed by Parliament.

Nor would an economic substance test be likely to have any impact on cases such as *Alta Energy* or *Lamesa*, where taxpayers are explicitly offered two alternative treatments in inconsistent treaties and elect to follow the path with the least tax burden. The government is well aware of the inconsistencies in the treaties that it has signed, and no policy objectives would be served if the courts were to step in and play a legislative role, telling taxpayers which option they should have chosen. The executive can address the inconsistencies at any time; it is not the role of the courts to fix known problems.

A separate group of transactions that could, in theory, be affected by the extension of GAAR comprises the so-called ordinary family dealings transactions that politicians introducing a GAAR in Parliament regularly promise will not be caught by the anti-avoidance rules.[46] The often-used euphemism for popular tax-avoidance arrangements commonly adopted by highest-income individuals is intended to protect from attack by tax authorities arrangements that would be considered anything but ordinary by most families—the mass of taxpayers who do not structure transactions to split income, convert remuneration and investment returns to preferentially taxed capital gains, or restructure holdings to extract profits in tax-effective forms.

Indeed, in one sense, the transactions contemplated by the ordinary family dealings label are precisely the sort of arrangements that should be targeted by a GAAR: transactions that are motivated almost exclusively by tax-minimization goals. It is thus not surprising that New Zealand's GAAR explicitly targets these arrangements,

46 Such assurances were made to both the Canadian and Australian Parliaments when their respective GAARs were introduced. See Graeme S. Cooper, "International Experience with General Anti-Avoidance Rules" (2001) 54:1 *Southern Methodist University Law Review* 83-130.

defining a "tax avoidance arrangement" as an arrangement that has a tax-avoidance purpose or effect "whether or not any other purpose or effect is referable to ordinary business or family dealings."[47] However, the explicit inclusion of these arrangements in one country's GAAR and the deliberate exclusion of the phrase from the Canadian rule, as well as the tacit acceptance by the CRA of many "ordinary family dealing" avoidance arrangements, mean that it is very unlikely that an expanded GAAR will have any impact on these tax-avoidance transactions.

Will the second change, the shift of the GAAR application threshold from "primary purpose" to "one of the main purposes," have a notable impact on the application of GAAR? Once again, this amendment will not protect any taxpayers carrying out tax-minimization schemes of the sort that have already been shown to fall within the scope of the rule. These are instances where parliamentary intent has been made clear through specific measures setting out the boundary between acceptable and unacceptable arrangements. Can the change help the CRA in situations where it has been unsuccessful—where the legislation provides taxpayers with options and taxpayers opt for the transaction that provides a lower tax liability? There is no reason to suspect that the change from primary purpose to one of the main purposes will have any effect on outcomes in these cases. Whether a primary purpose or one of the main purposes test is used, there must be a purpose of tax avoidance, and there is no tax avoidance if the legislature has seemingly endorsed the right of taxpayers to choose the option that they have chosen.

It thus seems highly likely that the concerns and speculation about the impact of the GAAR reforms are somewhat exaggerated. A look at the underlying foundations of judicial interpretations of GAAR in Canada and Australia suggests that those concerns may prove to be little more than a storm in a teacup.

47 New Zealand, Income Tax Act 2007, supra note 12, section YA1, definition of "tax avoidance arrangement."

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Policy Forum: Sailing Beyond the Sunset? Are De Jure Control and Other Bright-Line Tests Relevant After Deans Knight and the New GAAR?

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PRÉCIS

Cet article convie les lecteurs à un périple à travers l'arrêt *Deans Knight Income Corp. c. Canada* de la Cour suprême du Canada et les affaires subséquentes dans lesquelles l'interprétation qu'a fait cet arrêt de la règle générale anti-évitement (RGAE) a été appliquée. L'auteur se fonde sur des métaphores issues de la philosophie grecque et de la navigation pour appuyer — et alléger — ses propos sur l'immortalité des sociétés, les critères de démarcation et la Loi de l'impôt sur le revenu.

L'auteur fait valoir que, dans *Deans Knight*, la majorité de la Cour suprême a commis une « erreur d'objet » : en appliquant la RGAE, la majorité a insisté sur l'objet premier du paragraphe 111(5), soit celui d'arrêter les échanges de pertes entre sociétés, aux dépends des autres objets de la loi, notamment celui d'apporter de la certitude aux sociétés publiques dont la rotation des actionnaires est élevée. Les futures affaires qui seront jugées à l'aune de la RGAE modifiée pourraient être encore plus vulnérables à une erreur d'objet.

L'auteur se demande ensuite si d'autres critères de démarcation de la Loi sont vulnérables au même genre d'erreur d'objet lorsque la RGAE est appliquée. Par exemple, il examine s'il pourrait y avoir abus du délai de 30 jours des règles sur la minimisation des pertes si le contribuable attend un jour de plus pour se conformer aux règles, abus des règles relatives aux « biens à revente précipitée » des paragraphes 12(12) à (14) si le contribuable attend un jour de plus pour vendre une maison, et abus de la partie IV ou de l'article 113 lorsque le contribuable achète une action de plus pour respecter un seuil de propriété. Bien qu'on puisse faire valoir que chacune de ces stratégies est abusive selon l'approche adoptée dans *Deans Knight*, ce serait une erreur de toujours interpréter les règles de manière aussi large. Les tribunaux devraient tenir compte de l'objectif du législateur pour l'utilisation

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d'un critère de démarcation avant d'appliquer la RGAE et se demander à quel point le critère est arbitraire et possiblement manipulable.

ABSTRACT

This article takes readers on a voyage through the Supreme Court of Canada's decision in *Deans Knight Income Corp. v. Canada* and subsequent cases that apply its interpretation of the general anti-avoidance rule (GAAR). The author draws on metaphors from Greek philosophy and sailing to aid—and lighten—the discussion of the immortality of corporations, bright lines, and the Income Tax Act.

The author argues that the majority of the Supreme Court in *Deans Knight* committed a "purpose error": in applying GAAR, the majority overemphasized subsection 111(5)'s primary purpose of stopping corporate loss trading at the expense of the legislation's other purposes, including providing certainty to public companies with high shareholder turnover. Future cases decided under the amended GAAR may be even more vulnerable to a purpose error.

The author then considers whether other bright-line tests in the Act are vulnerable to the same sort of purpose error if GAAR is applied. For example, he examines whether the 30-day time limit in the Act's stop-loss rules could be abused by waiting an extra day to comply with the rule, whether waiting one more day to sell a house could abuse the "flipped property" rules in subsections 12(12) to (14), and whether buying one more share to meet an ownership threshold could abuse part IV or section 113. While each of those strategies could arguably be abusive under the approach taken in *Deans Knight*, it would be an error to always interpret the rules so broadly. Courts should consider Parliament's purpose in using a bright-line test before applying GAAR, and ask how arbitrary and potentially manipulable the line is.

KEYWORDS: GAAR ■ STATUTORY INTERPRETATION ■ LOSS-RESTRICTION EVENT ■ STOP-LOSS RULES ■ FOREIGN AFFILIATE RULES ■ PUBLIC COMPANIES

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SETTING SAIL: AN INTRODUCTION

Theseus was the first king of Athens, and according to legend Athenians preserved his ship for centuries, replacing each piece as it wore out. Plutarch and other ancient philosophers debated when—if ever—the ship was no longer the Ship of Theseus: When there were no original parts left? Never?[1] Like the ship, a corporation's business and assets may change; its shareholders and directors may come and go; yet the corporation remains the same legal entity for tax purposes.

Tax and Plutarch make strange bedfellows, but tax needs to grapple with a similar question: When is a corporation so fundamentally transformed that it should no longer be able to deduct previous losses? Parliament answered the question in subsections 111(4) and (5) of the Income Tax Act[2] by drawing a bright line: when control of the corporation—understood to mean de jure control, or the ability to elect the majority of the corporation's directors—is acquired. Hence, it was long believed that the "loss-streaming" rules, as they are commonly described, applied when a person, or a non-arm's-length group, acquired a majority of the corporation's voting shares.

The Supreme Court of Canada in *Deans Knight Income Corp. v. Canada*[3] sunk that belief with its application of the general anti-avoidance rule (GAAR).[4] The majority's interpretation minimizes the role of the de jure control test in subsection 111(5) by characterizing it as the means chosen to implement Parliament's purpose but incompletely reflecting Parliament's purpose for the provision.

In my view, the court made a "purpose error" in its decision. As discussed further below, when a court interprets the text, context, and purpose of legislation with so much emphasis on one purpose that it ignores the legislation's other, competing purposes,[5] the court commits a purpose error. *Deans Knight* overemphasized subsection 111(5)'s primary purpose of stopping corporate loss trading at the expense of the legislation's other purposes, including providing certainty about when the rules apply in a wide variety of contexts.

In this article, I consider whether the court's reasoning in *Deans Knight* could blur other bright lines in the Act. Could such lines be dismissed in future GAAR cases as merely being the means that Parliament chose to implement a broader objective? Will the preamble to GAAR in new subsection 245(0.1)—which suggests that "certainty" is

1 Plutarch, *Plutarch's Lives*, trans. A.H. Clough (Boston: Ginn and Company, 1918).

2 RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as "the Act"). Unless otherwise stated, statutory references in this article are to the Act.

3 2023 SCC 16. Unless otherwise noted, a reference to *Deans Knight* refers to the majority reasons written by Rowe J.

4 The general anti-avoidance rule is in section 245.

5 Mark Mancini, "The Purpose Error in the Modern Approach to Statutory Interpretation" (2022) 59:4 *Alberta Law Review* 919-48 (https://doi.org/10.29173/alr2702).

only a taxpayer concern and must be balanced against the government's "responsibility to protect the tax base"[6]—encourage courts to ignore, or de-emphasize, bright lines?

In my view, this would be a mistake. A bright-line rule also reflects a rationale: that Parliament values certainty to make the system easier for taxpayers to comply with and easier for the Canada Revenue Agency (CRA) and the courts to administer.[7] I suggest that, when applying GAAR to a bright line, courts should consider how arbitrary the line is, and how easy (or not) it is to manipulate compliance with the line, along with the purpose of the provision.

WHAT IS A PURPOSE ERROR?

A purpose error[8] occurs when a court determines legislation's primary purpose abstractly, and then overemphasizes that abstract purpose in a textual, contextual, and purposive interpretation. The court's emphasis on primary purpose risks blinding it to the secondary purposes that are also part of the legislation, and may overlook the fact that Parliament rarely, if ever, wants to achieve its primary purpose at all costs. The further back the court goes in its interpretation—the more abstractly it determines purpose—the more likely it is to commit a purpose error.[9]

Metaphorically, a law's primary purpose may be to build a large cargo ship. But if the courts interpret that law to make the ship ever larger, they might forget that Parliament also needed the ship to fit under bridges to make it to port; otherwise, the ship would be useless.[10]

How Is a Purpose Error Relevant to GAAR?

GAAR practically invites courts to make a purpose error as they go "behind the words of the legislation to determine the object, spirit or purpose of the provision or provisions relied upon by the taxpayer"[11] and determine whether the taxpayer frustrated

6 Bill C-59, An Act To Implement Certain Provisions of the Fall Economic Statement Tabled in Parliament on November 21, 2023 and Certain Provisions of the Budget Tabled in Parliament on March 28, 2023; SC 2024, c. 15; royal assent June 20, 2024, section 66(1).

7 Frank H. Easterbrook, "The Role of Original Intent in Statutory Construction" (1988) 11:1 *Harvard Journal of Law & Public Policy* 59-66.

8 See Mancini, supra note 5, for an in-depth discussion of the concept.

9 Ibid.

10 For a more concrete example of competing purposes, consider the foreign accrual property income (FAPI) rules in sections 91 and 95. They have to balance two mutually exclusive goals: capital export neutrality (according to which Canadian residents should be taxed the same if they invest abroad or at home) and business competitiveness in foreign jurisdictions (which means that Canadians doing business abroad should not suffer because the tax rate in Canada is higher than the rate applied to their competitors in the foreign jurisdiction). *Canada v. Loblaw Financial Holdings Inc.*, 2021 SCC 51, at paragraphs 54 to 56.

11 *Copthorne Holdings Ltd. v. Canada*, 2011 SCC 63, at paragraph 66.

that rationale. However, a "GAAR analysis is a species of statutory interpretation."[12] Courts use the same method to search for a rationale as in any other application of statutory interpretation: a unified textual, contextual, and purposive approach, but applied to determine the provision's rationale "that may not be captured by the bare meaning of the words themselves."[13] In analyzing purpose, courts should recognize that legislation may reflect competing purposes and that Parliament had a purpose in mind when it chose a particular means, such as a bright-line test, over other ways of achieving its purpose.

Does the New Purpose Provision in GAAR Downplay Certainty Too Much?

Paragraph (b) of the new preamble in subsection 245(0.1) states that GAAR

> (b) strikes a balance between:
>
> (i) the *Government of Canada's* responsibility to protect the tax base and the fairness of the tax system, and
>
> (ii) *taxpayers'* need for certainty in planning their affairs [emphasis added].[14]

The juxtaposition is striking. The government wants fairness (and revenue); certainty is something that only taxpayers want. Subsection 245(0.1) seems to ignore the fact that certainty may be as much a part of the object, spirit, and purpose of a provision as the provision's primary objective is, and that certainty can benefit everyone. Simple, certain tests are easier for the CRA and the courts to apply. The danger is that the new purpose statement may reinforce the error in *Deans Knight* of dismissing a bright-line test as the means chosen to carry out Parliament's primary purpose, rather than properly weighing secondary purposes in the interpretation.

TURNING OFF THE LIGHTS? THE BRIGHT-LINE DE JURE CONTROL TEST AND DEANS KNIGHT

How the Supreme Court in Deans Knight Commits a Purpose Error

The majority of the Supreme Court in *Deans Knight* focused almost exclusively on the general mischief that subsection 111(5) sought to prevent: corporations being acquired so that new shareholders with a new business could use the corporation's losses for their benefit.[15]

12 *Deans Knight*, supra note 3, at paragraph 151, from the dissenting reasons of Côté J.

13 *Copthorne*, supra note 11, at paragraph 70.

14 Bill C-59, supra note 6, section 66(1).

15 *Deans Knight*, supra note 3, at paragraph 113.

Although the decision acknowledges that "the way a provision has been drafted is important within the text, context and purpose analysis,"[16] it dismisses any consideration of the test chosen by Parliament as the mere means that Parliament chose to target loss trading: "In [subsection] 111(5), Parliament has clearly chosen a test for control: *de jure* control. . . . This being so, it is primarily a means of giving effect to Parliament's aim, rather than a complete encapsulation of the aim itself."[17]

De jure control was adopted because it was simple and certain.[18] The test is basically a mathematical test. It means the control exercised by the person or persons who own enough voting shares to elect a majority of the corporation's directors. In the simplest of cases, if a shareholder owns 50 percent plus one of the (voting) shares, that shareholder has control.[19] The analysis in *Deans Knight* erases the certainty and ignores the simplicity of this test.

The (Public) Shareholders of Theseus, Inc. Conundrum

In two subsequent cases, *Madison Pacific*[20] and *Total Energy*,[21] the Tax Court of Canada applied *Deans Knight* to transactions involving widely held, publicly traded loss companies that were acquired for their losses while avoiding subsection 111(5). Should the Tax Court have been so quick to apply *Deans Knight* to public companies? Public companies raise a number of issues that were not considered by the Supreme Court in *Deans Knight*.

First, a significant shareholder may have practical (that is, de facto) control over public company board elections with far fewer than 50 percent plus one of the votes,

16 Ibid., at paragraph 71. See also *DEML Investments Limited v. The King*, 2024 TCC 27, at paragraphs 31 to 33.

17 *Deans Knight*, supra note 3, at paragraph 116.

18 *Duha Printers (Western) Ltd. v. Canada*, [1998] 1 SCR 795, at paragraph 58. See also *Deans Knight*, supra note 3, at paragraph 92.

19 *Duha Printers*, supra note 18. For a detailed analysis of de jure control, see Roger Taylor and Marie-Claude Marcil, "Duha Printers Revisited: Issues Regarding Corporate Control" (2022) 70:3 *Canadian Tax Journal* 495-561. Taylor and Marcil discuss how the actual threshold may not be 50 percent depending on the constating documents of the corporation (corporate articles, bylaws, or a unanimous shareholders' agreement) and the applicable corporate law. In some corporations, director decisions may require a supermajority, or unanimity, and more than a bare majority of votes may be required to have control. In other cases, a shareholder may have control *without* the current ability to elect the number of directors needed to pass resolutions—because the shareholder *does* have enough votes to alter the corporation's constating documents to reduce those thresholds or change the election procedure. Trust agreements may also be considered in the de jure control analysis.

20 *Madison Pacific Properties Inc. v. The King*, 2023 TCC 180; under appeal to the Federal Court of Appeal, docket no. A-30-24.

21 *Total Energy Services Inc. v. The King*, 2024 TCC 12; under appeal to the Federal Court of Appeal, docket no. A-86-24.

as recognized by Canadian securities law. Under the early warning system,[22] an acquiror must publicly disclose when it acquires any voting securities that constitute 10 percent or more of the outstanding securities of that class to ensure that "the marketplace is promptly informed of significant accumulations of securities of a reporting issuer that may influence control of that issuer."[23]

Unlike in *Deans Knight*, such shareholders need not rely on a non-unanimous shareholders' agreement to avoid a de jure acquisition of control.[24] All that they need to rely on is human nature. Other shareholders who might oppose them will have trouble coordinating, and some shareholders may not bother to vote at all at a shareholders' meeting.

That is exactly what happened in *Madison Pacific*. One group acquired 46.56 percent of the voting shares and effectively controlled the company. The Tax Court found that 93.56 percent of the remaining, disparate shareholders would have to both vote, and vote for the same opposing slate of directors, to thwart that group. The Tax Court noted that at the 1999 annual general meeting, a little over half of the shares were voted—and the 46.56 percent shareholders represented 81 percent of shares voted. The taxpayer's witness even admitted that the "broad base of shareholders . . . made it easier to avoid an acquisition of control."[25]

Second, public company shareholders change all the time. This can affect the subjective question of practical control[26] and brings us closer to the heart of the conundrum: *Deans Knight* states that the purpose of subsection 111(5) is to prevent unrelated parties with a new business from *acquiring* the loss company and making use of its losses for the benefit of *new* shareholders;[27] but *Deans Knight* does not tell us what "acquired" means, how it relates to control, or who "new" shareholders are in the public company context.

22 *National Instrument* 62-104, "Take-Over Bids and Issuer Bids," at part 5.

23 Ontario Securities Commission, "Early Warning System and Alternative Monthly Reporting System" (www.osc.ca/en/industry/companies/mergers-and-acquisitions/early-warning-system-and-alternative-monthly-reporting-system).

24 A friendly party purchased a nominal number of shares but did not become a party to the investment agreement considered by the court, meaning that the investment agreement was not a unanimous shareholders' agreement and would not be considered a constating document for the purpose of applying the de jure control test. *Deans Knight*, supra note 3, at paragraphs 15 and 132.

25 *Madison Pacific*, supra note 20, at paragraph 162. See also *Total Energy*, supra note 21, at paragraph 68.

26 For example, imagine that one active shareholder sells its shares to less interested new shareholders. With less concentrated opposition, a pre-existing shareholder may suddenly have "control." But could that shareholder be said to have "acquired" control in these circumstances?

27 *Deans Knight*, supra note 3, at paragraph 113; *Madison Pacific*, supra note 20, at paragraph 136; and *Total Energy*, supra note 21, at paragraphs 77 and 78.

"Acquired" could mean that there is a chance, or a strong chance, or a near-certainty, that a new significant shareholder will prevail in a board election, but *Deans Knight* does not say which. Certainly, "new shareholders" does not mean that GAAR could apply every time public company shares change hands; but what degree of ownership must change, and how "concentrated" must the new shareholder group be?

Citing *Silicon Graphics*,[28] *Deans Knight* acknowledges that Parliament chose de jure control, in part, in consideration of public companies:

> [Subsection] 111(5) does not refer merely to a change in control, but to a situation where control has been "acquired by a person or group of persons." The provision indicates Parliament's focus on circumstances in which there is a shift in the locus of control, rather than, for example, high turnover in the shares of a publicly traded company.[29]

Parliament used the bright line of de jure control to avoid subjective debates about the control of public companies. Unfortunately, neither *Madison Pacific* nor *Total Energy* addresses whether the analysis should have been influenced by this competing purpose.

The public company conundrum may have no firm answer under the current jurisprudence. C'est la vie. Plutarch and his fellow Greeks never resolved their conundrum either. Half said that Theseus's ship was the same, and half said that it was not.[30]

How Should a Court Reconcile Bright Lines and GAAR?

Taken too far, my argument could appear to suggest that where Parliament legislates with a precise bright line, the object, spirit, and purpose of the provision are fully captured by the words such that GAAR has no application.[31] *Deans Knight* correctly rejected the idea that GAAR cannot apply to specifically worded provisions *solely* because Parliament legislated with precision.[32]

28 *Silicon Graphics Ltd. v. Canada*, 2002 FCA 260.

29 *Deans Knight*, supra note 3, at paragraph 81, citing *Silicon Graphics*, supra note 28, at paragraph 36.

30 Plutarch, supra note 1.

31 I am not suggesting that the result in *Deans Knight* was incorrect. Rather, the court should have placed greater emphasis on the legislative history, including how Parliament previously deemed certain transactions to be acquisitions of control, notwithstanding that they were not, strictly speaking, acquisitions of de jure control. However, it is beyond the scope of this article to further explore the reasoning in *Deans Knight*.

32 *Deans Knight*, supra note 3, at paragraphs 72 and 73. See also *Lehigh Cement Limited v. Canada*, 2010 FCA 124, at paragraph 37: "When Parliament adds an exemption to the *Income Tax Act*, even one as detailed and specific as subparagraph 212(1)(b)(vii), it cannot possibly describe every transaction within or without the intended scope of the exemption. Therefore, it is conceivable that a transaction may misuse a statutory exemption comprised of one or more bright-line tests."

In dissent, Côté J agreed, but found that the majority invoked this principle to skirt the real question: Saying that GAAR *can* apply to precisely worded provisions is not the same as saying that GAAR *should* apply to *this* precisely worded provision because *these* transactions frustrate the object, spirit, or purpose of the provision.[33]

Courts should, as *Deans Knight* says, consider the primary purpose of the provision and what, if any, purpose the bright line serves. In determining whether to apply GAAR to a transaction or transactions that avoid—or that comply with (if it is advantageous to do so)—a bright-line provision, courts could also consider the following questions:

- How arbitrary is the line?
- How open is the line to manipulation?
- Is the impugned provision "positive," in granting a tax benefit, or "negative"—that is, a specific anti-avoidance rule?

OTHER BRIGHT LINES AND GAAR

In this section, I consider whether the reasoning in *Deans Knight* could or should apply to some of the Act's "stop-loss" rules, and other bright lines based on time or ownership. I examine how arbitrary and how manipulable those other lines are, their purpose, and how that should influence a GAAR analysis.

Other Share Ownership Thresholds: Section 113 and Part IV

In section 113, a corporation may deduct in computing taxable income an amount in respect of dividends received from a "foreign affiliate." In part IV, a corporate taxpayer does not pay the refundable part IV tax on dividends if the payer is "connected" to the taxpayer (unless the payer itself receives a dividend refund as a consequence of paying the dividend).

These rules, like subsection 111(5), are triggered by share ownership.[34] Compared to de jure control, however, the 10 percent threshold in section 113 is more arbitrary. Acquiring just one more voting share makes a real difference when the one extra vote is the difference between having de jure control over directors' elections and not having control. There is no practical difference between 9.99 percent ownership and 10 percent ownership, other than certain tax consequences. The taxpayer who genuinely increases their investment in a foreign corporation to the 10 percent threshold, even with the tax advantages in mind, ought to be able to claim the benefit of the deduction under section 113 without fear of GAAR. We must, however,

33 *Deans Knight*, supra note 3, at paragraphs 150 to 152.

34 Grossly simplified, if the taxpayer owns, with related parties, directly or indirectly, 10 percent or more of a class of shares of the foreign corporation, the foreign corporation is a foreign affiliate. See the definitions of "foreign affiliate" and "equity percentage" in section 95. In part IV, "connected" means that the recipient either controls the payer or owns at least 10 percent of the votes and 10 percent of the fair market value of all of the payer's shares.

ask what a "genuine" investment is, because share ownership can be manipulated to land on the "right" side of the line and to allow the tax benefits to be claimed by temporarily increasing ownership.

In applying GAAR, the courts would need to consider the provisions' broader purposes. Part IV exists to prevent undue deferral of individual-level tax on dividends from domestic "portfolio" investments.[35] Section 113 is part of a similar scheme applying to foreign corporations that, in general, aims to prevent the deferral of Canadian tax on foreign portfolio investments while at the same time exempting from tax dividends paid out of active business income earned abroad by foreign corporations.[36] In both part IV and the foreign affiliate rules, the ownership threshold is a proxy that divides passive portfolio investment from active investment that the Act says deserves special treatment.[37] In both cases, if shareholders are, temporarily or artificially, trying to transform a portfolio investment into something more to claim the tax benefit and inappropriately defer Canadian tax, GAAR ought to have a role in policing such manipulations.

Unlike under subsection 111(5), the taxpayer acquiring 10 percent of a foreign corporation or 10 percent of the votes and value of a domestic corporation is trying to claim the benefit of a "positive" bright line. Dividends are part of income;[38] receipt of income should not be artificially deferred. Yet, in both part IV and section 113, Parliament grants relief to corporations that invest beyond the portfolio level. When Parliament grants an extraordinary benefit, as opposed to denying the normal operation of the Act, extra attention should be given to the benefit's purpose.

Before 2024, GAAR would not have applied to a purchase (or disposition) of shares to manipulate foreign affiliate status because the Act already has a specific anti-avoidance rule targeting such transactions.[39] If "it can reasonably be considered that the principal purpose for the acquisition or disposition"[40] is to reduce or defer tax by manipulating foreign affiliate status, paragraph 95(6)(b) applies, although, unlike in GAAR, there is no exception if there is no misuse or abuse.[41]

35 David G. Duff and Geoffrey Loomer, *Taxation of Business Organizations in Canada*, 2d ed. (Markham, ON: LexisNexis Canada, 2019), at 275.

36 *Loblaw*, supra note 10; and Jinyan Li, Arthur Cockfield, and J. Scott Wilkie, *International Taxation in Canada: Principles and Practices*, 4th ed. (Markham, ON: LexisNexis Canada, 2018), at 253 and 316-17. The summary above has numerous qualifications, but a more detailed discussion of the FAPI and foreign affiliate rules is beyond the scope of this article.

37 Canadian securities regulators also consider 10 percent ownership significant enough that the market must be made aware of that investor's involvement. See the text accompanying note 22, supra.

38 Sections 82 and 90.

39 Paragraph 95(6)(b). See also *Lehigh Cement Limited v. Canada*, 2014 FCA 103.

40 Paragraph 95(6)(b).

41 With potentially harsh results. Imagine that Canada enters into a new treaty. A taxpayer with a 9.99 percent investment in an existing company in the new treaty partner realizes that there

Since the enactment of the GAAR amendments, if the principal purpose of the acquisition or disposition is not to reduce or defer tax, but *one* of the main purposes is to obtain such a tax benefit, GAAR may apply because of the expanded definition of an avoidance transaction.[42]

Is 31 Days the Functional Equivalent of 30 Days? Timing Under the Stop-Loss Rules and GAAR

The Act contains numerous rules that deny a loss when property is sold and the same, or identical, property is acquired or reacquired by the taxpayer or affiliated parties during the 30 days on either side of the transaction.[43] The rule says 30 days. If a taxpayer waits 31 days to acquire the same or identical property, they comply with the rule, and it appears to be an article of faith that GAAR would not apply where this bright line is avoided.[44]

But could GAAR apply now? The rationale of the stop-loss rules

> appears to be to preclude a taxpayer from claiming an accrued capital loss by disposing of a "loser" and repurchasing it within a matter of days. . . . [T]he taxpayer shows by his repurchase that he did not really desire to part with his loser.[45]

Imagine a taxpayer with an accrued loss on shares who desires to offset other realized gains. The taxpayer sells the "loser" to recognize the loss. Having read the Act, the taxpayer waits patiently for 31 days before acquiring identical shares of the loser, and has a tax benefit from the use of the loss. This is an avoidance transaction because the

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are now tax advantages if it increases its investment. Paragraph 95(6)(b) may apply because the primary purpose of the acquisition is to qualify for foreign affiliate status and reduce tax, even though that acquisition may not be considered abusive because the taxpayer is genuinely responding to the incentives in the Act and the new tax treaty for foreign affiliate status. But, unlike GAAR, paragraph 95(6)(b) includes no misuse or abuse exception. For a discussion of a similar issue, but in an international treaty context, see CRA document 2023-0964521C6, May 17, 2023, and Organisation for Economic Co-operation and Development, *Model Tax Convention on Income and on Capital: Condensed Version* (Paris: OECD, 2017), at 593-94. It is beyond the scope of this article to compare the interpretation of the Act's bright lines for the purposes of GAAR with the interpretation of tax treaties.

42 The amendments to GAAR lower the "avoidance transaction" threshold from a transaction that is "primarily" tax-motivated to a transaction where "one of the main purposes" is to obtain a tax benefit. Bill C-59, supra note 6.

43 For non-depreciable capital property, see subparagraph 40(2)(g)(i), subsection 40(3.4), and section 54, the definition of "superficial loss." For depreciable property, see subsection 13(21.2). For inventory of moneylenders, see subsections 18(13) to (15). For further details, see Duff and Loomer, supra note 35, at 950-58.

44 Brian M. Studniberg, "Minding the Gap in Tax Interpretation: Does Specificity Oust the General Anti-Avoidance Rule Post-Copthorne?" (2012) 38:1 *Queen's Law Journal* 209-57; and Robert Couzin, "Canada GAAR: Trap Set for the Unwary" (1998) 10:1 *International Tax Review* 41-43.

45 Warren Grover, "Superficial Losses" (1974) 22:3 *Canadian Tax Journal* 253-59, at 253.

taxpayer sold the shares in order to realize the tax benefit, not because they desired to part with the investment. Certainly, one of the main reasons was to realize the benefit, and the taxpayer sailed around the stop-loss rules by waiting 31 days. Following the reasoning in *Deans Knight*, these transactions may frustrate the primary purpose of the stop-loss rules and GAAR may sink the taxpayer's ship.

However, GAAR should not apply in this way. Parliament's 30-day bright line in these circumstances is truly arbitrary. Parliament could have chosen 1 day, or a year, or not have bothered with a stop-loss rule at all,[46] but in the end copied the United States and prescribed a 30-day bright line.[47] A 30-day rule stops the most egregious cases of tax-loss selling, and it is certain and easy to apply, but it is not a principled rule. The taxpayer who "genuinely" sells but reacquires 29 days later for sound investment reasons is caught, while the taxpayer who is willing to risk parting with their investment for 31 days may claim a loss.

Unlike shares, time cannot be bought, sold, borrowed, or loaned, or otherwise manipulated. And, unlike part IV or the foreign affiliate rules, the stop-loss rules are negative rules. Taxpayers can normally claim losses on dispositions; only an arbitrary time limit prevents them from doing so. In earlier GAAR jurisprudence, it appears that the courts may have given taxpayers avoiding a negative rule more latitude because the precise and unequivocal negative rule departed from the normal operation of the Act.[48]

Both the arbitrariness of the rule, and its relative invulnerability to manipulation, favour finding that the line's certainty is as important as the legislation's primary purpose. Even if a taxpayer intended to sell in order to claim the tax losses, the Act ignores that intent if the taxpayer complies with the arbitrary time limit.[49]

Waiting To Flip a House

Like the stop-loss rules, the "flipped property" rules in subsections 12(12) to (14) apply if a minimum holding period is not met.[50] If they apply, the rules deem any gain on the sale of a housing unit to be on income account and not capital account, and fully included in income.

46 The Carter commission thought that regulations to prevent selling securities to recognize tax losses "only lead to more complex manipulations." Canada, *Report of the Royal Commission on Taxation*, vol. 3 (Ottawa: Queen's Printer, 1967), chapter 15, at 367.

47 Grover, supra note 45.

48 See, for example, *Canada v. Landrus*, 2009 FCA 113, at paragraph 45, in respect of the stop-loss rule applying to depreciable property. The same reasoning may not be as persuasive after *Deans Knight*.

49 Limitation periods act the same way. They are "acts of peace," meaning the peace of mind from knowing that past deeds can no longer be litigated after an arbitrary amount of time. Ontario, *Report of the Ontario Law Reform Commission on Limitation of Actions* (Toronto: Department of the Attorney General, 1969), at 9-10.

50 The rules apply if a housing unit was owned, or held, "by the taxpayer for less than 365 consecutive days prior to its disposition." Paragraph 12(13)(b).

Arguably, GAAR could apply to the canny taxpayer who waits 1 extra day before selling, but it is unnecessary. The purpose of the rules is to curb residential property speculation,[51] and a taxpayer who is speculating is taxable on income account regardless of the length of ownership.[52] If the taxpayer is not speculating, they are not guilty of the targeted mischief, and they have not misused or abused the rules by selling after 365 days.

Like 30 days or 10 percent ownership, the time limit is arbitrary.[53] But in contrast to the stop-loss rules, the taxpayer's intention matters if they avoid the bright line—although not because of GAAR, but because distinguishing between capital and income account already depends on intention.

COMING HOME TO PORT: PLATO, FAIRNESS, AND THE GOOD SHIP TAX

To parrot another Athenian,[54] if judges were philosopher-kings, there would be no need for this debate. Enlightened and politically adept rulers would make perfectly fair decisions about every dispute, including how much tax to pay. In this less than ideal world, we are stuck with the Act, and a judiciary that must interpret compromises between competing purposes, between allegedly fair but vague principles, and certain, but often arbitrary, bright lines. Maybe it is not always fair for new owners to benefit from a corporation's previous losses. Maybe it is not fair if taxpayers realize a loss without giving up their investment.

But applying GAAR to make things fair—or a judge's perception of fair—would be a purpose error. When Parliament draws a bright line, where and how Parliament draws the line means something. If courts forget that, taxpayers are going to look down and find that the Good Ship Tax has been replaced by judges, one plank at a time, and wonder whether it is still the same ship or not.

51 Canada, Department of Finance, 2022 Budget, Budget Plan, April 7, 2022, at 49.

52 Jinyan Li, Joanne Magee, and J. Scott Wilkie, *Principles of Canadian Income Tax Law*, 10th ed. (Toronto: Thomson Reuters, 2022), at chapter 10.2.

53 There are other arbitrary time limits in the Act, and, similarly, GAAR should not apply solely because the taxpayer waited long enough. See the three-year time limit in subsection 69(11), and *Canada v. Oxford Properties Group Inc.*, 2018 FCA 30. GAAR applied, but not because the taxpayer outwaited the time limit. (The taxpayer did argue, successfully in the Tax Court but unsuccessfully on appeal, that GAAR should *not* apply because the taxpayer *had* waited long enough.)

54 Plato, *The Republic of Plato*, trans. Allan Bloom (New York: Basic Books, 1968).

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Finances of the Nation

Federal and Provincial Income Support Programs for Seniors in Canada

*Tammy Schirle**

For almost 60 years, the Canadian Tax Foundation published an annual monograph, Finances of the Nation, *and its predecessor,* The National Finances. *In a change of format, the 2014* Canadian Tax Journal *introduced a new "Finances of the Nation" feature, which presents annual surveys of provincial and territorial budgets and topical articles on taxation and public expenditures in Canada.*

This article describes the main federal and provincial income support programs available to seniors in Canada. Key provisions of programs, differences in demographic characteristics, and differences in labour market experience are important for understanding differences in the receipt of benefits across and within provinces. The author constructs and uses synthetic work histories to illustrate differences in expected contributions and benefits under the enhanced Canada Pension Plan. The author also describes how components of federal and provincial programs that target support to low-income seniors drive high marginal effective tax rates, resulting in provincial differences in the rewards for continued work at older ages.

The underlying data for the Finances of the Nation monographs and for the articles in this journal will be published online in the near future.

KEYWORDS: RETIREMENT ■ PENSION PLANS ■ OLD AGE BENEFITS ■ SENIOR CITIZENS

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INTRODUCTION

Canada's retirement income system involves a complex web of policies. The programs support Canadians' efforts to save for their retirement years, protect against risks associated with aging, and ensure a minimum standard of living for seniors.[1] It is arguable that existing federal and provincial income support programs have been successful in reducing poverty among seniors, and they remain an important source of retirement income.[2] The objective of this article is to describe key federal and provincial income support programs and to illustrate how seniors' interactions with the programs that are available across and within provinces may vary substantially. While the provisions of federal programs apply to all Canadians equally, individuals' demographic characteristics and work histories affect how they interact with programs over their lifetime, resulting in fairly different benefits and contributions across and within provinces. Moreover, the programs designed to target benefits to the lowest-income seniors often involve steep clawback rates that make higher-income seniors ineligible, resulting in high marginal effective tax rates (METRs) and discouraging work at older ages.

The article proceeds as follows. First, I provide a description of the main federal income support programs for Canadian seniors—the Canada Pension Plan (CPP), old age security (OAS), and the guaranteed income supplement and related allowances (collectively, GIS)—and the benefits received in each province over the years 2015-2019, based on the Canadian Income Survey (CIS).[3] Then, focusing on the recently enhanced CPP, I construct a set of synthetic work histories and use them to illustrate how different individuals interact with the program, resulting in very different benefits and contributions over their lifetime. The synthetic work histories are designed to reflect provincial differences in earnings, jobless spells, fertility, and time taken away from the labour market for the primary caregiving of children. The examples are intended to represent the expectations of a young person entering the labour market at the age of 18 in 2025 with plans to retire at the age of 65 in 2072. The variation in work histories, as well as differences in life expectancy, result in interesting similarities and differences across groups in both monthly and lifetime benefits. I then describe the income support programs that are available

1 For a discussion of the system, see Kevin Milligan and Tammy Schirle, *The Retirement Income System and the Risks Faced by Canadian Seniors*, prepared as the final synthesis report for the Canadian Labour Market and Skills Researcher Network's Challenges to Canada's Retirement Income System Research Program, Working Paper no. 120 (Waterloo, ON: Canadian Labour Market and Skills Researcher Network, 2013).

2 For example, Tammy Schirle, "Senior Poverty in Canada: A Decomposition Analysis" (2013) 39:4 *Canadian Public Policy* 517-40 (https://doi.org/10.3138/CPP.39.4.517), suggests that retirement income policies are an important determinant of senior poverty in Canada.

3 I use the public use microdata files of the CIS provided by Statistics Canada: Statistics Canada, "Canadian Income Survey: Public Use Microdata File" (www150.statcan.gc.ca/n1/en/catalogue/72M0003X). See the notes to this article's tables and figures for sample details.

to low-income seniors at the provincial level before considering how the structure of these programs affects seniors' METRs and, ultimately, their willingness to work at older ages.

FEDERAL INCOME SUPPORT PROGRAMS FOR SENIORS

Current Income Support Programs

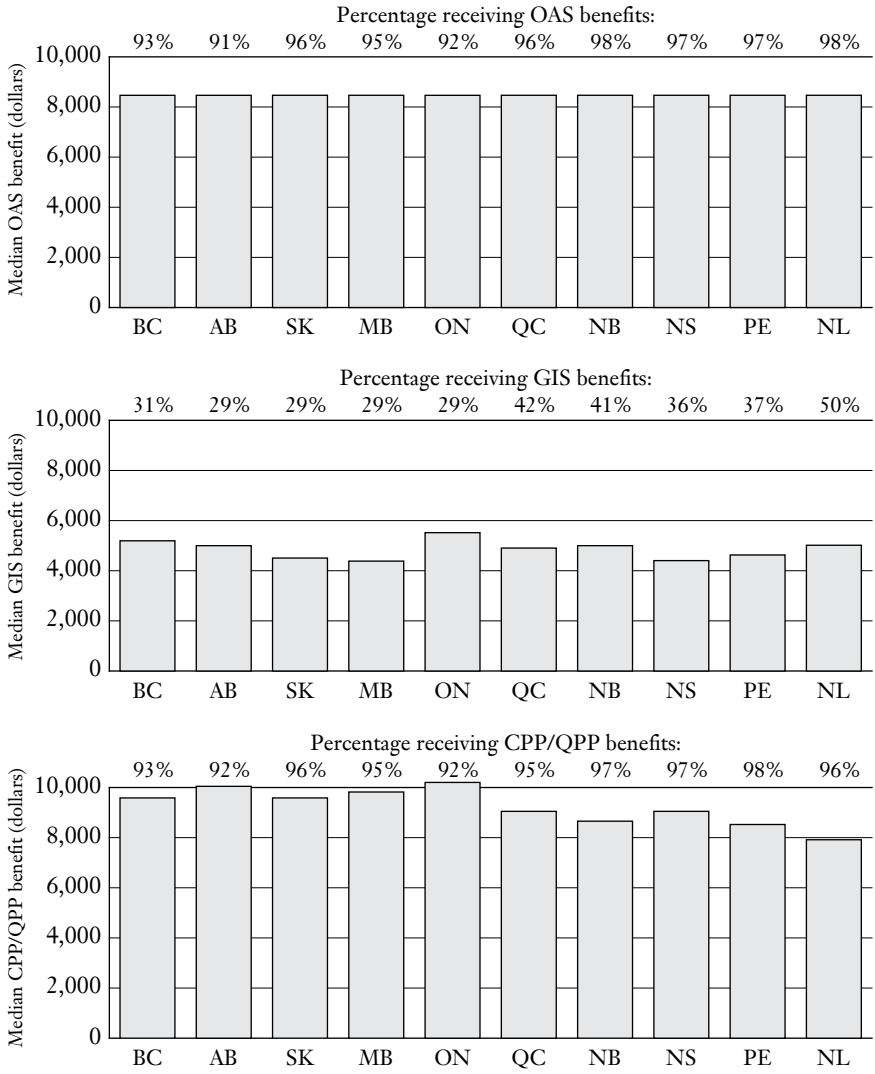
It is useful to think of federal income support for seniors as being provided primarily through three programs—OAS, GIS, and CPP.[4] (Note that individuals who contributed to the Quebec Pension Plan [QPP] exclusively, or who contributed to both CPP and QPP and reside in Quebec when they begin receiving pension benefits, will access QPP rather than CPP for their retirement pension. Because QPP has historically been structured similar to CPP, I do not address QPP differences in this section and instead focus on the federal programs.) Figure 1 shows the takeup rates and median benefit levels of recipients for each of these programs across provinces over the years 2015-2019.

For each of these programs, differences in benefit takeup rates and typical annual benefits across provinces largely reflect the parameters that define eligibility. OAS (represented in the top panel of figure 1) is commonly thought of as a universal demogrant, in that most individuals aged 65 and over are eligible for the full benefit. In 2024, OAS benefits are reduced for *individual* net income over $90,997 with a clawback rate of 15 percent, so that high-income individuals over age 65 may not qualify. Instead, they may choose to defer initiating benefits until age 70 and receive a higher monthly benefit upon takeup. There are also residency requirements to consider. To be eligible for benefits, a person must have resided in Canada for at least 10 years. For those who have been resident for less than 40 years, the benefit is prorated. As a result, differences across provinces in employment at older ages and length of residence in Canada largely explain provincial differences in benefits received. However, once benefits begin to be received, the typical OAS benefit is the same across provinces.

GIS is an income-tested benefit, with eligibility depending on the income of the unmarried individual or the married couple. Some income is exempt from the test—$5,000 of employment income, and 50 percent of self-employment income between $5,000 and $15,000—but the benefit is generally phased out for any other taxable income at a clawback rate of 50 percent. As a result, differences across provinces in the employment rates of seniors, or in the receipt of other retirement income (from CPP, employer-based pensions, or other taxable sources), explain the provincial differences in GIS receipt and benefit levels observed in figure 1 (middle panel).

4 For an overview of federal programs and a summary of changes since the 1960s, see Kevin Milligan and Tammy Schirle, "Retirement Incentives and Canada's Social Security Programs," in Axel Börsch-Supan and Courtney Coile, eds., *Social Security Programs and Retirement Around the World: Reforms and Retirement Incentives* (Chicago: University of Chicago Press, 2021), 79-107.

FIGURE 1 Takeup Rates and Median Benefit Levels Across Provinces, 2015-2019



BC = British Columbia; AB = Alberta; SK = Saskatchewan; MB = Manitoba; ON = Ontario; QC = Quebec; NB = New Brunswick; NS = Nova Scotia; PE = Prince Edward Island; NL = Newfoundland and Labrador.

OAS = old age security; GIS = guaranteed income supplement and related allowances; CPP = Canada Pension Plan; QPP = Quebec Pension Plan.

Note: All benefits are reported in February 2024 dollars. The sample includes individuals aged 65 and older, and benefit amounts reflect the median benefits among those individuals receiving some benefits.

Source: Author's tabulations using Statistics Canada, "Canadian Income Survey: Public Use Microdata File," for years 2015-2019 (www150.statcan.gc.ca/n1/en/catalogue/72M0003X).

For example, Manitoba is among the provinces with the lowest rate of GIS receipt (29 percent), and recipients tend to have lower benefits. Over the same period, Manitoba seniors were also most likely to report that someone in their family was receiving registered pension plan (RPP) income (79 percent). In contrast, Newfoundland and Labrador seniors were the least likely to report RPP income (62 percent) and the most likely to receive GIS (50 percent).[5]

CPP is different from OAS and GIS in that benefit eligibility depends almost entirely on a person's work history in Canada. To be eligible for CPP retirement benefits, a person must have made at least one contribution to CPP, which should happen as long as one earns more than the CPP's year's basic exemption (YBE) from employment in any year after turning 18 years old. Benefits may be initiated as early as age 60, with adjustments made to offer a higher monthly benefit if takeup is deferred to later ages (up to age 70).[6] The vast majority of eligible Canadians start receiving CPP by age 65.[7] Differences across provinces in the percentage of individuals aged 65 or older receiving CPP (shown in the bottom panel of figure 1) largely reflect differences in the timing of CPP/QPP takeup across provinces as well as differences in work histories affecting the eligibility of individuals.

When we consider the CPP benefits currently received by seniors, some of the differences observed across provinces (in the bottom panel of figure 1) reflect individual work histories and related contributions to the plan. However, some of those differences also reflect the age at which individuals typically take up benefits. Moreover, some differences reflect the year in which benefits were initiated and the rules for calculating benefits that were in place at that time. Making comparisons across a range of seniors at a single point in time makes it difficult to disentangle the mechanisms at work.

For this reason, in the next section I consider the provisions of the recently enhanced CPP framework and focus on a simple example—a person who will be 18 years old in 2025 and plans to take up CPP on turning 65. This person will be eligible for CPP after the enhanced framework's contributions and benefits are fully phased in. From her perspective today, and seeing what is typical in her province, what might she expect in terms of lifetime CPP benefits and contributions? By examining a range of potential work histories and expectations for this person's future—histories and expectations that vary by province, gender, and level of education—we can get a better sense of how different individuals expect to benefit from CPP provisions.

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5 Based on author's tabulations using the same CIS sample noted for figure 1. Statistics Canada, "Labour Force Survey: Public Use Microdata File," for years 2015-2019 (www150.statcan.gc.ca/n1/en/catalogue/72M0003X).

6 Gender differences in participation in CPP were historically significant, but the gap has narrowed as the employment rates of men and women have converged over time. See Milligan and Schirle, supra note 4.

7 For estimates, see Office of the Chief Actuary, Office of the Superintendent of Financial Institutions Canada, *Actuarial Report (31st) on the Canada Pension Plan as at 31 December 2021, Published December 2022* (Ottawa: Office of the Chief Actuary, 2022).

The Enhanced Canada Pension Plan

In 2016, the Canadian provinces agreed to an expansion of the CPP. This expansion and the contributions to fund it are being phased in over time. Higher contribution rates are being phased in over the 2019-2024 period, and entitlement to additional benefits will depend on whether one made those additional contributions. In this section, I consider the situation of a person who will turn 18 years old in 2025 and is estimating her potential retirement income at age 65 in 2072. How does this enhanced CPP work, how much might it cost her to contribute, and how much might she benefit in return?

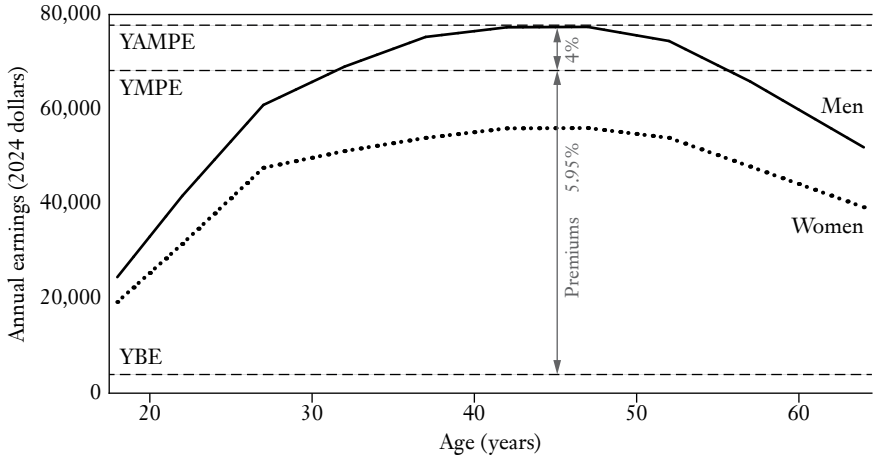
I begin with an overview of key enhanced CPP provisions that define a person's contributions and benefits. I consider how one's work history may vary across and within provinces, along the lines of gender and level of education. I then estimate the potential CPP benefits one might expect to receive on the basis of synthetic work histories that are constructed to reflect provincial differences in earnings, fertility, and jobless periods. When these considerations are together, we see that the enhanced CPP provisions offer Canadians benefits that closely align with their pensionable earnings and contributions, with differences resulting from provisions that resemble insurance to cover jobless periods and longevity risk.

CPP Contributions and Benefit Calculation

The enhanced CPP is best described as being made up of three parts. "Basic" CPP represents the provisions of the plan that were in place prior to 2016. The basic pension was designed to replace 25 percent of a person's average earnings up to an earnings cap—the year's maximum pensionable earnings (YMPE). The next two parts represent the recent expansion of CPP. The "first additional" CPP represents the expanded replacement rate—an additional 8.33 percent of average earnings (up to the YMPE) is replaced. The "second additional" CPP represents the expansion of the earnings cap, with the new standard of the year's additional maximum pensionable earnings (YAMPE) being set 14 percent higher than the YMPE, and additional pensionable earnings being replaced at a rate of 33.33 percent.

As an example, consider the earnings profiles presented in figure 2, representing the earnings of men and women from ages 18 to 64 in Canada. (The profiles' earnings are stated in 2024 dollars and represent the median earnings of men and women working full year in Canada over the period 2015-2019.) For the enhanced CPP, these individuals will make contributions only on earnings that fall below the pensionable earnings cap (YAMPE) and above the YBE. CPP premiums on earnings below the YMPE are set at 5.95 percent, while premiums on earnings between the YMPE and YAMPE are set at 4 percent. The higher contribution rate on earnings below the YMPE reflects the fact that current contributions to CPP are used to pre-fund the future pensions of current contributors as well as to help fund the current pensions of current pensioners. (Until the late 1990s, the CPP was entirely funded on a pay-as-you-go basis. Note that current pensioners will receive an expansion of benefits that is related only to the enhancement of the CPP in proportion to their additional contributions.) As

FIGURE 2 Median Annual Earnings of Full-Year Employees in Canada, 2015-2019



YAMPE = year's additional maximum pensionable earnings; YMPE = year's maximum pensionable earnings; YBE = year's basic exemption.

Note: In 2024, the YBE was $3,500 and the YMPE was $68,500. When the enhanced Canada Pension Plan is fully implemented, the YAMPE will be the YMPE times 1.14 ($78,090).

Source: Estimates based on author's tabulations using Statistics Canada, "Canadian Income Survey: Public Use Microdata File," for years 2015-2019 (www150.statcan.gc.ca/n1/en/catalogue/72M0003X), for individuals aged 18-64 working full year within each age group.

shown in figure 2, women who work full year do not typically earn more than the YMPE and will make contributions at a rate of 5.95 percent at all ages; their total contributions are lower when they are closer to age 18 and higher in their 40s, when their earnings are higher. The earnings profile of men in this example is similar to women's. Their total contributions are lower early in their working lives, when earnings are below the YMPE; by their mid-30s, their earnings surpass the YMPE and reach the YAMPE mid-career. At this stage, men make the maximum contributions, with no contributions on earnings above the YAMPE threshold.

Calculating the benefits that a person will receive at age 65 is not as straightforward as determining their contributions. There are several steps to the exercise because the provisions related to each part of enhanced CPP benefits (basic, first additional, and second additional) have slight differences. For each part, we must calculate the average ratio of annual earnings to the pensionable earnings thresholds (YMPE and YAMPE) after applying the provisions for exclusions and adjustments to a person's earnings history. These provisions for calculating initial CPP benefits are summarized in table 1. Once CPP is initiated, benefits are indexed to increase with price inflation.

TABLE 1 Overview of the Calculation of Initial Enhanced CPP Benefits

Provision	Basic CPP	First additional CPP	Second additional CPP
1. Begin with full work history, age 18-64 (47 years); calculate the relevant ratios (capped at 1)	Ratio: each year's earnings/YMPE	Ratio: each year's earnings/YMPE	Ratio: each year's (earnings − YMPE)/(YAMPE − YMPE)
2. Apply child-rearing provisions for children under age 7	Consider years while the child is under age 7: remove years with earnings below the YBE from the history; remove years in which earnings/YMPE is lower than average	Attribute the five-year average ratio prior to the child's birth, while the child is under age 7, if the attributed ratio is higher than the actual ratio	Attribute the five-year average ratio prior to the child's birth, while the child is under age 7, if the attributed ratio is higher than the actual ratio
3. Apply low-earnings provisions	Remove 17% of years with the lowest ratios; at least 10 years remain	Keep the 40 years with the highest ratios	Keep the 40 years with the highest ratios
4. Find the average ratio (*AR*) for each part	AR^{Basic}	AR^{1st}	AR^{2nd}
5. Find the five-year average of thresholds for each part at the time of takeup	*YMPE5*	*YMPE5*	*YAMPE5*
6. Calculate the initial monthly benefit, to be paid over one's lifetime, indexed to inflation	CPP benefit = $(0.25*YMPE5*AR^{Basic} + 0.833*YMPE5*AR^{1st} + 0.3333*(YAMPE5 - YMPE5)*AR^{2nd})/12$		

CPP = Canada Pension Plan; YMPE = year's maximum pensionable earnings; YAMPE = year's additional maximum pensionable earnings; YBE = year's basic exemption.

From table 1, we can see that the enhanced CPP is designed to replace 33.33 percent of a person's average earnings (up to the YAMPE earnings cap). However, the calculation of average earnings within each part of CPP implies that the relationship between earnings, contributions, and benefits will not be identical for all recipients.

Provincial Differences That Matter

The benefit levels presented in figure 1 suggest that there are significant differences in the experience of CPP recipients across provinces. Below, I consider how the various provisions for enhanced CPP benefits (table 2) may have different effects on

contributions and benefit eligibility across and within provinces, given differences in individual characteristics and labour market experiences.

Caregiving of Children

The child-rearing provisions in the CPP effectively attribute higher contributions than are actually made by primary caregivers who have relatively low earnings while their children are young. The provisions work as a subsidy, with the greatest benefit going to those who have more children and take extended parental leaves. Typically, mothers are designated as the primary caregivers for the purposes of these provisions, although parents can choose which parent will be designated as the primary caregiver for child benefit and pension purposes.

To the extent that there are differences across provinces in the number of children that people have, the caregiving provisions will result in some differences across provinces in CPP benefits. In figure 3, it is clear that total fertility rates vary across provinces, being higher in the prairie provinces and Quebec than in other provinces.

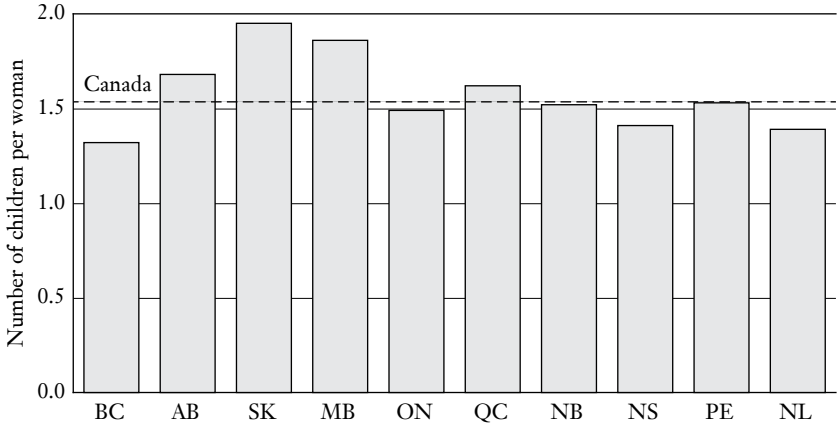
Jobless and Other Low-Earnings Periods

In addition to the child-rearing provisions, low-earnings provisions allow individuals with a long enough work history to drop some of their lowest-earnings years before calculating their average earnings for CPP purposes. These provisions benefit individuals who had significant time away from paid work after they reached age 18, whether for education purposes or as a result of spells of unemployment, which may vary in both frequency and duration across groups. To give a sense of how individuals across provinces might benefit from these provisions, figure 4 shows estimates of the unemployment rate and the average duration of unemployment for men and women aged 18 to 64.

In the 2015-2019 period, men in the Atlantic provinces tended to have the highest unemployment rates. Men in Alberta had the longest spells of unemployment across all provinces and had slightly lower unemployment rates than men in the Atlantic provinces. To obtain an estimate of the extent to which such spells can matter over one's entire work history, I estimate the number of years that people between the ages of 23 and 49 spend working full year, part year, or not at all, by gender and highest level of education (based on the CIS). The results are presented in figure 5.

The variation both within and across provinces gives us a sense of how the CPP's low-earnings provisions offer a source of insurance to cover jobless spells. For example, those with lower levels of education (high school or less [H] in figure 5) spend more years making low (or even zero) contributions to CPP, while those who are more likely to work without interruption (that is, those with higher levels of education—college/trades [C] or university [U]) are effectively required to make higher contributions that subsidize those facing jobless periods. The gender differences seen in figure 5 largely reflect gender differences in caregiving roles, since women (particularly those with lower levels of education) are more likely to remain out of the paid workforce (often as caregivers) but do not typically have longer unemployment spells than men when they are searching for work (as in figure 4).

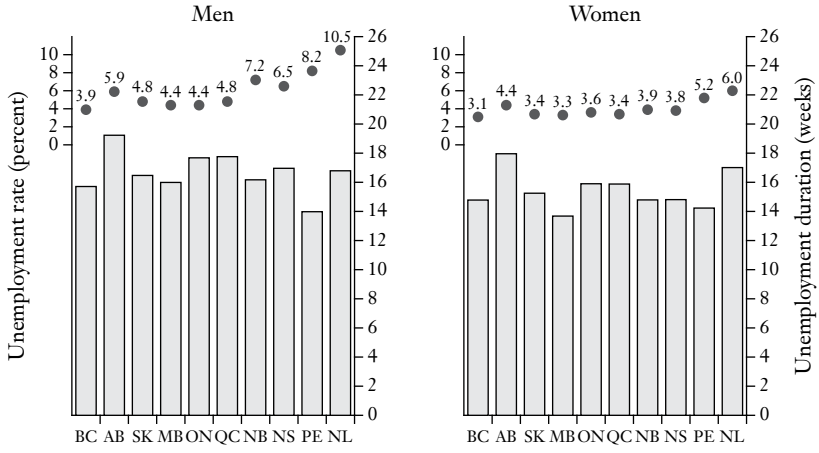
FIGURE 3 Total Fertility of Women in Canada, by Province, 2015-2019



BC = British Columbia; AB = Alberta; SK = Saskatchewan; MB = Manitoba; ON = Ontario; QC = Quebec; NB = New Brunswick; NS = Nova Scotia; PE = Prince Edward Island; NL = Newfoundland and Labrador.

Source: Based on information in Claudine Provencher and Nora Galbraith, *Fertility in Canada, 1921 to 2022* (Ottawa: Statistics Canada, 2024) (www150.statcan.gc.ca/n1/pub/91f0015m/91f0015m2024001-eng.pdf).

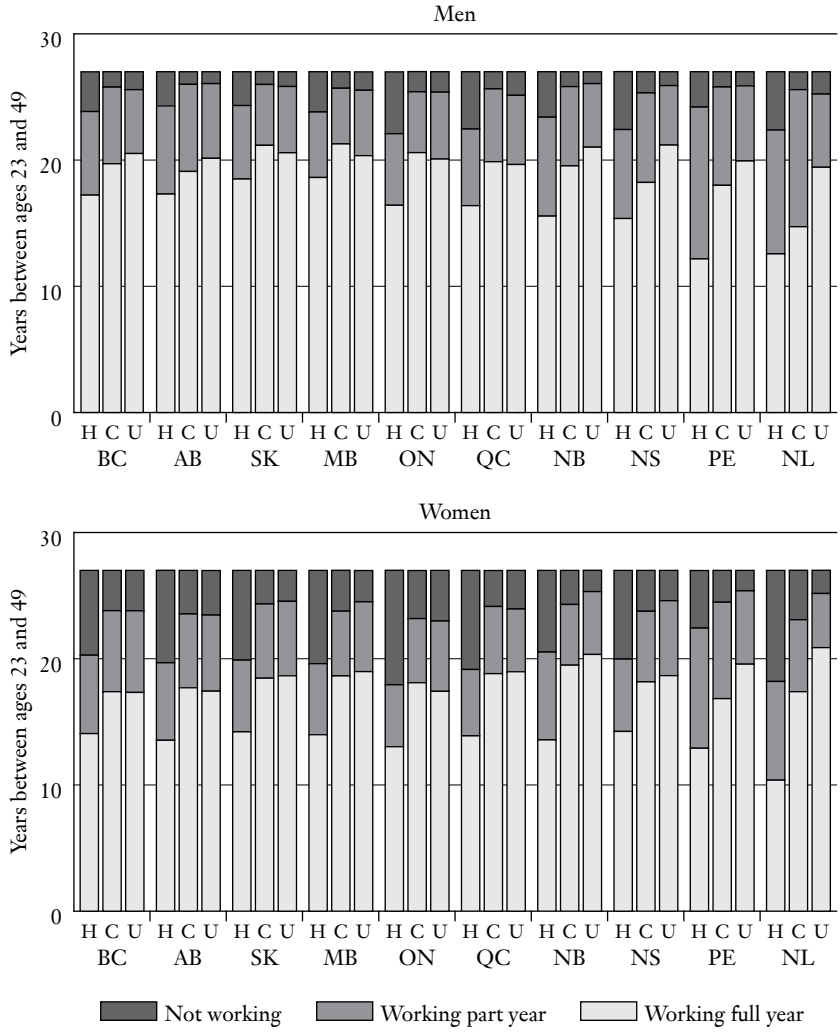
FIGURE 4 Unemployment Rate and Duration, by Gender, Ages 18-64, 2015-2019



BC = British Columbia; AB = Alberta; SK = Saskatchewan; MB = Manitoba; ON = Ontario; QC = Quebec; NB = New Brunswick; NS = Nova Scotia; PE = Prince Edward Island; NL = Newfoundland and Labrador.

Source: Author's tabulations using Statistics Canada, "Labour Force Survey: Public Use Microdata File," for years 2015-2019 (https://doi.org/10.25318/71m0001x-eng), using a sample of men and women aged 18-64 in each province.

FIGURE 5 Estimated Years Not Working, Working Part Year, and Working Full Year, by Gender and Highest Level of Education, Ages 23-49, 2015-2019



BC = British Columbia; AB = Alberta; SK = Saskatchewan; MB = Manitoba; ON = Ontario; QC = Quebec; NB = New Brunswick; NS = Nova Scotia; PE = Prince Edward Island; NL = Newfoundland and Labrador.

H = high school or less; C = college/trades; U = university.

Source: Author's tabulations based on Statistics Canada, "Canadian Income Survey: Public Use Microdata File," for years 2015-2019 (www150.statcan.gc.ca/n1/en/catalogue/72M0003X).

Longevity Differentials

Once a person takes up CPP, the benefit is paid every month for the rest of the person's life, with adjustments for inflation. As a result, there are differences in the lifetime benefits that one might expect to receive, given differences in life expectancy across provinces and genders. Similar to an employer-provided defined benefit pension plan, CPP provides a form of longevity insurance for Canadians, with the pensions of those who live longer effectively being supported by those with shorter lives. Women are likely to live and enjoy benefits longer than men after age 65 in all Canadian provinces (see figure 6). Across provinces, those in British Columbia tend to live the longest, followed by those in Ontario. Men in Newfoundland and Labrador have the shortest life expectancy in Canada.

Potential Initial and Lifetime CPP Benefits

Initial CPP Benefits

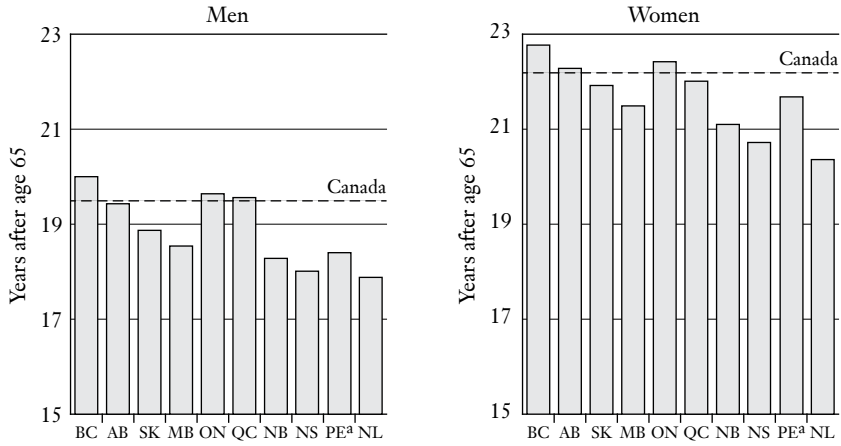
To get a sense of the differences in CPP benefits that might be expected within and across provinces, I construct synthetic work histories to represent men and women with different levels of education in each province and derive their expected annual CPP benefits upon retirement at age 65. These histories reflect the provincial differences presented above, and incorporate estimates of men's and women's median full-year earnings at each age, lower earnings while going to school, expected jobless spells, and the timing and number of children that women have.[8] Using these synthetic work histories, I apply the provisions summarized in table 1 and construct estimates of individuals' initial CPP benefits at age 65. The results are presented in table 2.

From table 2, it is clear that there is a close relationship between average earnings over a person's lifetime and benefit levels. However, when considering individuals with similar average earnings, we can see examples of the disconnect between earnings and benefits.

For example, consider men with low levels of education in Newfoundland and Labrador and in British Columbia. The former expect nearly the same annual benefits from CPP as the latter, despite much higher average earnings in British Columbia. The lower average in Newfoundland and Labrador, however, in part reflects more years spent jobless (as in figure 5) rather than significantly lower earnings while working full year. When CPP provisions allow low-earnings years to be dropped from a person's work history, average earnings for men in Newfoundland and Labrador

8 The earnings and jobless spells (between ages 23 and 49) are based on the 2015-2019 CIS estimates for each gender, province, and education group, similar to those presented in figures 2 and 5. Statistics Canada, "Labour Force Survey: Public Use Microdata File," for years 2015-2019 (www150.statcan.gc.ca/n1/en/catalogue/72M0003X). For the number of children, women are assigned one child if their provincial total fertility is lower than the Canadian average (in figure 3) and two otherwise, with the timing of a first child being based on estimates in Statistics Canada, "First-Time Mothers in Canada, 2019" (www150.statcan.gc.ca/n1/pub/11-627-m/11-627-m2020071-eng.htm).

FIGURE 6 Life Expectancy After Age 65, by Gender and Province, 2017-2019



BC = British Columbia; AB = Alberta; SK = Saskatchewan; MB = Manitoba; ON = Ontario; QC = Quebec; NB = New Brunswick; NS = Nova Scotia; PE = Prince Edward Island; NL = Newfoundland and Labrador.

a Life expectancy estimates for Prince Edward Island are available only for age interval 65-69.

Sources: Statistics Canada table 13-10-0114-01, "Life Expectancy and Other Elements of the Complete Life Table, Three-Year Estimates, Canada, All Provinces Except Prince Edward Island" (https://doi.org/10.25318/1310011401-eng); and Statistics Canada table 13-10-0140-01, "Life Expectancy and Other Elements of the Abridged Life Table, Three-Year Estimates, Prince Edward Island and the Territories" (https://doi.org/10.25318/1310014001-eng).

are boosted more for CPP purposes, bringing their benefits more in line with those for men in British Columbia.

Consider also women in Newfoundland and Labrador and in Prince Edward Island with college and trades degrees, who have average earnings in a range similar to the earnings of men with high school or less in Nova Scotia. In the synthetic work histories for these provinces, it is assumed that these women have one child. They are allowed to drop up to seven years of relatively low earnings from their work history for the basic CPP calculation, before they apply the same low-earnings provisions that the men in Nova Scotia can apply. As a result, these provisions substantially raise the average earnings used for the purposes of the CPP benefits calculation, leading to higher CPP benefits for the women who are primary caregivers.

Lifetime CPP Benefits and Contributions

These small differences in initial CPP benefits can add up to large differences over a person's lifetime. Given substantial differences across provinces and gender in life expectancy after age 65 (see figure 6), we expect to see provincial differences in a

TABLE 2 Average Earnings and Initial CPP Benefits at Age 65 (Synthetic Work Histories)

	Men					
	High school or less		College/trades		University	
	Average earnings	CPP at 65	Average earnings	CPP at 65	Average earnings	CPP at 65
	dollars					
British Columbia	49,198	17,711	65,819	23,248	71,106	23,554
Alberta	54,712	19,847	77,383	23,700	88,897	24,245
Saskatchewan	45,376	16,462	71,671	23,708	78,934	23,927
Manitoba	45,860	16,636	62,086	21,984	68,969	22,631
Ontario	44,918	16,786	64,279	22,795	76,445	23,138
New Brunswick	42,175	15,554	56,421	20,077	73,625	23,036
Nova Scotia	38,759	14,384	55,698	20,273	75,773	23,233
Prince Edward Island	38,152	13,887	49,951	17,762	67,132	22,144
Newfoundland and Labrador	46,430	17,422	66,725	22,513	84,469	23,320

	Women					
	High school or less		College/trades		University	
	Average earnings	CPP at 65	Average earnings	CPP at 65	Average earnings	CPP at 65
	dollars					
British Columbia	30,366	12,071	39,408	15,118	49,790	19,541
Alberta	33,674	13,588	47,413	17,873	58,539	21,666
Saskatchewan	28,811	11,715	42,616	16,424	58,255	22,094
Manitoba	30,181	11,778	40,726	15,565	57,481	22,479
Ontario	26,984	10,709	41,158	15,616	54,287	20,785
New Brunswick	28,615	10,971	35,531	13,327	61,712	22,888
Nova Scotia	27,027	10,488	37,486	14,420	56,355	21,064
Prince Edward Island	24,737	9,423	38,668	14,688	57,716	20,892
Newfoundland and Labrador	21,943	9,168	38,994	15,345	69,700	22,918

CPP = Canada Pension Plan.

Note: Quebec is omitted because most Quebec residents contribute to and benefit from the Quebec Pension Plan rather than the CPP.

Sources: Author's tabulations using Statistics Canada, "Canadian Income Survey: Public Use Microdata File," for years 2015-2019 (www150.statcan.gc.ca/n1/en/catalogue/72M0003X); and provisions of the Canada Pension Plan Act.

person's lifetime benefits. To clarify the connection between a person's lifetime CPP benefits and contributions, I consider the individuals with synthetic work histories described above, and their initial CPP benefits described in table 2, and then assume that they live to age 102. Their contributions and benefits are discounted from age 65 by 2 percent per year, and their expected benefits depend on their province- and gender-specific probability of survival to each age after reaching 65.[9] Summing benefits and contributions over their lifetime, I then obtain the ratio of individuals' lifetime benefits and contributions. The resulting ratios, representing men and women at each education level in each province, are presented in figure 7 in relation to their life expectancy after age 65.

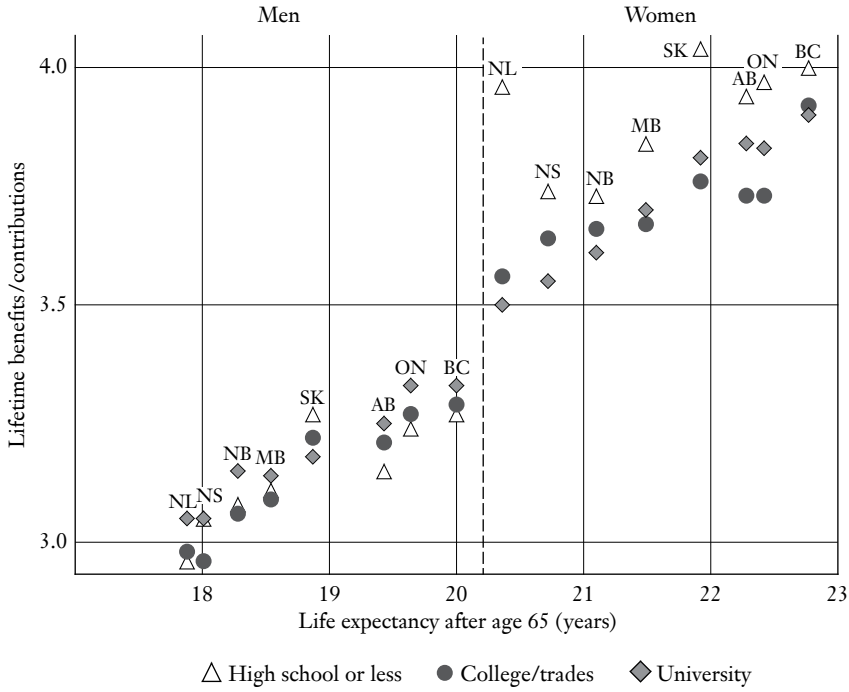
The higher life expectancy of women clearly drives the higher CPP benefits-to-contributions ratio for women compared to that for men in all provinces. Across provinces, we can see that lower-educated women in Newfoundland and Labrador have among the highest benefits-to-contributions ratios. Despite having the lowest life expectancy and lowest average earnings among women, they appear to benefit the most from the child-rearing and low-earnings provisions in terms of their initial CPP benefits, and that adds up over their lifetime. The differences seen across education groups within a province, however, are worthy of further consideration. In the example shown here, the same survival probabilities have been applied to all women in the same province. The literature, however, suggests that individuals in higher-income groups are expected to live longer than individuals in lower-income groups.[10] If provincial survival estimates were adjusted to capture this, one would expect the benefits-to-contributions ratios for those with lower education to fall, and the ratios for those with higher education to rise.

Among men, the estimates in figure 7 more clearly represent the relationship whereby individuals with higher life expectancy enjoy higher CPP benefits relative to the contributions they made over their lifetime. Among men, we see that those in British Columbia enjoy the highest ratio of benefits to contributions, while men in Newfoundland and Labrador tend to have the lowest ratio. This relationship is

9 I use age-, gender-, and province-specific survival probabilities at each age, based on the 2019 mortality rates in Statistics Canada's life tables. See the source note to figure 6: Statistics Canada table 13-10-0114-01, "Life Expectancy and Other Elements of the Complete Life Table, Three-Year Estimates, Canada, All Provinces Except Prince Edward Island" (https://doi.org/10.25318/1310011401-eng); and Statistics Canada table 13-10-0140-01, "Life Expectancy and Other Elements of the Abridged Life Table, Three-Year Estimates, Prince Edward Island and the Territories" (https://doi.org/10.25318/1310014001-eng). I do not provide lifetime benefit estimates for Prince Edward Island because age-specific rates are not available.

10 For example, Kevin Milligan and Tammy Schirle, "The Evolution of Longevity: Evidence from Canada" (2021) 54:1 *Canadian Journal of Economics* 164-92 (https://doi.org/10.1111/caje.12497), provide estimates suggesting that there is a 3.6-year gap in life expectancy between women from the top and bottom 5 percent of earners, and an 8-year gap between men in the top and bottom 5 percent.

FIGURE 7 Ratio of CPP Lifetime Benefits to Contributions, and Life Expectancy



BC = British Columbia; AB = Alberta; SK = Saskatchewan; MB = Manitoba; ON = Ontario; NB = New Brunswick; NS = Nova Scotia; NL = Newfoundland and Labrador.

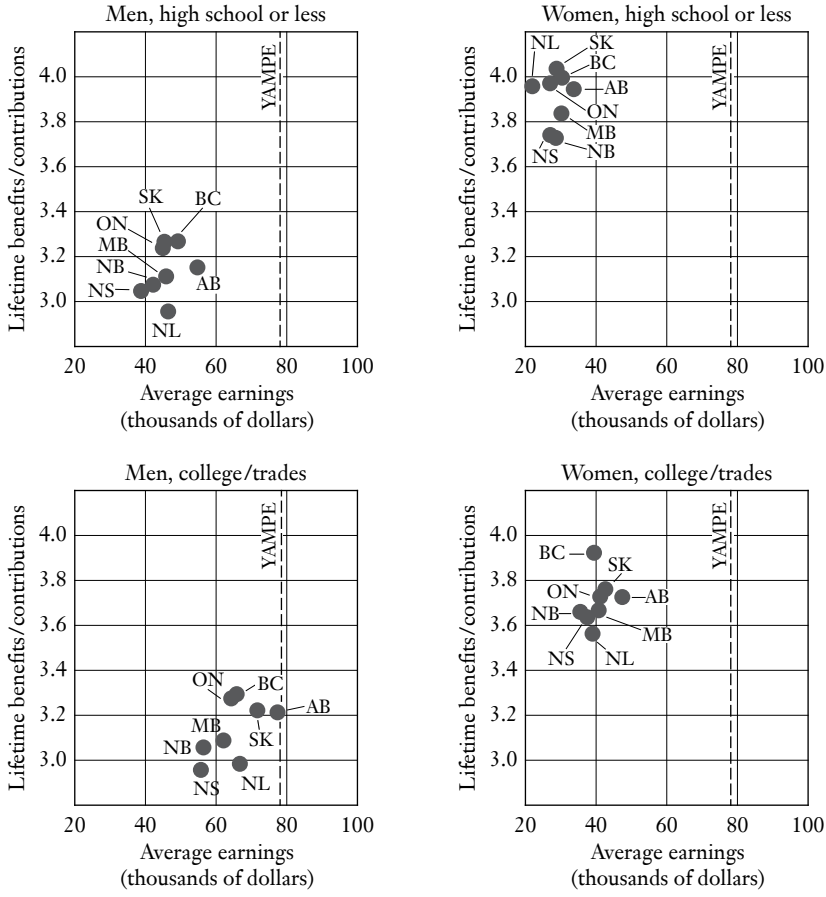
CPP = Canada Pension Plan.

Note: Quebec is omitted because most Quebec residents contribute to and benefit from the Quebec Pension Plan rather than the CPP. Prince Edward Island is omitted because life expectancy and survival probability estimates are available only for age intervals, so its results are not directly comparable with those for other provinces.

Source: Author's tabulations.

further exemplified in figure 8, which groups individuals with similar synthetic work histories (by gender and education) and relates their ratio of lifetime benefits to contributions and average earnings. The small differences in average earnings within groups are effectively diminished once low-earnings provisions are applied to the benefits calculation, so that most differences in the ratio of lifetime benefits to contributions relate to life expectancy. Only among women with lower education (in the top panel of figure 8) do the child-rearing and low-earnings provisions play a dominant role in affecting women's relative benefits-to-contributions ratios. Across groups of men in figures 7 and 8, it is worth noting that the ratios of lifetime benefits to contributions fall within a similar range across education groups. This suggests

FIGURE 8 Ratio of CPP Lifetime Benefits to Contributions and Average Annual Earnings, by Gender and Highest Level of Education

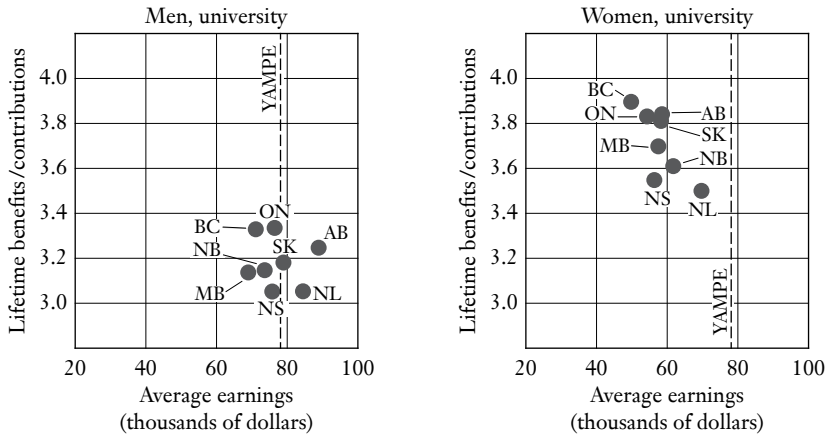


(The figure is concluded on the next page.)

that the cross-subsidization of CPP contributions among men, resulting from the low-earnings provisions, is minimal.

Overall, the enhanced CPP system is designed to ensure that one's benefits and contributions are closely related. Differences arise, however, reflecting the various cross-subsidies—within and across provinces—built into the system that are intended to support individuals' time in primary caregiver roles, subsidize the contributions that individuals cannot make during jobless periods, and offer longevity insurance by providing a defined benefit guarantee in retirement. Combined with OAS and GIS provisions, the federal system offers a foundation for many Canadians' retirement plans.

FIGURE 8 Concluded



BC = British Columbia; AB = Alberta; SK = Saskatchewan; MB = Manitoba; ON = Ontario; NB = New Brunswick; NS = Nova Scotia; NL = Newfoundland and Labrador.

CPP = Canada Pension Plan; YAMPE = year's additional maximum pensionable earnings.

Note: Quebec is omitted because most Quebec residents contribute to and benefit from the Quebec Pension Plan rather than the CPP. Prince Edward Island is omitted because survival probability estimates are available only for age intervals, so its results are not directly comparable with those for other provinces.

Source: Author's tabulations.

PROVINCIAL INCOME SUPPORT PROGRAMS FOR SENIORS

For low-income seniors, several provinces offer a top-up to federal income support programs. In those provinces that offer additional cash transfers, the benefits potentially depend on a senior's marital status, other income available, and whether the person is living in a seniors' residence or long-term-care facility. The maximum monthly benefits available to single seniors at age 65 (living in a private dwelling) are summarized in table 3.

The provincial benefits described table 3 are designed to top up the incomes of the lowest-income seniors, so seniors with even modest incomes are typically ineligible to receive any additional benefits. The maximum monthly benefit is highest in Saskatchewan, at $360 per month, but it is subject to a high clawback rate: the benefit is entirely clawed back if a senior's income reaches $380 per month (for example, from CPP). Manitoba's monthly benefit is lower, but the clawback rate is also lower; the benefit is reduced by 6.6 percent for every dollar of income, and phases out entirely once a senior's income reaches $812 per month.

Several provinces also offer broad support for services, even when direct income support is not available. For example, Quebec's financial assistance program for

TABLE 3 Provincial Income Support Programs for Single Seniors

Province	Cash transfers to seniors	Maximum monthly benefit	Clawback rate	Income considerations
British Columbia	Senior's Supplement	$99.30	50%	Same as GIS
Alberta	Alberta Seniors Benefit	$316	16.60%	Exemptions include $3,600 of earnings and CPP death benefits
Saskatchewan	Seniors Income Plan	$360	95%	Same as GIS
Manitoba	55 PLUS Program	$53.93	6.60%	Same as GIS
Ontario	Guaranteed Annual Income System (GAINS)	$83	50%	Based on "private income"
Quebec	na	—	—	
New Brunswick	na	—	—	
Nova Scotia	na	—	—	
Prince Edward Island	na	—	—	
Newfoundland and Labrador	Newfoundland and Labrador Seniors' Benefit	$126	11.66%	Based on net income

GIS = guaranteed income supplement and related allowances; CPP = Canada Pension Plan.

na = not applicable.

Notes: This table shows the maximum monthly benefit for 2024 for unmarried seniors at age 65 who are living in a private dwelling (not a long-term-care facility), based on the most recent publicly available information. In some provinces, clawbacks and income considerations are not clearly reported or easily summarized. Where that is the case, the clawback is estimated on the basis of available information regarding the income required to reduce a benefit to zero. GIS income considerations for the calculation of benefits use line 23600 of the federal T1 tax form for annual net income, exempting $5,000 in employment income.

domestic help services is an income-tested benefit that helps to cover the hourly rate charged for domestic services such as housekeeping and meal preparation. Several provinces offer programs that help to cover the costs of prescription drugs or home-care services for seniors, with coverage rates that are income-tested.

MARGINAL EFFECTIVE TAX RATES FOR LOW-INCOME SENIORS

The federal and provincial income support programs discussed in the previous sections are designed to offer foundational retirement income support to seniors. The clawback rates described above—particularly for GIS and provincial support programs—are intended to ensure that the funds are well targeted to support low-income seniors. Among seniors, one might expect that the opportunity to work for wages is often limited by health constraints, especially at older ages. However, the capacity to work at older ages appears to have increased over time, and many seniors are able to work.[11] Before accepting employment, though, seniors should consider the extent to which earning a bit more income will reduce their federal and provincial benefits.

The existing literature describes the importance of the GIS clawback for the incentives to continue working at older ages. There are important interactions between GIS and CPP to consider here—for every year that a person postpones CPP takeup or continues working, the monthly CPP benefit will be higher for the rest of the person's lifetime. However, for every dollar of CPP income that is gained, 50 cents of GIS benefits will be lost. If the person lives in a province with other GIS top-ups, those benefits may be reduced as well. This results in an incentive for seniors who expect to be eligible for GIS and other supports to retire earlier rather than later.

More generally, we can think of the employment decisions of a low-income senior who has already retired. If she chooses to take up employment, she may not be eligible for some benefits. If wages earned exceed $5,000 per year, her GIS benefits will be reduced by 50 cents for every dollar earned. If the senior lives in Ontario, she may also lose 50 cents of her Ontario Guaranteed Annual Income System (GAINS) benefit for every dollar earned. When we account for the clawback of benefits from just GIS and GAINS alone, the METR on the extra dollar earned for an Ontario senior is already 100 percent. If we further consider any loss of services associated with an income test and personal income taxes paid on income earned, a senior's METR can easily exceed 100 percent.

The METRs for higher-income seniors are less affected by federal and provincial income support programs, since their high-income status implies that they are not eligible for benefits, and thus additional income is not subject to the programs' clawback rates. One exception is OAS, for which higher-income seniors' benefits are reduced by 15 cents for every dollar earned. (Note that the clawback is assessed on

11 For example, Kevin Milligan and Tammy Schirle, "Health and Capacity To Work of Older Canadians: Gender and Regional Dimensions" (2018) 44:2 *Canadian Public Policy* 159-72 (https://doi.org/10.3138/cpp.2017-028), estimate changes in the relationship between health capacity and work. They suggest that men between the ages of 55 and 69 could work five more years in order to keep pace with how men with the same health capacity worked in 1976, while women could work two more years, with important regional differences in health capacity at older ages.

an individual basis, unlike GIS, which is assessed on a family basis.) To avoid this, seniors can defer taking up OAS benefits to age 70, when seniors' employment income tends to be less than at age 65.

To the extent that seniors' labour supply may be more responsive to financial incentives than the labour supply of other workers, the potentially high METRs for low-income seniors described here should be of concern to policy makers. In response, provinces could consider measures that incentivize work at older ages. For example, Quebec introduced the tax credit for career extension, a non-refundable tax credit designed to function as a wage subsidy that lowers the METR applied to seniors' employment earnings, similar to the Canada workers benefit.[12] There has been discussion of introducing a similar tax credit at the federal level. The interaction of CPP and GIS (as well as other income-tested programs) may also be worthy of further consideration.

DISCUSSION

There are two key takeaways from this article. First, while the federal income support programs for seniors are applied equally to all seniors across the country, the importance of different provisions for the income received varies quite a lot across seniors. The available provisions in CPP for child rearing and periods of low earnings mean that some individuals get more out of the system, in terms of benefits, relative to their contributions. These small differences add up over one's lifetime, and even greater variations across individuals result from large differences in life expectancy. These provisions, however, may be thought of as being a kind of insurance whereby Canadians have agreed to support each other in covering the risk of earnings loss as a result of primary caregiving priorities or jobless periods, and protect each other against longevity risk in order to ensure sufficient income at the oldest ages. Second, by targeting support to low-income seniors, the available federal and provincial programs create high METRs that may disincentivize working at older ages. While some seniors may be limited for health reasons in their capacity to work at older ages, there is room to redesign policies in a way that would minimize work disincentives among those seniors who are able to work more in the interest of supplementing their private and public pension income in retirement.

12 The Quebec tax credit offers someone 65 years old in 2023 a 14 percent wage subsidy on earnings between $5,000 and $16,000, with the maximum benefit being clawed back at a rate of 5 percent on income over $38,945.

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Personal Tax Planning

Co-Editors: Chris Watt Bickley,* Sonia Gandhi,** Dino Infanti,*** and Bessy Triantafyllos****

GRIN AND BARE IT—THE RECENT KERFUFFLE OVER BARE TRUSTS

*Joel Nitikman*****

The Income Tax Act has been amended to require bare trusts to file tax returns. This article explores the nature of a bare trust.

KEYWORDS: TRUSTS ■ TRUSTEES ■ AGENTS ■ AGENCY

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Planification fiscale personnelle

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RÉCENT BROUHAHA AUTOUR DES SIMPLES FIDUCIES — UN CONCEPT PEUT-ÊTRE PAS SI SIMPLE

*Joel Nitikman******

La Loi de l'impôt sur le revenu a été modifiée afin d'exiger des simples fiducies qu'elles produisent des déclarations de revenus. Le présent article explore la nature de la simple fiducie.

MOTS CLÉS : FIDUCIES ■ FIDUCIAIRES ■ MANDATAIRES ■ MANDAT

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Corporate Tax Planning

Co-Editors: Mark Brender,* Brian R. Carr,** Michael R. Smith,*** and Christopher J. Steeves****

MAKING SENSE OF CANADA'S CLEAN ENERGY INVESTMENT TAX CREDITS

*Colena Der and Edward Rowe*****

To advance Canada's transition to a green economy, the federal government has introduced a number of tax incentives intended to help fund the capital cost of qualifying clean energy projects. This article discusses six new clean energy investment tax credits (ITCs), four of which were included in legislation enacted in June 2024. The authors outline the design elements of these clean energy ITCs and provide details of the terms and conditions that apply, or are proposed to apply, in each case.

KEYWORDS: INVESTMENT TAX CREDITS ■ ENERGY POLICY ■ TAX INCENTIVES ■ CAPITAL INVESTMENTS

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Current Tax Reading

Co-Editors: Kim Brooks, Jinyan Li, Alan Macnaughton, and Michael Veall*

François Vaillancourt and Nathaniel Li, *Personal Income Tax Compliance for Canadians: How and at What Cost?* (Vancouver: Fraser Institute, 2024) (www.fraserinstitute.org/sites/default/files/personal-income-tax-compliance-for-canadians.pdf)

This is a report of a survey of 1,523 Canadian residents, aged 18 or older, who were drawn from a panel. The survey, conducted by a polling firm in May 2023, asked about the preparation of 2022 personal income tax returns. The questionnaire itself is provided. Other than that, we are given little information about the survey's methodology. No information is included, for example, about any bias created by the low response rate and its consequence—namely, that those surveyed are not representative of Canadian taxpayers. Respondents were assigned survey weights to match the Canadian population on key demographic variables and types of income received.[1]

The aggregate statistics are of most interest: on average, individual Canadian taxfilers spent 1.5 hours on accumulating required tax data and filing tax returns, and their out-of-pocket expenses were $88. On the basis of a question regarding respondents' pre-tax hourly wage—a question designed to put a value on the time they spent preparing their returns (averaging $42 for the 1.5 hours)—the survey found that a taxfiler's total compliance cost averaged $130.[2] This amounted to 1.2 percent (on average) of total personal income tax revenue.[3] The report involves no comparison with research results from other countries, although this information is available in previously published research of the report's senior author.[4]

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1 At 18-19, table A-1.

2 At 1.

3 At 12.

4 For intertemporal comparisons, see Feriel Grine and François Vaillancourt, *Modes de préparation et coûts de produire une déclaration de revenus des particuliers au Canada: résultats pour 2018 et comparaisons intertemporelles*, Cahier de recherche 2023/18 (Québec: Université de Sherbrooke, Chaire de recherche en fiscalité et en finances publiques, 2013).

One of the survey questions was how respondents would react "if the federal government sent you a prefilled form for both federal and provincial taxes."[5] The option of a prefilled form has been mentioned in recent budgets and is under consideration by the Canada Revenue Agency (CRA). The survey responses were converted into quantitative results through assumptions regarding how each of the responses affected compliance costs. These assumptions ranged from a 100 percent reduction in compliance costs for a response of "accept it [that is, the prefilled form] as such with no verification on your part" to a 0 percent reduction for a response of "continue preparing your own income tax return."[6] The results showed that average compliance costs would go down by one-third, from $130 to $87, if pre-filled returns were offered.[7] Although the report does not comment on the age breakdown, the proportion of respondents who would not use the prefilled return rises monotonically with age, from 5 percent of respondents aged 18-24 to 36 percent for respondents aged 65 and over.[8] Thus, younger respondents would receive the largest reduction in compliance costs if prefilled returns were used.

The survey showed that half of the filers (50 percent) prepared their own tax returns, while more than one-third (37 percent) used a paid tax preparer; the remainder had a friend, family member, or volunteer prepare the return.[9] Of the filers who used software to prepare their own return, about 60 percent used the "auto fill my return" option to download tax data from the CRA.[10]

One of the survey questions was how much of the respondents' time was spent on "general issues, payment and federal form," as opposed to "provincial form or annex."[11] Canadian filers overall reported a 60/40 split, while Quebecers reported a 50/50 split.[12] This seems to imply that filers outside Quebec spent at least 30 percent of their time specifically on provincial forms. Although the report does not comment on this figure, it seems high. These provinces have agreed, under the tax collection agreements, that provincial differences are limited to the rate schedule and tax credits; the differences do not involve the definition of "taxable income." Also, many provincial credits are simply the application of provincial credit rates to the federal definition of "qualifying expenditures."[13]

A key component of the report is various cross-tabulations. For example, time spent in the preparation and filing of returns is correlated with various socio-demographic

5 At 38.

6 At 14, table 4.

7 At 14, table 4.

8 At 13, figure 4.

9 At 4.

10 At 7.

11 At 36.

12 At 10.

13 One case of provincial complexity is Ontario's childcare access and relief from expenses (CARE) tax credit.

characteristics and types of income.[14] Other tables show similar results for out-of-pocket expenses.[15] However, the report notes that these bivariate results can be misleading: "[W]hen we observe the relationship between income levels and compliance costs, we do not control for age or education—two determinants of income."[16]

To deal with this problem, the report also carries out a multivariate analysis of total compliance costs (which combine taxpayers' hours with out-of-pocket expenses). In the authors' preferred statistical model, the only statistically significant relationships were with income and self-employment: the effect of moving from income under $60,000 to income over $100,000 was to increase compliance costs by $118, and the effect of moving from being an employee to being self-employed was to increase compliance costs by $104.[17]

The statistical model above included only socio-demographic variables. Using a different statistical model that also considered the method of preparing the tax return, the survey found that using a paid tax preparer, as opposed to using purchased software to prepare the tax return oneself, increased total compliance costs by $26.[18] Given that total compliance costs included the value of the taxpayer's time, using a paid preparer did not save the taxpayer enough time to justify the increased costs.

AM

Fei Men, Andrée-Anne St-Germain, Kent Ross, Ronaz Remtulla, and Valerie Tarasuk, "Effect of Canada Child Benefit on Food Insecurity: A Propensity Score-Matched Analysis" (2023) 64:6 *American Journal of Preventive Medicine* 844-52

Previous studies have shown that the Canada child benefit (CCB) is effective at raising income, food expenditure, and living standards. This study shows that the CCB is also effective at reducing food insecurity. The authors had very good data—namely, Statistics Canada's Canadian Income Survey, which is linked to tax records. The survey was administered for three years, from 2019 to 2021.

To measure food insecurity, 18 questions were asked regarding income-related access to food in the preceding 12 months. From the answers to these questions, a binary (zero or one) measure of food insecurity was developed.

A possible approach would have been to weigh the effect of the CCB on the food-security measure by comparing CCB recipients with non-recipients. However, it was considered that this approach would bias the results because of systematic differences in household characteristics between the two groups (for example, some households are childless families while others are families with children). Therefore, a different approach was adopted. Families with at least one child under 6 years old were the

14 At 25-26, table A-5.

15 At 27-28, table A-6.

16 At 11.

17 At 11 and 30-31.

18 At 31.

"treatment group," (or "treated households"). Families with children who were all 6 to 17 years old were the "untreated group" (also referred to as "the control group"). Because the CCB provides higher benefits for children under 6, a typical treated household had $724 higher CCB per child per year than did an untreated household. Therefore, the treated households were expected to be less food-insecure.

The statistical results confirmed this hypothesis. In short, treated households, relative to untreated households, were found to have a 12 percent lower probability of being food-insecure (24.3 percent of the untreated households were food-insecure, while 21.42 percent of the treated households were food-insecure).

AM

Kelly Foley, David A. Green, and W. Craig Riddell, "Canadian Inequality Over the Last 40 Years: Common and Contrary Variations on Universal Themes" (2024) 45:2 *Fiscal Studies* 119-30

James Banks, Richard Blundell, Antoine Bozio, Jonathan Cribb, David Green, and James P. Ziliak, "Changing Labour Market and Income Inequalities in Europe and North America: A Parallel Project to the IRS Deaton Review of Inequalities in the 21st Century" (2024) 45:2 *Fiscal Studies* 111-17 (https://doi.org/10.1111/1475-5890.12379)

Jake Fuss and Grady Munro, *Canada's Rising Personal Tax Rates and Falling Tax Competitiveness* (Vancouver: Fraser Institute, 2024)

Tegan Hill and Nathaniel Li, *Undoing Alberta's Personal Income Tax Hikes* (Vancouver: Fraser Institute, 2024)

Jake Fuss and Nathaniel Li, *Measuring Progressivity in Canada's Tax System* (Vancouver: Fraser Institute, 2024)

Economic inequality, and the contribution of the tax and transfer system to that inequality, continues to be of wide interest. These five studies illuminate different aspects of the topic.

Foley, Green, and Riddell take a long-term perspective on Canadian inequality, examining trends from 1995 to 2019. Both the inequality of market incomes and the inequality of disposable incomes are studied and explained. The difference between the two, of course, is the effect of the tax and transfer system.

There are three main findings. First, there were strong increases in the inequality of market incomes in the 1980s and early 1990s—not just in Canada but also in the United Kingdom and the United States. In Canada, however, these increases were almost completely offset by changes in tax and transfer policies. Second, inequality increased in the subsequent decade, largely because of cuts in both taxes and transfers. Third, from about 2000 to 2019, both the inequality of market incomes and the inequality of disposable incomes have been flat. This last finding is perhaps particularly surprising, given that inequality of both types rose in many other countries. Unfortunately, the lack of data beyond 2019 prevents an examination of more recent trends.

Banks et al., reporting on a multi-country project (of which the article by Foley, Green, and Riddell is one component), situate these Canadian findings in the context of three other English-speaking countries (the United States, the United Kingdom, and Ireland) and four Scandinavian countries. Perhaps the most interesting finding is that the Canadian experience described above is sharply different from the US experience; in the United States, the inequality of disposable income has been steadily rising for the past five decades. This has largely been driven by increases in the inequality of market incomes (especially for the highest-income group). The main factors in this increased inequality of market incomes were the decline of work and marriage in the non-college-educated group and the tendency of higher-income individuals to marry other higher-income individuals ("associative mating"). This increasing inequality of pre-tax incomes translates into increasing inequality of disposable incomes because the tax and transfer system, although it is redistributive, is not sufficiently so to reverse these market forces.

While the two *Fiscal Studies* articles discussed above devote much space to examining the reasons for the inequality of market incomes, the three Fraser Institute reports—by, respectively, Fuss and Munro, Hill and Li, and Fuss and Li—pay no attention to the inequality of before-tax incomes; they focus exclusively on the tax and transfer system. Generally speaking, the issue examined is the burden of personal income taxes on higher-income individuals, which is a key factor in reducing inequality in disposable incomes.

Fuss and Munro measure the extent to which marginal tax rates on higher-income individuals have been rising in the recent years, and they provide detailed information, organized according to province, for the 2009-2023 period. The federal government increased the top marginal rate from 29 percent to 33 percent in 2016, but it was far from alone: beginning with Nova Scotia in 2010, 7 out of 10 provinces also increased top marginal rates in this period. Of these increases, the largest was in Newfoundland and Labrador, which raised its top marginal rate over 10 percentage points.[19] In the 2009-2023 period, three provinces did not increase their top rates: Manitoba and PEI kept their rates steady, while Saskatchewan reduced all marginal tax rate brackets.[20]

The highest marginal tax rate in 2023 was Newfoundland and Labrador (54.8 percent), closely followed by Nova Scotia (54 percent) and Ontario (53.53 percent). In 2009, the top marginal tax rate in all provinces was below 50 percent; the only provinces in 2023 with top rates so low were Alberta (48 percent) and Saskatchewan (47.55 percent).[21]

Fuss and Munro also examine changes in marginal tax rates at other income levels, providing a detailed historical account of the year-by-year changes in each province. Rate thresholds are also examined. Comparisons are made with the tax

19 At 3.

20 At 9.

21 At 13.

rates in all US states. Comparisons are also made with all OECD countries on the basis of OECD data, according to which Canada had the fifth-highest top combined personal marginal tax rate in 2022.[22]

Hill and Li likewise examine the issue of marginal tax rates, but they do so from a more forward-looking perspective. They note that Alberta had a single, 10 percent personal income tax rate as recently as 2014, before being replaced by a conventional progressive structure. The authors propose an 8 percent single-rate provincial tax for Alberta, with the main purpose, it appears, of reducing the top marginal federal-provincial rate so as to make the province more competitive relative to energy-producing US jurisdictions. The marginal tax rates of seven such jurisdictions, including Colorado and Texas, are singled out for comparison with Alberta's. The 8 percent rate is said to produce tax savings for Albertans in all income groups—presumably because the lowest rate bracket in 2024 (that is, 10 percent) is higher than 8 percent.[23] However, the report also briefly mentions the possibility of eliminating some unspecified (all?) credits, deductions, and exemptions, with a view to achieving the other component of a "flat tax."[24] Presumably, not everyone would get a tax cut if these additional reforms were also implemented.

Fuss and Li undertake a more speculative project—namely, examining the progressivity of the personal income tax in Canada for 2024. They project past taxpayer incomes for a sample of individuals grouped into families, and then apply 2024 tax parameters.[25] The authors' main table compares personal income tax paid with total income earned for five quintiles (20 percent slices) of family incomes. At one extreme, the bottom 20 percent of the income distribution have a 5 percent share of total income but a 0.8 percent share of all personal income taxes paid. At the other extreme, the top 20 percent of the income distribution have a 46.4 percent share of total income and a 62.7 percent share of all personal income taxes paid. Together, the middle three quintiles (60 percent) of the income distribution have the remaining 36.5 percent share of all personal income taxes paid.[26]

AM

Reuven S. Avi-Yonah, ed., *Research Handbook on Corporate Taxation*
(Cheltenham, UK and Northampton, US: Edward Elgar, 2023)

This book is a collection of papers written by some of the world's leading tax law scholars and practitioners, from the United States and other countries. These papers

22 At 27.

23 At 7, table 3.

24 At 8.

25 The study cites the Fraser Institute's Canadian Tax Simulator, which incorporates data from Statistics Canada's SPSD/M program. However, the study reports far fewer details about the assumptions used than would typically appear in academic research, and it would not be possible to replicate the work without further information.

26 At 3.

explore, and offer insights into, theoretical and policy issues regarding corporate taxation, especially the taxation of multinational enterprises (MNEs). From various perspectives (policy, system design, and professional practice), the papers cover the corporate tax system in the United States, the European Union, and 11 countries. The book is designed, accordingly, to be useful to tax practitioners, policy makers, and academics.

In the United States, Canada, and most of the jurisdictions examined in this book, corporations are "everywhere" and "nowhere." Corporations are everywhere because of their role in the economy—over 80 percent of economic activity in the United States is effectuated through the corporate form.[27] At the same time, corporations are nowhere because they are legal fictions, even though corporate management is real and the corporate power over employees, shareholders, and society at large is real. In a fiscal sense, corporations are real because corporate income tax accounts for about 10 percent of total tax revenues in Organisation for Economic Co-operation and Development (OECD) countries.

The book has five parts and 26 chapters, organized as follows: foundations (part I, chapters 1-4); [taxation of US] corporate operations (part II, chapters 5-8); comparative corporate taxation (part III, chapters 9-20); corporate tax planning (part IV, chapters 21-24); and conclusion (part V, chapters 25-26).

Part I discusses basic and mostly academic questions. Chapter 1 (by Yariv Brauner) discusses the rationale for the corporate tax, examining the various arguments for it: (1) technical arguments (for example, corporations are separate legal persons and should pay the price, in the form of taxation, for the benefits of that status); (2) policy arguments (for example, the ability-to-pay principle, on the assumption that shareholders bear the burden of corporate tax); and (3) political arguments (for example, the need to restrain corporate management power and regulate corporate activities). In chapter 2, Steven Bank describes the history of the US corporate tax in terms of four elements: revenue, shielding, avoidance, and regulation or mitigation. Chapter 3 (written by Eric Toder) presents evidence regarding the incidence of the corporate tax on economic rent and normal returns, and what it means for the distribution of the tax burden among income groups. The evidence shows that between 75 and 81 percent of the burden falls on recipients of capital income and between 18 and 25 percent on recipients of labour income. Chapter 25 (written by Daniel Shaviro) considers the future of international corporate tax. It presents recent changes in the methods of taxing MNEs as something old as well as something new. It situates these changes in the broader context of (1) back-and-forth shifts in legal policy and (2) intellectual debates about issues such as the source of income and significance of corporate residence:

> Recent calls for increased entity-level corporate income taxation of multinationals, on both a source and a residence basis, have a distinctly back-to-the-future cast. At least

27 At 2.

> as to the bottom line, they have far more in common with 1986-era thinking than with that which has often prevailed in more recent decades.[28]

Chapter 25 also notes some possible reasons to hope that countries might cooperate in efforts to restrain international tax competition. Chapter 26 (by Reuven Avi-Yonah) argues that the United States should tax corporations, but not for the traditional reasons (that is, because taxing corporations is a proxy for taxing shareholders). The rationale for taxing corporations should be same as it was in 1909, when the United States originally adopted the corporate tax—that is, the necessity of taxing monopolistic rent at progressive rates.

Parts II and IV of the book are about US corporate taxation. Chapter 5 (by George Yin) discusses the US treatment of corporate and shareholder integration. Chapter 6 (by Gregg Polsky) examines the tax implications of incorporation. Chapter 7 (by Heather M. Field) considers taxable and tax-free corporate mergers, divisions, and liquidations. Chapter 8 (by J. Cliff Fleming) covers the US international tax system. Chapter 21 (by Joshua Blank and Ari Glogower) discusses corporate tax shelters. Chapter 22 (by Amandeep S. Grewal) explains the "economic substance" doctrine. Chapter 23 (by Peter Barnes) examines the issue of corporate social responsibility, while chapter 24 (by Michael Doran) considers executive compensation and corporate governance.

Given the recent proposal to include an economic substance doctrine in the Canadian general anti-avoidance rule (GAAR), Canadian readers may find chapter 22 to be particularly relevant. Economic substance doctrine in the United States was originally a judicial anti-avoidance doctrine, codified in 2010 as section 7701(o) of the Internal Revenue Code.[29] There are two judicial approaches to economic substance. Under the extra-statutory approach, which is the majority approach, a court requires that a transaction exhibit objective economic substance or a subjective business purpose (or both), regardless of whether any statute imposes those requirements. In other words, the economic substance doctrine provides an independent rule created by common law. Under the statutory approach, the economic substance doctrine aids statutory interpretation, and, if the statute does not require economic substance in transactions, a court cannot deny the benefit that the taxpayer derived from complying with the statute. Section 7701(o) applies "in the case of any transaction to which the economic substance doctrine is relevant" but does not define when the doctrine is relevant. Therefore, the different judicial approaches continue to apply when it comes to interpreting when economic substance is relevant. Amandeep Grewal, the author of chapter 22, regards section 7701(o) as being difficult to reconcile with the extra-statutory approach because "[s]imply announcing that the economic substance doctrine establishes a prerequisite to every tax benefit will cast too wide a

28 At 433.

29 See Health Care and Education Reconciliation Act of 2010, Pub. L. no. 111-152, at section 1409; Internal Revenue Code of 1986, as amended.

net."[30] He also sees the challenge for the statutory approach in the following terms: the "Congressional Committees apparently wanted to codify a doctrine that allows courts considerable authority to override tax code provisions."[31]

Part III of the book includes chapters about the European Union (by Christiana HJI Panayi) and 11 countries: the United Kingdom (Michael McGowan), Germany (Joachim Englisch), France (Marilyne Sadowsky), Italy (Carlo Garbarino), Canada (Scott Wilkie), Turkey (Funda Basaran Yavaslar), New Zealand (Craig Elliffe), Japan (Yoshihiro Masui), China (Wei Cui), India (Arvind P. Datar), and Brazil (Luis Eduardo Schoueri and Guilherme Galdino). The ordering of these chapters is not explained. Though touted as "comparative," these chapters are not really comparative in the usual sense; they do not tease out the major similarities and differences among the countries, let alone explain the underlying reasons for similarities and differences.

Scott Wilkie's chapter on the Canadian context will be interesting for Canadian readers. Wilkie ends his chapter with a question: "Is the corporate tax system in the Act, if thoroughly and properly understood, the 'anti-corporate tax'?"[32] He actually answers the question in the affirmative, sort of. Viewing the corporate tax rules as a "system within a system," Wilkie writes the following:

> Elegantly the Act confronts the fiscal significance of corporations, notably as devices to facilitate the fragmentation and manipulation of economic unities, by denying it, effectively recombining corporations and shareholders except for genuine business income, that is, the kind of income from conducting business with third parties. There, the Act conveys a subsidy, a deferral of shareholder level tax until, if the income still exists to be distributed, individual shareholders receive it. That subsidy is the product of deliberate economic and fiscal policy that envisages corporate business corporations as engines of growth and opportunity deserving of public support and contribution.
>
> On the other hand, much of the regime for taxing private corporations and their shareholders, like equivalent aspects of the "foreign affiliate" (controlled foreign corporation) part of the Act, is devoted to identifying and tracking investment income despite corporate intermediation to ensure no undue deferral compared to the outcome had the corporation(s) not been involved.
>
> Regardless of popular mythology about "surplus stripping," a fundamental feature, then, of corporate taxation under the Act is to avoid corporate taxation as a silo, systemically, and to preserve income due still to be taxed at the individual shareholder level, in the condition where that will occur, that is, to policy and mitigate "surplus stripping"—the diversion of income the Act expects to be taxed at each of the corporation and shareholder levels in order for it to be adequately taxed within the system of corporation taxation.[33]

30 At 373.

31 Ibid.

32 At 249.

33 Ibid.

To advance his thesis, Wilkie also examines various rules: (1) the rules applicable to the passive income of resident private corporations, (2) the integration rules, (3) the term preferred share rules, and (4) the reorganization rules. Wilkie notes some interesting features of Canadian tax law—for example, the principle that tax law is accessory to the general or private law, and the way in which the Act strives to achieve the desired fiscal objectives without formally recharacterizing transactions on the basis of economic substance.

Generally speaking, this book is, as its title indicates, a "research handbook" on corporate income tax. The respective chapters provide succinct descriptions of corporate taxation in the 13 jurisdictions and offer thoughtful—and sometimes provocative—insights into the deficiencies and areas where reform is needed. Readers can use these chapters as starting points for their own research, and the book may help them imagine the future of corporation taxation.

JL

Craig Elliffe, ed., *International Tax at the Crossroads: Institutional and Policy Reform in the Era of Digitalisation* (Cheltenham, UK and Northampton, US: Edward Elgar, 2023)

The literature on international tax reform is rich and growing, especially literature on the reforms brought about by the G20/OECD base erosion and profit shifting (BEPS) project and the pillar 1 and pillar 2 measures introduced by the Inclusive Framework. Readers who have not been following these reforms closely can catch up by reading this book.

The book has an introductory chapter and 12 substantive chapters. The introduction notes that we live in an era of digitalization: "There is a perception that highly digitalised businesses operating scale-without-mass models derive their profits from the locations where their users or customers are located, despite having limited physical presence in such markets."[34] The current international system, as is shown by the model tax convention or the arm's-length principle, does not allocate taxing rights to market jurisdictions. As a result, there exists a "systemic income allocation problem."[35] A fundamental overhaul of the system is thus necessary. Pillar 1 is designed to provide such an overhaul: it addresses the problem by creating new taxing rights for market jurisdictions and new ways of allocating profit to replace the arm's-length principle. The era of digitalization also exposes and exacerbates another problem—namely, the "race to the bottom" tax competition among governments. Pillar 2 is designed to address this problem by requiring the profits of multinational enterprises (MNEs) to be taxed at a minimum effective tax rate of 15 percent, no matter where the profits are earned. Both pillar 1 and pillar 2, by requiring multilateral cooperation, create a new road to multilateralism. Meanwhile, some countries may prefer unilateral solutions, thus maintaining the road of unilateralism. As a result,

34 At 2.

35 Ibid.

"countries are metaphorically standing at the crossroads,"[36] deciding whether to take the road to multilateralism or to return to the road to unilateralism.

Chapters 1 to 4 examine the institutional and overarching aspects of international tax reform. In chapter 1, "Robustness and Resilience in International Tax Reform," Wolfgang Schön argues that any international tax rules must be "robust" and "resilient" in order to cope with unforeseen developments. In a turbulent world full of geopolitical conflicts, "[i]t is amazing to see to what degree the flow of international tax policy seems to be uncontaminated by the poisoned waters of those frightening geopolitical developments."[37] This lack of "contamination" may be too good to be true. The obvious dissonance between (on one hand) the confrontation and fragmentation evident in the geopolitical sphere and (on the other hand) the widespread coordination in the tax sphere leads to some "big questions": Is it possible to immunize tax policy against world politics and international crises at large? What are the incentives for countries to stick to tax coordination in spite of growing confrontations on other fronts?[38]

In chapter 2, "The Reform of the Institutional Structure of International Taxation," Philip Baker argues that the OECD should largely be replaced by new UN structures consisting of an intergovernmental commission, one or more subcommissions or subcommittees, various working parties, and special rapporteurs. In his view, there are several problems, disadvantages, and even dangers with having the OECD as the leading institution in international tax reform. For example, as a membership organization and a consensus organization, the OECD lacks democratic legitimacy and a comprehensive agenda. A new UN organization could have broader representation and legitimacy.

In chapter 3, "Unilateralism and Multilateralism in International Tax," Reuven Avi-Yonah reviews (1) the historical origin of the current efforts to draft a pillar 1 multilateral convention, (2) the role of the United States between 1918 and 2010 (for example, in leading the development of rules on foreign tax credit, foreign investment funds, the arm's-length standard, controlled foreign corporations, limitation on benefits, and the recent global intangible low-taxed income [GILTI] and the base erosion anti-abuse tax [BEAT]); and (3) the role of the European Union/Group of Twenty/OECD in leading the BEPS project and the two-pillar project. He predicts that "the prospects of Pillar 1 succeeding are not good"[39] because, among other reasons, the US Senate is unlikely to ratify the convention, and abolishing the digital services tax would be politically unpopular in some countries.

In chapter 4, "Stability of the International Tax System in a Changing World," Victoria Plekhanova and Chris Noonan argue that the current process for international tax reform is flawed and that the Inclusive Framework's narrative regarding

36 At 2.

37 At 24.

38 At 24-25.

39 At 91.

DSTs (that they will destabilize the income tax system) is unsubstantiated. They suggest that the OECD built its pillar 1 narrative on several logical fallacies, one of which is a "false cause" fallacy: it has not been proved that uncoordinated DSTs destabilize the existing system.[40]

Multilateralism is examined in chapters 5 to 9. In chapter 5, "Tax States, Jurisdiction and the Multilateral Reality," Miranda Stewart notes a multilateral trend toward a coordinated international tax regime that transcends the limitations of tax sovereignty, and she notes that modern multilateralism differs from the traditional kind in that it aims to increase taxation as opposed to simply preventing double taxation. In chapter 8, "Multilateral Tax Reform," Michael Littlewood discusses a similar trend. In chapter 6, "The Impact of the Global Minimum Tax on Tax Competition," Michael Devereux and John Vella suggest that the global minimum tax, at an effective tax rate of 15 percent, would not have been achieved without the qualified domestic minimum top-up tax (QDMTT) and that tax competition will continue through governments' use of grants and qualifying refundable tax credits. In chapter 7 ("Is the Shift to Taxation at the Point of Destination Inexorable?"), Matt Andrew and Richard Collier describe pillar 1 as a destination-based tax that represents a fundamental change. In chapter 9, "Arbitration of Tax Disputes After the BEPS Two Pillar Solution," Chris Noonan and Victoria Plekhanova discuss the mandatory binding arbitration under the two-pillar solution and argue that past experience in international trade and the gridlock experienced at the World Trade Organization does not bode well for the new international tax arbitration.

Unilateral measures are examined in the final three chapters. In chapter 10, "The Canadian Digital Services Tax," Wei Cui describes the Canadian DST as a "sector-, product-, or business-model-specific excise tax that captures economic rent realized by digital platforms characterized by non-rival technology, zero marginal cost of production, and multi-sided business models."[41] Cui argues that the economic rent captured by the DST is location-specific because it can be traced to particular locations in a principled manner. The DST can be analogized to royalties charged on natural-resource extraction. He also argues that DST is compatible with the existing WTO regime—for example, the General Agreement on Trade in Services (GATS). In chapter 11, "Legal Problems with Digital Taxes in the United States and Europe," Ruth Mason argues that a DST will result in double taxation if it is not a creditable tax against corporate income tax. Other legal problems include the potential breach of the WTO rules and the US threat of tariff retaliation. In Chapter 12, "Data as a Tax Base," Alison Pavlovich explores the possibility of taxing data and using the tax revenue to reduce wealth inequality.

In general, this book contains some insightful commentaries and thought-provoking ideas. Anyone interested in international tax law should find it very helpful.

JL

40 At 107.

41 At 246.

Craig Elliffe, "Designing a Powerful General Anti-Avoidance Rule: Reflections on the New Zealand Experience" [2023] no. 5 *British Tax Review* 704-23 (https://ssrn.com/abstract=4668585)

New Zealand has a general anti-avoidance rule (GAAR) that was originally introduced in 1878. Being older does not automatically make the NZ GAAR better than the Canadian GAAR, which was introduced in 1988. That said, Craig Elliffe explains in this paper that the NZ GAAR has much to offer and can, in fact, teach a lesson or two to the younger GAARs of the world.

The NZ GAAR functions "more as a signpost pointing out the general direction of travel rather than a detailed map."[42] The NZ Supreme Court formulated the parliamentary contemplation test in *Ben Nevis Forestry Ventures Ltd. v. CIR*.[43] This is a two-pronged test consisting of a legal analysis and a factual analysis. The legal analysis considers the purpose of the specific provisions that provide definitive taxpayer outcomes (such as a deduction), and it ensures that taxpayers' use of the provisions is consistent with the use Parliament had contemplated. The factual analysis involves examining how the taxpayer has used those provisions. The examination of the facts goes beyond the legal form of structures and documentation and considers the commercial and economic reality of the transaction that occurred or the economic substance of the arrangement. The NZ GAAR is considered effective in preventing tax avoidance.

In contrast, the Canadian GAAR is evidently not considered effective, or effective enough, because it is being amended through the addition of, among other things, an economic substance test. Will a more detailed GAAR make the GAAR more powerful? Elliffe says no:

> Reflecting on the New Zealand GAAR experience suggests that because of commonsense purposive interpretation, broad assessment of the law and facts, and the flexible, dynamic development of principles, the courts are better than the legislature in designing and implementing effective GAARs. It also means that there is no need for legislative amendments because the judicial law will continue to evolve, meeting any taxpayer ingenuity in aggressive tax planning head-on.[44]

JL

Brian J. Arnold, "Earth to OECD: You Must Be Joking—The Subject to Tax Rule of Pillar Two" (2024) 78:2 *Bulletin for International Taxation* 42-62

The "subject to tax" rule (STTR) is perhaps the least known element of the pillar 2 global minimum tax package. It was intended to allow developing countries to impose a top-up tax on certain low-taxed payments to connected non-residents. Unlike the top-up tax imposed under the income inclusion rule (IIR) or the undertaxed

42 At 705.

43 [2008] NZSC 115.

44 At 722-23.

profit rule (UTPR) (a tax that aims to bring the effective tax rate to the minimum 15 percent), the top-up tax under the STTR is intended to bring the withholding tax rate to 9 percent. The STTR has been considered the least "urgent" of these measures: the OECD/G20 Inclusive Framework released the model treaty provisions for the STTR and the multilateral convention to implement the STTR ("the STTR package") after releasing the model rules and commentaries on the IIR and UTPR.

In this article, Brian Arnold is critical of the STTR. He argues that the STTR package is unreasonably complex and unlikely to benefit developing countries much. Given that "the STTR is designed to help developing countries—notably those with lower administrative capacities—to protect their tax base"[45] and that this help was intended to compensate developing countries for agreeing to support pillar 2, the OECD must have been joking when it made the STTR so technically complex and difficult to apply. Reviewing the history and rationale of the STTR and providing a detailed description and analysis of the STTR package, Arnold argues that the STTR has been deliberately designed to produce no significant tax revenues for developing countries and "has been misleadingly portrayed by the Inclusive Framework as an important concession to developing countries."[46] He concludes with the following warning to developing countries:

> The STTR is a package of complex rules that appears at first glance to be a new self-contained tax regime that allows developing countries to impose gross-based withholding taxes on certain payments to connected persons in the other contracting state. However, when the STTR is analysed, unpacked and deciphered, the STTR can be seen for what it really is—nothing more than a sophisticated illusion of increased taxing rights for developing countries. Accordingly, developing countries should be very, very cautious about buying in to the STTR.[47]

JL

Kasper Dziurdź, "The Concept of the 'Object and Purpose' in Tax Treaty Law Based on the Vienna Convention (1969) and the Principal Purposes Test Rule" (2024) 78:3 *Bulletin for International Taxation* 110-26

In *Canada v. Alta Energy Luxembourg SARL*,[48] the Supreme Court of Canada held that the Canadian general anti-avoidance rule (GAAR) did not apply to the treaty-shopping arrangement in this case on the grounds that the object, spirit, and purpose of the pertinent provisions of the Canada-Luxembourg tax treaty[49] were not abuse.

45 At 44.

46 At 62.

47 Ibid.

48 2021 SCC 49.

49 Convention Between the Government of Canada and the Government of the Grand Duchy of Luxembourg for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital, signed at Luxembourg on September 10, 1999 (herein referred to as "the Canada-Luxembourg tax treaty").

In determining the object, spirit, and purpose (or rationale) of article 4 and of the carve-out clause in article 13(4), the court recognized the relevance of the Vienna Convention on the Law of Treaties ("Vienna Convention") in interpreting Canadian tax treaties, and it emphasized the dual nature of tax treaties (that is, contractual and statutory) and the "implied exclusion" principle. Even though tax treaties are generally intended to prevent double taxation and fiscal evasion, the court found that the Canada-Luxembourg treaty was also intended, in effect, to facilitate treaty shopping as a means of encouraging foreign investment in Canada.

The Supreme Court's reasoning in *Alta Energy* may be short lived: many of Canada's treaties, including the treaty with Luxembourg, have been modified by the multilateral instrument (MLI),[50] through the inclusion of a principal purpose test (PPT). Questions about how to apply the PPT will arise. For example: Is facilitating treaty shopping a principal purpose of the carve-out in article 13(4) of the Canada-Luxembourg treaty? What is the principal purpose of defining "corporate residence" by reference to the phrase "liable to tax" in article 4? How is the principal purpose of a specific treaty provision contextualized by the principal purpose of the treaty as a whole? Kasper Dziurdź's analysis of the "object and purpose" in the Vienna Convention and of the PPT sheds light on these questions.

According to Dziurdź, treaty interpretation under the Vienna Convention involves a circular exercise: the terms of a treaty must be interpreted in their context and in the light of the treaty's object and purpose; at the same time, the object and purpose of a treaty must be identified primarily from the text of the treaty itself. Therefore, the object and purpose of a treaty is both the result of interpretation and a means of interpretation. In addition, the Vienna Convention refers to the object and purpose of a treaty as a whole. If a treaty pursues several objects and purposes, these objects and purposes may conflict with each other, requiring difficult decisions about which object and purpose should take precedence in a specific case.

As to the PPT rule, Dziurdź teases out two possible roles for it. One is to signal the importance of "object and purpose" in treaty interpretation, which is in line with the general rule of interpretation enshrined in the Vienna Convention. Another is to permit "going beyond the wording of the treaty terms, thereby deviating from the concept of the Vienna Convention (1969) and rendering the object and purpose [of] the only relevant benchmark"[51] for determining treaty abuse. His view is summarized as follows:

50 Organisation for Economic Co-operation and Development, Multilateral Convention To Implement Tax Treaty Related Measures To Prevent Base Erosion and Profit Shifting, released on November 24, 2016 (herein referred to as "the MLI"). The MLI was enacted by Parliament through the Multilateral Instrument in Respect of Tax Conventions Act, SC 2019, c. 12. The MLI entered into force for Canada on December 1, 2019. Canada listed its tax treaties with 84 countries for the purposes of the MLI. Most of those countries are expected to become parties to the MLI and to list their tax treaty with Canada. A major exception is the treaty with the United States, because the United States is not a signatory to the MLI.

51 At 126.

> [T]he PPT rule gives priority to the object and purpose of the relevant provisions of a tax treaty. It thereby allows deviation from the traditional meaning of concepts, such as "residence" and "beneficial owner," by putting more weight on the object and purpose of the relevant tax treaty provisions. It does more than just reminding interpreters of the object and purpose. At the same time, the object and purpose should be reflected in the wording of the relevant treaty provisions, and not go beyond it. This prevents an independent inquiry into the object and purpose that would not be informed by, but would disregard, the agreed terms of the tax treaty. With or without the PPT rule, the main challenge remains the identification of the object and purpose of the tax treaty and its provisions.[52]

JL

André Lecours, Daniel Béland, Trevor Tombe, and Eric Champagne, eds.,
Fiscal Federalism in Canada: Analysis, Evaluation, and Prescription
(Toronto: University of Toronto Press, 2023)

This book is in memory of Richard Bird (1928-2021), a luminary of fiscal federalism studies. The book's aim is to become a "central and enduring reference on fiscal federalism in Canada" and "to stimulate both public and expert debate" in Canada.[53] The chapters are authored by some of Canada's leading scholars from various disciplines, including political science, economics, and law. They provide expert analysis of (1) the three major transfer programs in Canada (that is, equalization, the Canada health transfer, and the Canada social transfer); (2) other areas of spending, such as federal transfers to First Nations, infrastructure spending, and spending on early learning and childcare; and (3) the underlying policy and political tensions involved in these programs. They also evaluate these programs and recommend ways to address the pressures and challenges that they entail. One of the authors' ideas for reforming the governance of fiscal federalism is to create an arm's-length fiscal federal commission.

The book contains 23 chapters, of which the first is introductory. Chapters 2 to 4 examine equalization, the constitutional basis for the federal transfers, and the state of federal-provincial finances. Chapters 5-7 discuss the major federal-provincial transfers. Chapters 8 and 9 explain the two dilemmas facing fiscal federalism in Canada —namely, the complications posed by natural resource revenues and the long-term sustainability of provincial finances. Chapters 10 to 12 consider some emerging issues, such as demography and environment, and new actors, such as First Nations and municipalities. Chapters 13 to 15 focus on the municipal sector. Chapters 16 and 17 look at the funding of elementary and secondary education and of early learning and childcare. Chapters 18 to 21 focus on the provinces—for example, the Atlantic provinces in chapter 18, Ontario in chapter 20, and Alberta in chapter 21. Chapter 22 compares Canadian fiscal federalism with a standard of "best practices." Chapter 23 highlights the major contributions of this book and puts forward some recommendations for reform.

52 Ibid.

53 See "Acknowledgments."

The book's multidisciplinary approach to analysis, and its deep insights into the history, current struggles, and future direction of fiscal federalism in Canada, make it a critical read for anyone interested in this important topic. The book advances the scholarship on fiscal federalism in Canada, and it should stimulate thinking about how to make fiscal federalism work better in the face of new and emerging challenges.

JL

Henry L. Friedman, Andrew Sutherland, and Felix Vetter, *"Technological Investment and Accounting: A Demand-Side Perspective on Accounting Enrollment Declines"* (2024) (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4707807)

US data show that the percentage of graduating business majors that are accounting majors has declined from about 21 percent in 1990 to about 17 percent in 2020. Meanwhile, during the same period, the percentage of graduating business majors that are finance majors has increased from about 10 percent to about 16 percent.[54] This development is explained by Friedman, Sutherland, and Vetter through a model showing how individuals compare making different types of human capital investments: individuals face lower wages in accounting careers than they do in careers in finance or other business specialties. The reason for this, according to the paper, is that technological change has brought new tools that can substitute for accounting labour. This adversely affects the financial returns from accounting careers.

Specifically, the authors model employment and wages for accounting, finance, and other business majors as functions of software spending in a sector. The finding is that, as software spending grows, the employment of accounting majors grows, but it grows at a far slower rate than the employment of other business majors, especially finance majors. In particular, an 11 percent annual growth rate of software spending (the average for the sample period) increases the employment of accounting majors by 0.8 percent, as opposed to 2.4 percent for finance majors and 1.7 percent for other business majors.[55]

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54 At 24, figure 1.

55 At 4.