

Soft Law and Taxation: A Canadian Perspective

JUSTICE ROBERT J. HOGAN



1. Source of Domestic Soft Law - Finance

The Department of Finance (Finance) is responsible for:

- i) the annual budget;
- ii) tax policy initiatives;
- iii) federal tax legislation; and
- iv) bilateral and multilateral tax treaty negotiations.

As a result, Finance is closely connected with the legislative process.

1. Source of Domestic Soft Law - Finance

Technical notes

- In almost all cases, Finance includes technical notes with the notice of ways and means motion used to introduce tax legislation to Parliament.
- Technical notes provide an explanation of each provision contained in the notice of ways and means motion in layman's terms.

1. Source of Domestic Soft Law - Finance

Technical notes – persuasive value/CRA

- Technical notes are considered and applied by the Canada Revenue Agency (CRA) when issuing advance income tax rulings and during the audit and assessment process.
- Taxpayers and their advisors routinely use technical notes when they are to their advantage.

1. Source of Domestic Soft Law- Finance

Technical notes – persuasive value/general litigation

- While technical notes do not form part of the final tax legislation adopted by Parliament, they are considered a useful extrinsic aid because they are closely connected with the legislative process.
- Technical notes are admissible as aids because they illuminate the legislative context and the purpose and rationale of a provision (*Owen Holdings Ltd. v. Canada*, 1997 CanLII 16702 (FCA)).

1. Source of Domestic Soft Law- Finance

Technical notes – persuasive value with respect to the general anti-avoidance rule (GAAR)/litigation

Technical notes are routinely considered in the context of a GAAR analysis.

In *OSFC Holdings*, the FCA reasoned as follows:

[63] The difficulty with the appellant's approach has been pointed out by the respondent. If, in a misuse or abuse analysis, the Court is confined to a consideration of the language of the provisions in question, it would seem inevitable that the GAAR would be rendered meaningless... Having regard only to the language of the provisions will therefore always result in a finding of compliance and therefore no misuse or abuse. I agree with the respondent that it will be necessary for the Court to have regard to the context of the provisions in question and, in the abuse analysis, the Act as a whole, and that reference may be made to extrinsic aids such as technical notes, writings, Hansard and enacting notes.

(Emphasis added.)

OSFC Holdings Ltd. v. Canada, [2002] 2 F.C. 288 (Appeal Division)

1. Source of Domestic Soft Law - Finance

Technical notes – persuasive value/my practice

- While I routinely consider technical notes in the statutory interpretation process, in most cases, as a single source of information, they have limited persuasive value. The reason for this is that often the note simply restates the provision. More importantly, in the context of the GAAR, Finance has adopted the practice of stating that amendments to tax legislation are made for clarification purposes only. In many cases, however, an amendment often represents new law.
- That said, technical notes have a higher persuasive value than CRA publications.

1. Source of Domestic Soft Law - CRA

- The CRA is responsible for the administration and enforcement of federal tax legislation.
- The CRA is largely removed from the legislative process. That said, the CRA routinely consults with Finance to share information on troubling trends discovered on audit.
- Officials of the CRA sit with officials of Finance on the national GAAR committee. The GAAR committee's primary role is to set a national standard for the application of the GAAR.

1. Source of Domestic Soft Law – CRA

CRA publications

- The CRA routinely issues and updates the following:
 - i) tax guides, forms and pamphlets;
 - ii) information circulars;
 - iii) interpretation bulletins; and
 - iv) technical views and interpretations.
- The above publications serve different purposes. Generally speaking, publications that fall into (i) and (ii) are more administrative in nature. They advise taxpayers on how to comply with their filing obligations and outline the CRA audit practices. Publications that fall into (iii) and (iv) advise taxpayers of the CRA's interpretation of the law.

1. Source of Domestic Soft Law- CRA

Advance pricing arrangements

- The CRA's advance pricing arrangement (APA) program is administered by the Competent Authority Services Division of the CRA.
- Anecdotal evidence suggests that the program has had very limited success to date as an APA may take upwards of four years to obtain.
- APAs are confidential. They are known only to the advisors who worked on the project. An APA is considered binding on the CRA.

1. Source of Domestic Soft Law - CRA

Advance income tax rulings

- The CRA's advance income tax rulings program is administered by the Income Tax Rulings Directorate of the CRA.
- Generally speaking, rulings are applied for in the context of complex public transactions.
- Rulings are routinely published.
- Rulings are considered to be binding on the CRA vis-à-vis the applicant.

1. Source of Domestic Soft Law

CRA publications - persuasive value/audit and assessment process

- The published positions of the CRA are often strictly relied upon by the CRA's auditors during the audit and assessment process.
- The CRA rarely disavows its published positions.

1. Source of Domestic Soft Law

CRA publications – persuasive value/litigation

In *Nowegijick v. R.*, [1983] 1 S.C.R. 29, the following is stated at page 37:

Administrative policy and interpretation are not determinative but are entitled to weight and can be an “important factor” **in case of doubt** about the meaning of legislation.”

(Emphasis added.)

- In other words, CRA publications may be useful extrinsic aids in resolving an ambiguity. That said, trial judges often deal with the CRA’s publications in a practical way.

1. Source of Domestic Soft Law - CRA

CRA publications – persuasive value/ litigation/practical approach

This approach is best exemplified by former Chief Justice Bowman’s comment in *Northwest Hydraulic Consultants*:

[13] There is a further consideration that relates specifically to IC 86-4R3. That circular has been revised a number of times... It was the result of **extensive consultations** between government and the scientific community both in industry and in universities. It represents a broad consensus of persons in the public and private sector who are likely to be affected by or to have an interest in the interpretation of the SRED provisions of the *Income Tax Act*. The process demonstrates the sensitivity of the government to the concerns of the scientific and business communities in this area. Numerous submissions were received from organizations.

[14] Three basic criteria were considered by the panels who were involved in the process: scientific or technological uncertainty, scientific or technological content and scientific or technological advancement.

[15] In light of the extensive consultation and the impressive credentials of the persons who participated in the process, the document that emerged, IC 86-4R3 is a **generally useful and reliable guide**.

(Emphasis added.)

Northwest Hydraulic Consultants Ltd. v. R., [1998] 3 C.T.C 2520 (Tax Court of Canada)

1. Source of Domestic Soft Law - CRA

CRA publications – persuasive value/litigation/practical approach

Descarries v. The Queen, 2014 TCC 75 (No appeal)

- This case was decided by me.
- The taxpayers engaged in a series of dividend stripping transactions.
- Dividends were converted into capital gains.
- The taxpayers used their capital gains exemption to avoid tax on the corporate distributions.
- CRA invoked the GAAR. The Crown, in my opinion, relied on the wrong provision of the law to justify its GAAR assessment.

1. Source of Domestic Soft Law - CRA

CRA publications - persuasive value/litigation/practical approach

Descarries v. The Queen, 2014 TCC 75 (No appeal)

Important subtext:

- Section 84.1 is a specific anti-avoidance rule designed to prevent dividend stripping transactions involving the use of tax-free values (valuation day value and capital gains exemption).
- Taxpayers have lobbied for an exemption from section 84.1 for transactions involving an inter generational transfer of a privately owned family business.
- Anecdotal evidence suggests that Finance is sympathetic to taxpayers' demand in this regard.
- This creates uncertainty for taxpayers. However, an exception was not provided for because of a fear that it may be exploited.
- Compromise – the CRA issued a technical interpretation advising taxpayers that it will not invoke the GAAR where section 84.1 is circumvented in the context of an acceptable inter generational transfer of a business.

1. Source of Domestic Soft Law - CRA

CRA publications – persuasive value/litigation/practical approach

Descarries v. The Queen, 2014 TCC 75 (No appeal)

Important subtext:

- This was a case where the CRA decided that taxpayers could not benefit from its published positions.
- That said, the CRA did not want to disavow its technical interpretation.
- I surmise that the CRA did so to preserve its administrative discretion in that regard.

Conclusion:

- The GAAR applied on the basis that the transactions circumvented section 84.1;
- The CRA has advised taxpayers that it has withdrawn the technical interpretation;
- Taxpayers are still awaiting a legislative amendment to section 84.1.

2. Source of International Soft Law – Treaty Commentaries

Background

- Generally speaking, Canada concludes its tax treaties based on the Organisation for Economic Co-operation and Development (OECD) Model Tax Convention.
- Canada imports significant capital, particularly from the United States. The two economies are highly integrated. Significant divergences can be found between Canada's tax treaties and the OECD Model Tax Convention.
- Canada's tax treaties are adopted by Parliament. As a result, they are considered to be closely connected with the legislative process.

2. Source of International Soft Law – Treaty Commentaries

- OECD Model Tax Convention – commentaries
- Canadian tax treaties – commentaries
- UN Model Tax Convention - technical explanation
- Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting Multilateral Instrument (MLI) (adopted June 21, 2019) - commentaries

2. Source of International Soft Law – Treaty Commentaries

CRA administration and enforcement/highly persuasive

- CRA publications often deal with questions of treaty interpretation.
- Generally speaking, the CRA refers to the OECD Model Tax Convention and its commentaries.
- In some cases, the CRA deals specifically with a bilateral tax treaty and its commentaries or technical explanations.
- The CRA's published positions are strictly followed during the audit and assessment stages and the competent authority and the mutual agreement procedure process.

2. Source of International Soft Law – Treaty Commentaries

Litigation – treaty commentaries have high persuasive value

***In Crown Forest Industries Ltd. v. Canada* [1995] S.C.R. 802, the Supreme Court held as follows:**

44 Clearly, the purpose of the Convention has significant relevance to how its provisions are to be interpreted. I agree with the intervener Government of the United States' submission that, in ascertaining these goals and intentions, a court may refer to extrinsic materials which form part of the legal context (these include accepted model conventions and official commentaries thereon) **without the need first to find an ambiguity** before turning to such materials.

(Emphasis added.)

2. Source of International Soft Law – Treaty Commentaries

Litigation – treaty commentaries have high persuasive value

***Crown Forest Industries Ltd. v. Canada*, [1995] 2 S.C.R. 802**

55 Of high persuasive value in terms of defining the parameters of the Canada-United States Income Tax Convention (1980) is the OECD Model Double Taxation Convention on Income and on Capital (1963, re-enacted in 1977)... As noted by the Court of Appeal, it served as the basis for the Canada-United States Income Tax Convention (1980) and also has world-wide recognition as a basic document of reference in the negotiation, application and interpretation of multilateral or bilateral tax conventions...

(Emphasis added.)

2. Source of International Soft Law – Treaty Commentaries

Litigation – practical example/ divergence from OECD Model Tax Convention

Alta Energy Luxembourg S.A.R.L. v. The Queen, 2018 TCC 152

- This case was decided by me and is presently under appeal.
- In this case, two private equity firms (constituted as partnerships) invested in a Canadian shale oil start-up through a US limited liability corporation (LLC).
- The firms realized that the LLC was tax ineffective as a holding company and the firms reorganized their investments under a Luxembourg holding corporation (LUXCO) (S.A.R.L.) a Canadian shale oil corporation (CANCO).
- LUXCO sold CANCO and claimed an exemption from Canadian capital gains tax under Article XIII of the Canada-Luxembourg tax treaty.
- The appeal was allowed.

2. Source of International Soft Law – Treaty Commentaries

Litigation – practical example/divergence from OECD Model Tax Convention

Alta Energy Luxembourg S.A.R.L. v. The Queen, 2018 TCC 152

[83] The OECD Model Treaty does not include a carve-out for immovable property in which the business of the company is carried on. Departure from the model tax treaty may be significant as it demonstrates the intent of one, or both, parties to diverge from the general approach. When there is no common agreement on a specific point at the start of the negotiations, a divergence may be the result of a bargain struck by the parties. In the instant case, it is apparent that the parties intended to depart from the model treaty. This departure involved carving out from the definition of immovable property where economic activities were carried on.

2. Source of International Soft Law – OECD Transfer Pricing Guidelines

OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD Transfer Pricing Guidelines)

Background

- Canada's transfer pricing legislation incorporates the "arm's length principle – paragraphs 247(2)(a) and (c) of the *Income Tax Act* in Canada.
- Paragraphs 247(2)(a)(b) and (d) incorporate a specific transfer pricing anti-avoidance rule that allows for the re-characterization of non-arm's length transactions in certain limited circumstances.

2. Source of International Soft Law – OECD Transfer Pricing Guidelines

CRA

- The CRA's Information Circular 87-2R (the Circular) sets out the CRA's views on transfer pricing (CRA Transfer Pricing Guidelines"). It was last updated to reflect the 1995 revision by the OECD of the OECD's Transfer Pricing Guidelines.
- The Circular has not been updated to include later updates to the OECD Transfer Pricing Guidelines.
- There is no legislative foundation for the CRA Transfer Pricing Guidelines or the OECD Transfer Pricing Guidelines.

2. Source of International Soft Law – OECD Transfer Pricing Guidelines

Litigation

The OECD Transfer Guidelines are is well established in Canada .

[20] In the courts below and in this Court, there has been reference to the 1979 *Guidelines* and the 1995 *Guidelines* (the "*Guidelines*"). The *Guidelines* contain commentary and methodology pertaining to the issue of transfer pricing. However, the *Guidelines* are not controlling as if they were a Canadian statute and the test of any set of transactions or prices ultimately must be determined according to s. 69(2) rather than any particular methodology or commentary set out in the *Guidelines*.
***Canada v. GlaxoSmithKline Inc.*, [2012] 3 S.C.R. 3**

[18] The Supreme Court stated in *Canada v. GlaxoSmithKline Inc.* 2012 SCC 52, [2012] 3 S.C.R. 3 [*Glaxo*], at paragraphs 20 and 21 that the *Guidelines* are not controlling as if they were a Canadian statute but they are useful in determining the amount a reasonable business person, who was party to the transaction, would have paid if it had been dealing at arm's length. The Court also affirmed that a transfer pricing analysis is inherently fact driven.

(Emphasis added.)

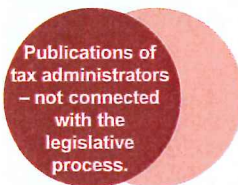
***Marzen Artistic Aluminum Ltd. v. Canada*, 2016 FCA 34**

3. Conclusion

CRA – guides pamphlets, interpretation bulletins, information circulars

OECD – 1995
 OECD Transfer Pricing Guidelines

Finance – technical notes
 OECD Model Tax Convention: commentaries
 Bilateral tax treaties– commentaries
 MLI - commentaries



Useful extrinsic aids that may help to resolve ambiguities



Slightly more useful



Highly persuasive