



TaxNewsFlash

Canada

Have Your Say — Finance Launches GAAR Consultation

August 15, 2022

No. 2022-40

Taxpayers may want to review and provide feedback on Finance's plans to revise Canada's anti-avoidance regime. Following an announcement in the 2022 federal budget, Finance released a consultation paper on August 9, 2022 that outlines possible changes to broaden the General Anti-Avoidance Rule (GAAR) that will affect how the CRA and courts address potential aggressive tax planning in the future. In particular, Finance is asking for general comments on the current definitions of "tax benefit" under the GAAR, as well as for feedback on potential changes to address mixed-purpose transactions, to clarify the "object, spirit and purpose" of the tax rules for purposes of the GAAR, and to better account for the economic substance of transactions. Finance is also considering amendments to increase certain GAAR penalties. Stakeholders are invited to submit comments on potential changes outlined in the consultation paper by September 30, 2022.

In its consultation paper, Finance contemplates several changes that appear to broaden the potential application of the GAAR, but also includes several questions to solicit broader feedback on selected issues. In particular, Finance says it intends to include a new rule to assess whether transactions have economic substance, and the paper also outlines suggested changes that shift the onus to the taxpayer to prove that certain transactions at issue are consistent with the object, spirit and purpose of the relevant provisions (rather than requiring the CRA to establish misuse or abuse).

Background

The GAAR is generally intended to enable tax authorities and courts to deny a tax benefit that results from abusive tax avoidance transactions. Generally, under the current regime, the CRA can apply the GAAR to deny a taxpayer's direct or indirect "tax benefit" that results from an "avoidance transaction", where it may reasonably be

considered that the transaction results in a misuse of the provisions of the Act, Regulations, Application Rules, a Tax Treaty, or certain other tax enactments, or in an abuse of these provisions read as a whole.

A tax benefit is generally defined as a reduction, avoidance or deferral of tax or other amount payable under the Act, or an increase in a refund of tax or other amount under the Act (including amounts payable but for a tax treaty, or refundable as a result of a tax treaty).

An avoidance transaction is any transaction that alone, or as part of a series of transactions, would directly or indirectly result in a tax benefit, unless the transaction may reasonably be considered to have been undertaken or arranged primarily for *bona fide* purposes other than to obtain the benefit.

If GAAR applies, the tax consequences of the taxpayer are determined as is reasonable in the circumstances to deny a tax benefit that would otherwise result from the transaction or transactions.

In addition to its announcement that it intended to release a consultation paper to GAAR, Finance also proposed certain legislative changes in the 2022 federal budget. In particular, to ensure that the GAAR would also allow for the adjustment of tax attributes that have not yet become relevant to the computation of tax, Finance proposed to amend the definition of “tax consequences” in the GAAR to include an amount that is, or could at a subsequent time be, relevant for purposes of computing a person’s income, taxable income or taxable income earned in Canada, or the tax or other amount payable by, or refundable to, a person. In addition, Finance proposed to expand the definition of tax benefit to ensure that the GAAR would also apply to transactions that affect tax attributes that have not yet become relevant to the computation of tax.

The 2022 federal budget changes, which were included in draft legislation that was also released on August 9, 2022, apply to transactions that occur on or after April 7, 2022, or transactions that occur before April 7, 2022 if a determination of tax attributes is made on or after April 7, 2022 in respect of the transaction.

For details, see *TaxNewsFlash-Canada* 2022-24, “[2022 Federal Budget Highlights](#)”.

Tax benefit

In the consultation paper, Finance asks for feedback on whether the wording of the “tax benefit” definition should be amended to ensure that it applies appropriately. Although Finance acknowledges that the definition is broad and does not propose any specific changes to it in the consultation paper, Finance notes that there have been limited situations in which no tax benefit was found even though tax planning was evident.

Mixed-purpose transactions

Finance notes in the consultation paper, that the GAAR may not currently apply to certain transactions with significant tax planning objectives that achieve a tax benefit in the context of transactions with primarily non-tax purposes because the transaction may not qualify as an “avoidance transaction”. In addition, Finance advises that the current definition of “transaction” includes an arrangement or event, but previous case law has found that this does not include a choice made by the taxpayer.

To address this issue, Finance has identified possible solutions to broaden the definition of avoidance transaction, including to:

- Provide an interpretive rule to specify what is not a "bona fide" purpose (e.g., reduction of foreign or provincial taxes)
- Extend the definition of "transaction" to include certain choices made by a taxpayer
- Lower the threshold for an avoidance transaction under the purpose test (e.g., introduce a "one of the main purposes [...] is to obtain the tax benefit" test to replace the "primarily for bona fide purposes other than to obtain the tax benefit" test).

Object, spirit and purpose

Finance’s consultation paper also outlines potential changes to make it easier to determine whether certain transactions frustrate the object, spirit and purpose of the *Income Tax Act* and therefore may be subject to GAAR. Finance acknowledges that this determination is often difficult for taxpayers, advisers, the CRA and the courts, and outlines several possible solutions, including to:

- Provide preambles and purpose statements in income tax legislation
- Emphasize purpose statements in certain extrinsic aids, including to reference these aids directly in legislation
- Emphasize the "abuse of the Act read as a whole" portion of the existing legislation
- Include an interpretive rule for assessing certainty, predictability and fairness
- Require taxpayers to demonstrate, for example, that it can reasonably be concluded that the tax benefit would be consistent with the object, spirit and purpose of the provisions relied upon by the taxpayer (currently the onus is on the CRA to establish misuse or abuse).

Economic substance

Finance is also looking at possible changes to ensure that the GAAR takes the economic substance of transactions into consideration. Specifically, Finance notes that it intends to

add an explicit economic substance rule to the GAAR. Finance's consultation paper requests feedback on different aspects of such a rule, such as how to:

- Determine lack of "economic substance", including by possible changes to:
 - Introduce a sole or dominant purpose test
 - Determine whether a transaction has the potential for pre-tax profit
 - Determine whether the transfers of rights and assumptions of obligations under the transaction affected the economic positions of the participants
 - Assess whether the legal form of the transactions differs significantly from their accounting treatment
 - Use a hybrid approach based on these considerations.
- Integrate the rule into GAAR analysis (i.e., by incorporating it into the avoidance transaction test or the misuse or abuse analysis, or by introducing a separate deeming rule or interpretive rule)
- Determine appropriate consequences associated with a lack of economic substance, including by possible changes to:
 - Automatically deem a transaction lacking economic substance to be abusive
 - Reverse the misuse or abuse burden (e.g., the taxpayer would be required to demonstrate that the tax benefit sought would be consistent with the object, spirit and purpose of the relevant provisions)
 - Introduce a more stringent misuse or abuse test
 - Adjust the "reasonable consequences" rules.

Penalties and other deterrents

According to the consultation paper, Finance is also considering introducing additional penalties to ensure that the GAAR is an effective deterrent for abusive tax planning. Specifically, Finance is looking at potential changes to:

- Introduce a penalty based on a percentage of the tax benefit (e.g., an automatic penalty) or introduce a penalty that only applies in certain circumstances either as a standalone penalty or as an addition to the automatic penalty
- Increase the interest rate on taxes in dispute under a GAAR assessment
- Extend the reassessment period for GAAR assessments.

KPMG observations

With this consultation paper, it appears that Finance is reconsidering essentially all aspects of the GAAR regime, which has applied for more than 30 years. Finance's plans to broaden the application of the GAAR will likely be contentious and, if implemented, could lead to an increase in disputes as taxpayers, the CRA and the courts all seek to determine the boundaries of a materially changed GAAR regime. As a result, we anticipate that the debate surrounding any GAAR changes will extend beyond the consultation deadline of September 30, 2022.

Finance says this paper does not address the application of GAAR to treaty abuse, and that it intends to announce more on its plans to address these issues at a later date. Finance also confirms it will release a consultation paper on Canada's transfer pricing rules in the near future.

We can help

Your KPMG adviser can keep you abreast of the progress of this consultation and what potential changes may make their way into law.

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