Case Name

Copthorne Holdings Ltd. v. Canada, 2011 SCC 63

Countries

Country of decision

Canada

Other countries

Netherlands

Barbados

Court

Supreme Court of Canada

Case Number

33283

Parties

Name

Copthorne Holdings Ltd.

Role

Appellant

Name

Her Majesty the Queen

Role

Respondent

Date of decision (format yyyy-mm-dd)

2011-12-16

Keywords

Tax avoidance; general anti-avoidance rule; series of transactions; paid-up capital of a corporation; return of share capital; amalgamation; non-resident withholding tax

Summary of Facts

The facts of this case involve a number of transactions over several years undertaken by corporations in Canada, the Netherlands, and Barbados. Only the key details of the transactions are set out below for summary purposes.

Two Canadian corporations, Copthorne Holdings Ltd. ("Copthorne I") and VHHC Holdings Ltd. ("VHHC"), were members of a multinational group of related entities. VHHC was a wholly-owned subsidiary of Copthorne I. The multinational decided to amalgamate Copthorne I and VHHC, as well as two additional corporations. At that time, the shares of VHHC owned by Copthorne I had paid-up capital ("PUC") of approximately $67 million.

Copthorne I's non-resident parent acquired all of VHHC's shares from Copthorne I. As a result, the related corporations became sister corporations, each owned by the same non-resident shareholder. The sister corporations were then horizontally amalgamated. The PUC of their shares was added together rather than being cancelled, resulting in total PUC of approximately $164 million. If the related corporations had been vertically amalgamated, the PUC of the shares in VHHC would have been cancelled upon amalgamation. Because Copthorne I's non-resident parent purchased the shares of VHHC and then horizontally amalgamated the related corporations, the PUC of the shares of VHHC was preserved. A number of other transactions occurred but ultimately, the non-resident parent redeemed most of the amalgamated corporation's shares. Since the payment was treated as a non-taxable return of capital, no withholding taxes were withheld or remitted by the amalgamated corporation.

The Minister of National Revenue (the "Minister") reassessed the amalgamated corporation, reducing its PUC by approximately $67 million. The Minister did so on the basis that the transactions undertaken to turn the parent and subsidiary corporation into sister corporations, thus preserving the PUC of each via a horizontal amalgamation, constituted an abuse of a provision of the *Income Tax Act* ("*Act*") and therefore violated the General Anti-Avoidance Rule ("GAAR"). The reassessment applied the GAAR on the basis that when Copthorne I and VHHC were amalgamated, the PUC of the VHHC should have been cancelled. This would have been the result if Copthorne I's non-resident parent had not acquired the shares of VHHC prior to the amalgamation. By reducing the PUC of the amalgamating shares, the Minister assessed the amount paid to the non-resident shareholder in excess of the PUC of the parent corporation as a deemed dividend for which withholding taxes were owed.

Both the Tax Court of Canada and the Federal Court of Appeal upheld the Minister's reassessment.

Issues

Did the transactions constitute an abuse or misuse of provisions of the Act, contravening the General Anti-Avoidance Rule under section 245?

Court Decision

The Supreme Court of Canada dismissed the appeal, upholding the Minister's reassessment and both the Tax Court of Canada and the Federal Court of Appeal's decisions in concluding that the transactions violated the GAAR.

The Court reiterated that the GAAR analysis under subsections 245(1) to (5) requires a Court to ask the following three questions:

1) Was there a tax benefit?
2) Was the transaction giving rise to the tax benefit an avoidance transaction?
3) Was the avoidance transaction giving rise to the tax benefit abusive?

1) Was there a tax benefit?

The Court noted that at the first stage of the inquiry, the taxpayer had the burden to refute the Minister's assumption that there was a tax benefit, and was unsuccessful in doing so at trial. The Tax Court of Canada concluded that there was a tax benefit based on the Minster's comparison of the results achieved via a horizontal amalgamation compared to those that would have resulted from a vertical amalgamation. The Court agreed that the vertical amalgamation was an appropriate comparison and affirmed the trial judge's factual finding.

2) Was the transaction giving rise to the tax benefit an avoidance transaction?

Regarding the second stage of the GAAR analysis, the Court reiterated that a transaction that led to a tax benefit will be characterized as an avoidance transaction if the taxpayer did not undertake that transaction primarily for a non-tax purpose. An avoidance transaction may be a single transaction or part of a series of transactions if it achieved a tax benefit and its primary objective was for tax purposes. Where a series produced a tax benefit, directly or indirectly, the series will be an avoidance transaction under subsection 245(3) unless each of the transactions individually was principally undertaken for non-tax reasons. On evaluating the facts in this case, the Court affirmed the trial judge's finding that the sale of VHHC shares to the non-resident parent corporation did not have a non-tax purpose and therefore was an avoidance transaction that was part of a series under subsection 245(3).

The Court explained that, at common law, transactions will be considered part of a series when their final result is pre-ordained. Subsection 248(10) of the *Act* expands the common law meaning of "series" by including related transactions and events undertaken "in contemplation" of the series. A Court must make a factual determination in each case, on a balance of probabilities, as to whether the impugned transaction or transactions were undertaken "in relation to" or "because of" the series. For a transaction to be considered part of a series, a "strong nexus" is not required; however, the mere possibility of a connection is insufficient. Nor will a transaction be considered to be part of a series where there is but an extreme degree of remoteness. The time elapsed and any events that took place between a series and a transaction may be relevant. Applying the law to the facts in this case, the Court affirmed the Tax Court of Canada's determination that there was a sufficient connection between the redemption of the shares of the amalgamated corporation and the previous amalgamation transactions that resulted in the PUC of Copthorne I and VHHC being aggregated.

3) Was the avoidance transaction giving rise to the tax benefit abusive?

The third stage of the GAAR analysis requires the Court to determine whether the taxpayer misused or abused the *Act*. The Court restated the need to determine the object, spirit or purpose of the provisions used to obtain the tax benefit. This requires the Court to study the provisions themselves, the scheme of the Act, and any allowable external aids. A transaction will result in a misuse or abuse if the Court finds that the benefit achieved was what the provision sought to prevent, or if the benefit went against the underlying rationale or the object, spirit, or purpose of the provision.

In this case, the Court explained that the provision in question, subsection 87(3), instructs that the PUC of the newly amalgamated corporation should not exceed the total PUC of the corporations being amalgamated and further, in parenthesis, requires that on a vertical amalgamation, the PUC of any shares held by one amalgamating corporation in the other amalgamating corporation is cancelled. The Court found that the object, spirit, and purpose of the text in parenthesis, read in the wider context and purpose of subsection 87(3), was to ensure that the PUC of a parent and subsidiary was not added together so as to increase the amount of share capital that can be returned tax-free beyond what was actually initially invested.

The Court affirmed that the sale of the VHHC shares to the non-resident parent corporation and the subsequent horizontal amalgamation were clearly undertaken to circumvent the application of the parenthetical words of subsection 87(3) by avoiding a vertical amalgamation. While the transaction itself did not violate subsection 87(3), the Court found that the tax-free return of the approximately $67 million in excess of what was actually invested contradicted the object, spirit, purpose, and underlying rationale of subsection 87(3).

Decision in Favour of

Her Majesty the Queen

Editor's Notes

The Supreme Court of Canada provides a clear review of how the General Anti-Avoidance Rule should be applied. The case also outlines guidelines for determining whether transactions are sufficiently related to one another to be considered part of the same series.

The case is interesting from an international tax perspective because it involves the application of the GAAR to the complex tax plans of a multinational entity involving an attempt on behalf of that entity to eliminate or reduce certain withholding taxes owed in Canada.

Language of Decision

English and French

Full Text of Decision

English: Judgments of the Supreme Court of Canada or CanLII

French: Judgments of the Supreme Court of Canada or CanLII