A-454-95

CORAM: MARCEAU J.A.
DESJARDINS J.A.
McDONALD J.A.

BETWEEN:

HER MAJESTY THE QUEEN

Appellant

- and -

NOVA CORPORATION OF ALBERTA

Respondent

REASONS FOR JUDGMENT

MARCEAU J.A.

I have had the advantage of reading the reasons for judgment of Mr. Justice McDonald.

I agree with my brother that Nova Corporation of Alberta did nothing to either create or increase the loss in the manner formally contemplated by subsection 55(1) of the Income Tax Act (the "Act"). It simply allowed some particular provisions of the Act to operate as they were intended to. The appellant argues that the object and purpose of the Act must be considered. Clearly, the provisions in question were

not intended to allow the rollover of capital losses between arm's length companies. There was no intention to create a market in capital losses. However, strictly speaking, there was no transfer of losses between unrelated companies here. The transactions were structured so as to provide for the transfer of the losses to companies that were related to each other at each step in the process. The fact that some of the companies were incorporated specifically for the purpose of effecting the transactions, and that the overall goal was to move the losses from one unrelated company to another does not change the reality that each individual step in the process involved the transfer of the losses from one company to a related company. The players simply structured themselves and their actions so as to capitalize on a window of opportunity left open in the Act. It is now trite to say that a taxpayer is entitled to arrange its affairs so as to maximize the tax shelter available to it under the law.

While I find it disturbing, to say the least, that a company can avoid paying $10 million in taxes by implementing such an intricate pre-meditated scheme, the Act, as it stood at the relevant time, not only allowed it, but actually caused the inflated deduction to exist.

I, too, reluctantly feel that the appeal can only be dismissed.

"Louis Marceau"
J.A.

A-454-95

OTTAWA, Ontario, Thursday, May 1, 1997.

CORAM: MARCEAU J.A.
DESJARDINS J.A.
McDONALD J.A.

BETWEEN:

HER MAJESTY THE QUEEN

Appellant

- and -

NOVA CORPORATION OF ALBERTA

Respondent

J U D G M E N T

The appeal is dismissed, with costs.

"Louis Marceau"
J.A.

A-454-95

CORAM: MARCEAU J.A.
DESJARDINS J.A.
McDONALD J.A.

BETWEEN:

HER MAJESTY THE QUEEN

Appellant

- and -

NOVA CORPORATION OF ALBERTA

Respondent

Heard at Ottawa, Ontario, on Thursday, January 23, 1997.

Judgment rendered at Ottawa, Ontario, on Thursday, May 1, 1997.

REASONS FOR JUDGMENT BY:	**McDONALD J.A.**
CONCURRING REASONS BY:	**MARCEAU J.A.**
DISSENTING REASONS BY:	**DESJARDINS J.A.**

IN THE FEDERAL COURT OF APPEAL

A-454-95

BETWEEN:

HER MAJESTY THE QUEEN

Appellant

- and -

NOVA CORPORATION OF ALBERTA

Respondent

REASONS FOR JUDGMENT

A-454-95

CORAM: **MARCEAU J.A.**
DESJARDINS J.A.
McDONALD J.A.

BETWEEN:

HER MAJESTY THE QUEEN

Appellant

AND

NOVA CORPORATION OF ALBERTA

Respondent

REASONS FOR JUDGMENT

McDONALD J.A.

The issue in this appeal is the application of what was then subsection 55(1) of the *Income Tax Act* (the "*Act*") to the taxpayer's acquisition of capital losses. The Minister took the position that section 55(1) operated to deny the taxpayer the losses claimed. The Tax Court Judge found in favour of the taxpayer, and the Minister appealed to this Court.

THE FACTS

In 1985, two transactions were undertaken by Nova Corporation of Alberta ("Nova") and a number of corporations to which Nova was not related within the meaning of section 251 of the *Act*. Through these transactions, Nova acquired shares with an adjusted cost base of approximately $42,000,000, but only nominal value. Nova's purchase price for these shares was $2,237,500. Once Nova disposed of these shares through a series of transactions, it claimed a capital loss of approximately $42,000,000 and thus an allowable capital loss of nearly $21,000,000 which it carried back to its 1985 taxation year and offset against a capital gain realized in that year, thus reducing its tax payable under Part I of the *Act* by approximately $10,000,000.

The specifics of the transactions were laid out in an agreed statement of facts which is reproduced below:

AGREED STATEMENT OF FACTS AND ISSUES

For the purposes of this appeal the parties, by their respective counsel, admit the following facts and agree upon the following issues to be decided by the Court. The parties agree that their admission of facts shall have the same effect as if the facts had formally been proved and accepted by the Court as true. The parties each reserve the right to adduce additional evidence which is relevant and probative of any issue before the Court and which is not inconsistent with the facts admitted herein. In this agreed statement of facts the terms "taxable Canadian corporation", "public corporation", "capital property", "disposition", "proceeds of disposition", "adjusted cost base", "allowable capital loss", "net capital loss" and "taxable capital gain" each have the meaning given to them in the *Income Tax Act* (the "*Act*").

1. The Appellant, Nova Corporation of Alberta, is a corporation incorporated by Special Act of the Legislature of the Province of Alberta. The Appellant was originally named Alberta Gas Trunk Lines Limited and, for a time, was known as Nova, an Alberta Corporation.

2. The Appellant's head office and principal place of business is located at 801 7th Avenue S.W., Calgary, Alberta, T2P 2N6.

3. This appeal relates to a Notice of Reassessment dated December 23, 1993, Number 3828084 (the "Reassessment"), with respect to the Appellant's 1985 taxation year.

4. The Appellant is a resident of Canada for purposes of the Act and, at all material times, was a taxable Canadian corporation and a public corporation.

Throughout its history the Appellant's taxation year has ended on December 31.

5.The Appellant owns and operates a natural gas gathering and transmission pipeline system in Alberta. Throughout its history the Appellant has made investments in subsidiaries and affiliates. Its subsidiaries and affiliates have carried on a variety of activities, including exploring for and marketing hydrocarbons, manufacturing and transporting petrochemicals and assembling and selling heavy duty trucks.

6.During its 1986 taxation year the Appellant disposed of the shares of two corporations, Allarco Group Ltd. ("Allarco") and Petralgas Chemicals N.Z. Limited ("Petralgas") which it held as capital property. In each case the Appellant reported that its proceeds of disposition were less than the adjusted cost base of the shares and, in each case, the Appellant reported a capital loss. The details of the Appellant's claims and the circumstances leading to the acquisition and disposition of the shares are set out in detail below.

The Carma Transactions

7.In late 1985, both Carma Ltd. ("Carma") and its wholly owned subsidiary, Allarco, were in serious financial difficulty. By this time both Carma and Allarco were in default on a debt restructuring which had been implemented in 1982. During 1986 Allarco was indebted to The Bank of Nova Scotia (the"Bank"), a Canadian chartered bank, in an amount exceeding $100,000,000 and the aggregate fair market value of its assets was considerably less than this amount. Allarco's indebtedness to the Bank was guaranteed by Carma.

8.Carma's guarantee of Allarco's debt to the Bank was secured by, among other things, a pledge of $25,000 Series "B" 11% Cumulative Redeemable Retractable Preferred Shares which it owned in the capital of Allarco (the "Allarco Preferred Shares").

9.Immediately before the transactions set out below the Allarco Preferred Shares had an adjusted cost base to Carma of $16,500,000.

10.By June 27, 1986, prior to the Appellant's involvement, virtually all of the value of the Allarco Preferred Shares had been lost due to Allarco's financial difficulties and the Allarco Preferred Shares had only a nominal market value. Accordingly, if Carma had sold the Allarco Preferred Shares to an arm's length party for their value at that time it would have realized a capital loss of $16,500,000. As a result of its financial and tax circumstances, Carma did not expect to be able to use that loss but believed the loss might be made available to a corporate purchaser which would be able to utilize it.

11.Carma took the following steps in order to facilitate the transfer of the inherent capital loss in the Allarco Preferred Shares to an unidentified prospective purchaser

(a)on May 22, 1986, it caused three taxable Canadian corporations, 348840 Alberta Ltd. ("840"), 348841 Alberta Ltd. ("841"), and 348842 Alberta Ltd. ("842") to be incorporated under the Business Corporations Act of Alberta;

(b)on June 19, 1986, Carma became the sole shareholder of 840, which in turn became the sole shareholder of 841, which in turn became the sole shareholder of 842; and

(c)on June 22, 1986, Carma sold the Allarco Preferred Shares to 842 for $1.00. The $16,499,999 capital loss which would otherwise have been realized by Carma on the sale to 842 was deemed to be nil by paragraph 85(4)(a) of the Act. As Carma did not own directly any shares in the capital of 842, a like amount of $16,499,999 was required to be added to 842's adjusted cost base of the Allarco Preferred Shares pursuant to paragraph 53(1)(f.1) of the Act. Accordingly, 842's adjusted cost base of the Allarco Preferred Shares became $16,500,000.

12.Once it became the owner of the Allarco Preferred Shares, 842 pledged the shares to the Bank as continuing security for Carma's guarantee of Allarco's debt to the Bank. The Bank was prepared to release its pledge of the Allarco Preferred Shares if it were instead granted a right of first refusal to acquire the shares if they were offered for sale.

13.On October 22, 1986, Carma, 842 and 348843 Alberta Ltd., another subsidiary of Carma, being the only shareholders of Allarco, entered into a unanimous shareholders' agreement in which they agreed to grant the Bank a right of first refusal with respect to the Allarco Preferred Shares. The right of first refusal provided the Bank with the right to purchase the Allarco Preferred Shares if any transfer of the Allarco Preferred Shares were proposed. The right of first refusal did not apply to a proposed transfer to a parent corporation on the winding up of 842 if it was the holder of the Allarco Preferred Shares as long as the parent corporation agreed to assume 842's obligations under the unanimous shareholders' agreement. Once the unanimous shareholders' agreement was signed the Bank released the pledge over the Allarco Preferred Shares which it held as security.

14.On October 22, 1986, the Appellant purchased the sole issued share of 842 from 841 for a purchase price of $1,237,500, which was equal to 15 cents for every dollar of allowable capital loss inherent in the only asset of 842, the Allarco Preferred Shares. The change of control of 842 resulting from this transaction did not affect the adjusted cost base of the Allarco Preferred Shares held by 842 which remained at $16,500,000.

15.On October 24, 1986, the Appellant commenced the dissolution of its wholly owned subsidiary, 842. The Allarco Preferred Shares were transferred to the Appellant in the course of winding up, and the Appellant assumed the obligations of 842 under the unanimous shareholders agreement so that the right of first refusal of the Bank referred to in paragraph 13 did not apply. 842 was legally dissolved and by virtue of subparagraph 88(1)(a)(iii), paragraph 88(1)(c) and paragraph 54(a) of the Act, the adjusted cost base of the Allarco Preferred Shares to the Appellant was deemed to be $16,500,000.

16.The only purpose of the series of transactions described in paragraphs 13 to 15 was to enable the Appellant to avail itself of the capital loss inherent in the Allarco Preferred Shares by acquiring those shares as capital property with an adjusted cost base of $16,500,000.

17.On November 19, 1986, as the last step in the series of transactions described in paragraphs 13 to 15, the Appellant sold the Allarco Preferred Shares to the Bank for $1.00 which were its proceeds of disposition. Pursuant to the provisions of paragraph 40(1)(b) of the Act the Appellant calculated that its loss from the disposition of the Allarco Preferred Shares was $16,500,00. Pursuant to the provisions of paragraph 39(1)(b) of the Act the Appellant calculated that its capital loss from the disposition of the Allarco Preferred Shares was $16,500,000. Pursuant to the provisions of paragraph 38(b) of

the Act the Appellant calculated that its allowable capital loss from the disposition of the Allarco Preferred Shares was $8,250,000.

18.The price of the share of 842 was determined in negotiations between the Appellant on the one hand, and Carma on the other hand, with Carma attempting to maximize its receipt and the Appellant attempting to minimize its payment. In these negotiations with respect to price the Appellant and Carma were each acting in their own self-interest.

19.The Appellant was not a party to any of the transactions described in paragraphs 11 to 13 inclusive and did not control or direct them. Before October 22, 1986, the Appellant had no right or obligation to purchase the sole issued share of 842, but before completing that purchase, the Appellant completed a due diligence review of the documentation relating to the transactions described in paragraphs 11 to 13 inclusive and satisfied itself that the transactions had occurred, that 842 owned the Allarco Preferred Shares, and that the adjusted cost base of the Allarco Preferred Shares in 842's hands was $16,500,000.

20.All of the documents relating to the transactions set out in paragraphs 11 to 17 herein were legally effective and binding upon the parties thereto and the transactions forth in the documents truly represent the agreements between the parties and were not shams.

21.The Minister examined all of the relevant documents in the course of an audit of the Appellant and concluded that the Appellant's adjusted cost base of the Allarco Preferred Shares was $16,500,000 immediately before it sold the shares to the Bank.

The Petralgas Transactions

22.Among the Appellant's investments in 1986 was an interest in Alberta Gas Chemicals Ltd. ("AGCL"), a taxable Canadian corporation which owned and operated several methanol plants in Canada. At all material times the issued and outstanding shares of AGCL were owned as to 50% by the Appellant and as to 50% by Allarco.

23.AGCL owned 49% of the issued and outstanding shares of Petralgas which was a New Zealand corporation. AGCL had acquired its interest in Petralgas in 1980. The remaining 51% of the shares of Petralgas were owned by Petroleum Corporation of New Zealand ("Petrocorp"), a New Zealand corporation which was controlled by the Government of New Zealand. Petralgas owned and operated a methanol plant in New Zealand.

24.An agreement between AGCL and Petrocorp obliged thern to provide capital and other financial support to Petralgas in proportion to their respective shareholdings. By early 1986, AGCL had invested $25,425,000 in Petralgas, but its interest in Petralgas had only nominal fair market value because Petralgas had encountered serious financial difficulties.

25.Immediately before the transactions described below, AGCL's adjusted cost base of its shares of Petralgas (the "Petralgas Shares") was $25,425,000. Accordingly, if AGCL had sold the Petralgas Shares to an arm's length party for their value at that time it would have realized a capital loss of $25,425,000.

26.By May of 1986, AGCL was also in financial difficulty and had commenced negotiations with its major creditors with respect to a restructuring of its own debts. AGCL's financial position was made worse by its funding obligations for Petralgas. AGCL's financial difficulties made its continuing involvement in Petralgas uneconomic and, at the insistence of its creditors,

AGCL approached Petrocorp to determine if Petrocorp would be prepared to acquire its interest and assume its funding obligations in respect of Petralgas. During May of 1986, Petrocorp agreed in principle that it would be prepared to take over AGCL's 49% interest in Petralgas and its continuing funding obligation.

27. AGCL also owned all of the issued shares of Alberta Gas Chemicals Resources Ltd. ("AGCR"), which, in turn, owned all the issued shares of 346976 Alberta Ltd. ("976"), a corporation newly incorporated for the purposes of the transactions described in paragraphs 28 and 29 below.

28. Between June 2 and September 22, 1986, the following steps were taken in order to facilitate the transfer of the inherent capital loss on the Petralgas Shares to the Appellant:

(a) AGCR granted the Appellant an option to purchase the shares of 976 for $100, subject to the condition that 976 be the owner of the Petralgas Shares at the time of the exercise of the option:

(b) AGCL sold the Petralgas Shares to 976 for $1,000,000 and paid by way of a demand non-interest bearing promissory note. The $24,425,000 capital loss which would otherwise have been realized on that sale was deemed to be nil by paragraph 85(4)(a) of the Act and a like amount of $24,425,000 was required to be added to 976's adjusted cost base of the Petralgas Shares pursuant to paragraph 53(1)(f.1) of the Act;

(c) the Appellant exercised its option to purchase the shares of 976 from AGCR for $100. The change of control of 976 resulting from this transaction did not affect the adjusted cost base of the Petralgas Shares held by 976 which remained at $25,425,000; and

(d) 976 then sold the Petralgas Shares to the Appellant for $1,000,000. The $24,425,000 capital loss which would otherwise have been realized on that sale by 976 was deemed to be nil by paragraph 40(2)(e) of the Act and a like amount of $24,425,000 was required to bc added to the Appellant's adjusted cost base of the Petralgas Shares pursuant to paragraph 53(1)(f.1) of the Act.

29. As the final step in the series, on September 22, 1986 the Appellant sold the Petralgas Shares to Petrocorp for $1.00 which were its proceeds of disposition. Pursuant to the provisions of paragraph 40(1)(b) of the Act the Appellant calculated that its loss from the disposition of the Petralgas Shares was $25,425,000. Pursuant to the provisions of paragraph 39(1)(b) of the Act the Appellant calculated that its capital loss from the disposition of the Petralgas Shares was $25,425,000. Pursuant to the provisions of paragraph 38(b) of the Act the Appellant calculated that its allowable capital loss from the disposition of the Petralgas Shares was $12,712,500.

30. The only purpose of the series of transactions described in paragraph 28 was to enable the Appellant to avail itself of the capital loss inherent in the Petralgas Shares by acquiring those shares as capital property with an adjusted cost base of $25,425,000.

31. 976 used the $1,000,000 received from the Appellant to pay the promissory note it had issued to AGCL.

32. The $1,000,000 purchase price paid by the Appellant for the Petralgas Shares was slightly less than 8 cents for every dollar of allowable capital loss inherent in them. That price was determined in negotiations between AGCL and the Appellant, with AGCL attempting to maximize its receipt and the Appellant attempting to minimize its payment. In these negotiations with

respect to price the Appellant and AGCL were each acting in their own self-interest.

33.The Appellant, as the owner of 50% of the shares of AGCL, reflected its share of the loss of the value of the AGCL investment in Petralgas in its own consolidated financial statements.

34.All of the documents relating to the transactions set out in paragraphs 28 and 29 were legally effective and binding upon the parties thereto and the transactions as set forth in the documents truly represent the agreements between the parties and were not shams.

35.The Minister examined all of the relevant documents in the course of an audit of the Appellant and concluded that the Appellant's adjusted cost base of the Petralgas Shares was $25,425,000 immediately before it sold the shares to Petrocorp.

Particulars of Tax Filings and Reassessments

36.In filing its return for its 1986 taxation year, the Appellant reported an allowable capital loss (the "Allarco Allowable Capital Loss") of $8,250,000 for its 1986 taxation year in respect of the sale of the Allarco Preferred Shares, such loss having been computed pursuant to paragraphs 40(1)(b), 39(1)(b) and 38(b) of the Act.

37.In determining its income under section 3 of the Act for its 1986 taxation year, the Appellant did not deduct any amount under paragraph 3(b) of the Act in respect of the Allarco Allowable Capital Loss.

38.In filing its return for its 1986 taxation year, the Appellant reported an allowable capital loss (the "Petralgas Allowable Capital Loss") of $12,712,500 for its 1986 taxation year in respect of the sale of the Petralgas Shares, such loss having been computed pursuant to paragraphs 40(1)(b), 39(1)(b) and 38(b) of the Act.

39.In determining its income under section 3 of the Act for its 1986 taxation year, the Appellant did not deduct any amount under paragraph 3(b) of the Act in respect of the Petralgas Allowable Capital Loss.

40.The Appellant made a timely claim for the deductions of $8,250,000 for the Allarco Allowable Capital Loss and $12,712,500 for the Petralgas Allowable Capital Loss in computing its taxable income for its 1985 taxation year in respect of the carry-back of these losses pursuant to paragraphs 111(8)(a) and 111(1)(b) of the Act. These losses were applied against its reported taxable capital gain of $82,549,667 which had been realized upon the disposition of its head office building in 1985. Prior to any in depth audit, the Minister reassessed the Appellant's 1985 taxation year to carry back these 1986 losses.

41.On December 23, 1993 the Minister issued the Reassessment reducing the net capital losses carried back from 1986 as follows

(a)Allarco Allowable Capital Loss:

Claimed $ 8,250,000
Disallowed 7,631,250
Allowed$ 618,750

(b)Petralgas Allowable Capital Loss:

Claimed $12,712,500

Disallowed 12,212,500
Allowed $ 500,000

42.At the time of issuing the Reassessment the Minister concluded that but for paragraph 55(1)(c) of the Act, the Allarco Allowable Capital Loss and the Petralgas Allowable Capital Loss as reported by the Appellant in 1986 would have been allowable capital losses of the Appellant in 1986 and the net capital loss claimed in 1985 would have been properly deducted. The Appellant takes issue with the conclusion that subsection 55(1) has any application to these transactions.

43.Upon being advised by the Minister of the proposed reassessment for 1985 the Appellant requested the Minister to allow it to claim additional discretionary deductions for its 1985 taxation year so as to minimize the tax payable by the Appellant as a result of the 1986 net capital loss carry back being reduced.

44.The result of the Reassessment was to reduce by $19,843,750 the 1986 net capital loss available to be carried back to the Appellant's 1985 taxation year and deducted in computing its taxable income for that year.

45.By Notices of Objection filed on the 25th day of January, 1994 the Appellant objected to the Reassessment.

46.By Notification dated March 30, 1994, the Minister confirmed the Reassessment.

47.By Notice of Appeal dated March 30, 1994 the Appellant appealed to this Court.

THE DECISION UNDER APPEAL

The Tax Court Judge considered the application of subsection 55(1) to the case at bar and found that it did not apply to reduce the losses claimed by Nova. In reaching this conclusion, the Tax Court Judge looked to whether the Allarco Preferred shares and the Petralgas Shares were disposed of by Nova under circumstances such that Nova may reasonably be considered to have artificially or unduly increased the amount of its losses from the dispositions.

The Tax Court Judge looked at the plain meaning of subsection 55(1) and held that the subsection required some action on the part of the taxpayer to increase the adjusted cost base of the assets it acquired. As the deduction came about by operation of the statute, the taxpayer had not actually done anything to increase the

ACB or decrease the proceeds of disposition, and the Tax Court Judge concluded that Nova was entitled to the losses claimed.

ANALYSIS

Both parties agree that this entire transaction was undertaken by Nova to avoid tax. It was, in effect, a purchase of losses with an eye to reducing Nova's tax burden. As has been held by this Court and the Supreme Court of Canada many times, there is no crime in tax avoidance. In this way, Nova's loss claim, though difficult to admire, is not inherently wrong, and must be assessed with a dispassionate eye.

1. The Statutory Framework

In 1986, subsection 55(1) held:

> 55(1) For the purposes of this subdivision, where the result of one or more sales, exchanges, declarations of trust, or other transactions of any kind whatever is that a taxpayer has disposed of property under circumstances such that he may reasonably be considered to have artificially or unduly
>
> (a) reduced the amount of his gain from the disposition,
> (b) created a loss from the disposition, or
> (c) increased the amount of his loss from the disposition,
>
> the taxpayer's gain or loss, as the case may be, from the disposition of the property shall be computed as if such reduction, creation or increase, as the case may be, had not occurred.

Following the Supreme Court of Canada in *Friesen* v. *The Queen*, [1995] 3 S.C.R. 103, the first step in assessing a provision of the *Income Tax Act* is to assess its plain meaning. Where the statutory language admits of no ambiguity, the plain meaning shall prevail, and there is no need to resort to an object and spirit analysis.

Upon a plain reading of this subsection, there is a precondition to the application of the subsection: the taxpayer must have done something to artificially or unduly increase his losses from disposition. That is, it is not enough that there be a loss, or that a loss be artificially or unduly increased in amount. For the subsection to apply,

it requires that "he" -- the taxpayer -- have increased the amount of his loss from disposition.

The term "loss from disposition" is defined in subparagraph 40(1)(b)(i) of the *Act* as the amount by which the adjusted cost base (ACB) exceeds the taxpayer's proceeds of disposition of the property. On a plain reading of subsection 55(1), then, the taxpayer must have done something to influence either the adjusted cost base or the proceeds of disposition in order to have artificially or unduly increased his losses.

The next logical step in the analysis is to assess whether Nova did anything to affect the ACB or the proceeds of disposition of the Allarco and Petralgas shares.

(a) The Petralgas Transactions

In the Petralgas transactions, paragraphs 85(4)(a), 40(2)(e) and 53(1)(f.1) operated to enable Nova to claim an ACB of $25,425,000. AGCL sold its Petralgas shares to '976, a subsidiary, for a $1,000,000 promissory note. The loss that AGCL might otherwise have been able to claim was deemed to be nil by paragraph 85(4)(a). At the same time, paragraph 53(1)(f.1) operated to require the $25,425,000 to be added to '976's ACB of the Petralgas shares.

As explained in the detailed statement of facts, AGCR owned '976. Nova held an option to purchase the shares of '976 from AGCR which it exercised after the above transactions were complete. In exchange for $100, control of '976 moved from AGCR to Nova. This did not affect the ACB of the Petralgas shares held by '976. At this point, '976 sold the Petralgas shares to Nova for $1,000,000. The capital loss of $24,425,000 which would otherwise have arisen on that sale was deemed to be nil by paragraph 40(2)(e), and 53(1)(f.1) again operated to add $24,425,000 to Nova's ACB. As a final step, Nova sold the Petralgas shares to

Petrocorp for $1.00, thus realizing a "loss from disposition" under paragraph 40(1)(b) of the *Act*.

(b) The Allarco Transactions

In the Allarco transactions, the adjusted cost base (ACB) came about through the operation of subsection 88(1) along with paragraphs 85(4)(a) and 53(1)(f.1). Paragraph 85(4)(a) states that where a taxpayer disposes of capital property to a corporation that it controls, its capital loss from the disposition is deemed to be zero. Thus, when Carma sold the Allarco shares to '842, a third-tier subsidiary,[1] paragraph 85(4)(a) of the *Act* deemed Carma's capital loss to be zero. At this point, paragraph 53(1)(f.1) operated to require the amount of capital loss Carma could have otherwise claimed to be added to '842's ACB for the shares. After a series of other transactions outlined in the detailed statement of facts, Nova purchased the sole share of '842 from '841 for $1,237,500. The change of control did not affect the ACB of the Allarco shares which remained $16,500,000. Two days after taking control, Nova commenced the dissolution of its now wholly-owned subsidiary, '842. By virtue of subparagraph 88(1)(a)(iii), as well as paragraphs 88(1)(c) and 54(a), the ACB of the Allarco shares to Nova was deemed to be $16,500,000. Once '842 had been wound up, Nova sold the Allarco shares to the Bank for $1.00. Hence, Nova suffered a loss on disposition.

There is no suggestion by the Minister's representative that Nova influenced the proceeds of disposition in either transaction. Similarly, there is no allegation that Nova tampered with the adjusted cost base of the shares. What is clear is that by operation of subsection 88(1) in the case of the Allarco preferred shares and by operation of paragraphs 40(2)(e) and 53(1)(f.1) in the case of the Petralgas shares, Nova inherited the adjusted cost base of the shares. That being the case, I cannot see

[1] I should note here that neither counsel could explain to the Court the need for a third-tier subsidiary to structure this transaction.

how Nova could be seen as having increased the amount of "loss from disposition" of the shares.

2. Scope of s.55(1)

It is clear that the tax loss claimed by Nova is far in excess of the actual loss sustained by Nova in this transaction. Thus, the Minister's Representative urges that this Court apply subsection 55(1) in a broad manner, arguing that this subsection is in essence the predecessor to the current anti-avoidance provisions and should be given a wide interpretation so as to maximize its scope. According to this position, the subsection should be given a purposive interpretation to counter "inappropriate tax avoidance" such as the transactions in this case.

Although the Minister's Representative argued ably, I am unable to agree that the subsection should be pushed beyond the limits of its plain meaning. Parliament has broad powers to enact and modify income taxation legislation. In cases where the plain meaning of the provision is unambiguous, it is not this Court's role to expand the scope of *Income Tax Act* provisions beyond the plain meaning of the words used in the subsection: *Canada* v. *Antosko*, [1994] 2 S.C.R. 312. While it is true that in situations of ambiguity, a purposive approach may be instructive in interpreting a provision, there is no such ambiguity here. A plain reading of the section leaves the reader with a clear indication of a requirement that the taxpayer have done something to artificially increase his losses.

I also note that in 1987, the *Act* was amended so as to prevent the type of loss purchase undertaken in this case. Parliament chose not to give these amendments retroactive effect. Although certainly not determinative of the issue before this Court, the subsequent amendment suggests that the legislators perceived a loophole. It is that loophole which the Respondent found and capitalized on while it was available. As was held in *I.R.C.* v. *Fisher's Executors*, [1926] AC 395 at 412 (HL), "[a taxpayer] may legitimately claim the advantage of any express terms or any

omissions that he can find in his favour in taxing *Acts*." This concept remains with us today in situations where the *Act* is clear on a plain reading. It appears to me that the loss on disposition claimed by the taxpayer in this case came about purely by operation of the provisions of the *Income Tax Act*. This operation of the *Act* has since been amended to prevent like occurrences. In my view, the taxpayer cannot be punished for taking full advantage of the operation of the *Act* while it so existed.

3. "His loss" v. "a loss"

Much was made in oral argument about the differentiation between the use of the phrase "his loss" in subparagraph 55(1)(c) and simply "loss" in subparagraph 55(1)(b). It was argued that the differing text required a different meaning be imparted to each of the two provisions. That is, the taxpayer Nova was precluded from claiming the Allarco and Petralgas losses under paragraph 55(1)(c), as the losses were not "his [the taxpayer's] losses."

It is clear that the economic losses actually incurred by Nova on the purchase of these shares were much less than the losses claimed. Once Nova purchased the shares in Allarco and Petralgas, though, the loss derived from disposition of those shares was deemed to be Nova's loss. The loss referred to in subsection 55(1) is the loss on disposition which, as explained earlier, is defined in the *Act* as being the difference between the ACB and the proceeds of disposition. Once the taxpayer inherits the ACB of the shares through operation of the *Act*, the loss is deemed to be the taxpayer's loss.

Subparagraph (b) refers to the taxpayer creating a loss, while (c) refers to the taxpayer increasing his loss. The Minister's Representative argued that the phrase "his loss" in (c) should be read as meaning "his economic loss." In my view, the different use of "a loss" and "his loss" does not advance the Minister's case. I do not understand the phrase "his loss" to mean the taxpayer's economic loss. Instead, it refers to the loss claimed by the taxpayer. To read in economic loss would render the postamble of the

provision at best ambiguous and at worst redundant. Further, the provision requires some undue or artificial increase in "his loss". If this is read as "his economic loss", then the section no longer operates to deny this taxpayer the losses claimed, as there has been no artificial or undue increase in the taxpayer's economic loss in this case.

4. Artificial or undue

Having concluded that subsection 55(1) requires some action on the part of the taxpayer, and that this action is not present in the case at bar, the issue of whether the losses claimed were artificially or unduly increased need not be decided. For the sake of completeness, though, an analysis of this issue serves to strengthen my overall conclusion that subsection 55(1) does not operate to deprive the taxpayer of the losses claimed in this case.

The issue of whether a deduction is "artificial or undue" has been considered by this Court in the context of the application of subsection 245(1). In *Mara Properties Ltd.* v. *The Queen* [1995] 2 FC 433, my brother Marceau J.A. and I agreed on the interpretation of the phrase "artificial or undue." As he said at pages 437-438:

> "Even if subsection 88(1) operates to allow the Respondent to consider the difference between the deemed cost and the actual proceed of sale as a loss sustained in the course of business, this loss could not be said to be "artificial" or "undue" as it would arise by specific operation of the Act."

The specific machinations of the *Act's* provisions in this case were outlined above. Although the transactions were complex, there is no indication that these provisions were stretched beyond their plain meaning at any time to accommodate these transactions. The losses claimed by the taxpayer came about by operation of the *Act*. I agree with Marceau J.A. that such losses cannot then be considered to be "artificial" or "undue".

Further to this point, it was argued before us that because the taxpayer's economic losses were different than the actual losses claimed, the losses are necessarily artificial. With respect, I cannot agree, as this interpretation would render the use of the words "artificial or undue" redundant. Had the legislature intended that any difference between economic loss and loss claimed could not be validly claimed by the taxpayer, then clear legislative wording to that effect would have been used.

CONCLUSION

Subsection 55(1) is not a broad anti-avoidance provision. It's scope cannot be expanded beyond its plain meaning where there is no ambiguity. A plain reading of the provision indicates that it requires some action on the part of the taxpayer in order for it to apply. That is, the taxpayer must actually do something to affect his loss on disposition of the property. As I have explained, this entails affecting either the ACB or the proceeds of disposition. In this case, the taxpayer did nothing to affect those figures. The ACB's of the shares were inherited by the taxpayer, and the shares were disposed of for their market value, which was nothing. The losses claimed by the taxpayer came about through the inheritance of ACB's, and this inheritance came about through operation of the *Act*. The taxpayer did nothing but avail himself of the provisions as they then existed.

Even if this Court were to find that the taxpayer had done "something" to affect the losses claimed, subsection 55(1) would not operate against the taxpayer in this case. The section requires that the increase in losses be artificial or undue. Looking at the transaction in isolation, the losses actually suffered by the taxpayer were substantially less than the losses claimed. However, this does not render the losses "artificial or undue." As was held by this Court in *Mara* (*supra*), losses are not "artificial or undue" when they arise by operation of the *Income Tax Act*, as occurred in this case.

For these reasons, I would dismiss the appeal with costs.

"F.J. McDonald"

J.A.

A-454-95

CORAM:MARCEAU J.A.
DESJARDINS J.A.
McDONALD J.A.

IN RE: *The Income Tax Act*

BETWEEN:

HER MAJESTY THE QUEEN

Appellant

- and -

NOVA CORPORATION OF ALBERTA LTD.

Respondent

REASONS FOR JUDGMENT

DESJARDINS J.A.

Reduced for purposes of simplicity and clarity are the relevant facts in the Allarco transaction drawn from the Agreed Statement of Facts. The principles involved in the Petralgas transaction are the same as those in the Allarco transaction.

In late 1985, both Carma and its wholly owned subsidiary, Allarco were in serious financial difficulty. At this time, both Carma and Allarco were in default on a debt restructuring plan which had been implemented in 1982. During 1986,

Allarco was indebted to The Bank of Nova Scotia (the "Bank"), in an amount exceeding $100,000,000 and the aggregate fair market value of its assets was considerably less than this amount. Allarco's indebtedness to the Bank was guaranteed by Carma. Carma's guarantee of Allarco's debt to the Bank was secured by, among other things, a pledge of 825,000 Series "B" 11% Cumulative Redeemable Retractable Preferred Shares (the "Allarco preferred shares" or the "loss shares") which it owned in the capital of Allarco.

Immediately before the transactions set out below, the Allarco preferred shares had an adjusted cost base to Carma of $16,500,000.

By June 27, 1986, prior to the respondent's involvement, virtually all of the value of the Allarco preferred shares had been lost due to Allarco's financial difficulties and the Allarco preferred shares had only a nominal market value. Accordingly, if Carma had sold the Allarco preferred shares to an arm's length party for their value at that time it would have realized a capital loss of $16,500,000. As a result of its financial and tax circumstances, Carma did not expect to be able to use that loss but believed the loss might be made available to a corporate purchaser which would be able to utilize it.

Carma took the following steps in order to facilitate the transfer of the inherent capital loss in the Allarco preferred shares to an unidentified prospective purchaser:

(a)on May 22, 1986, it caused three taxable Canadian corporations, 348840 Alberta Ltd. ("840"), 348841 Alberta Ltd. ("841"), and 348842 Alberta Ltd. ("842") to be incorporated under the *Business Corporations Act of Alberta*;

(b)on June 19, 1986, Carma became the sole shareholder of 840 which, in turn, became the sole shareholder of 841 which, in turn, became the sole shareholder of 842; and

(c)on June 22, 1986, Carma sold the Allarco preferred shares to 842 for $1. The $16,499,999 capital loss, which would otherwise have been realized by Carma on the sale to 842, was deemed to be nil by paragraph 85(4)(a) of the *Income Tax Act*[2] (the "Act"). As Carma did not own directly any shares in the capital of 842, a like amount of $16,499,999 was required to be added to 842's adjusted cost base of the Allarco preferred shares pursuant to paragraph 53(1)(f.1) of the Act. Accordingly, 842's adjusted cost base of the Allarco preferred shares became $16,500,000.

On October 22, 1986, the respondent purchased the sole issued share of 842 from a legal stranger 841 for a price of $1,237,500. At the time of purchase, 842's only asset was the shares in the capital stock of Allarco. The change of control of 842 did not affect the adjusted cost base of the Allarco preferred shares which retained a nominal value and an adjusted cost base (as defined by paragraph 54(a) of the Act) of $16,500,000.

On October 24, 1986, the respondent commenced the dissolution of its wholly-owned subsidiary 842. In the course of the liquidation, the Allarco preferred shares were transferred to the respondent. This attracted the application of subparagraph 88(1)(a)(iii) and paragraphs 88(1)(c) and 54(a) of the Act.

---

[2]R.S.C. 1985, c. 1 (5th Supp.).

In the result, there was no loss to 842 on the disposition of the Allarco preferred shares to the respondent, and the respondent inherited 842's adjusted cost base of the Allarco preferred shares of $16,500,000.

On November 19, 1986, the respondent sold the Allarco preferred shares to the Bank for $1. The arithmetic difference between the respondent's adjusted cost base of the Allarco preferred shares ($16,500,000) and its proceeds of disposition ($1) was its loss from the disposition of those shares pursuant to paragraph 40(1)(b) of the Act.

To sum up, therefore, Carma, which held the Allarco preferred shares with a market value equal to nil, but with a high adjusted cost base, created a subsidiary 840 which, in turn, created a subsidiary 841 which, in turn, created a subsidiary 842. Carma then sold the loss shares for $1 to the third-tier subsidiary 842 which acquired the high adjusted cost base. Nova came into the picture by buying from the second-tier subsidiary the sole issued share of 842 which owned the loss shares. 842 was then liquidated. Nova acquired the loss shares with the high adjusted cost base, sold the shares to the Bank for $1 and claimed a fiscal loss in its 1986 tax return.

The Petralgas transaction, as stated earlier, is substantially the same as the Allarco transaction except that the respondent's newly acquired subsidiary was not liquidated. Instead, the respondent purchased for $1,000,000 the Petralgas shares from the subsidiary at a time when their adjusted cost base was $25,425,000. Pursuant to paragraphs 40(2)(e) and 53(1)(f.1) of the Act, the respondent's adjusted cost base of the Petralgas shares became $25,425,000.

I shall deal principally with the Allarco transaction, but will sometimes make reference to the Petralgas transaction.

<u>The issue</u>

The issue before this Court is whether the Allarco and the Petralgas transactions are subject to the application of the anti-avoidance rules found in paragraph 55(1)(c) of the Act. In deciding this issue, the proper construction and scope of subsection 55(1) of the Act must be examined.

There is no doubt that the only purpose of these series of transactions was to enable the respondent to avail itself of the capital loss inherent in the Allarco and Petralgas preferred shares. The respondent does not dispute that fact. Nor is there any debate that, as a result of the transactions described, there was a loss and that the loss for tax purposes exceeded the respondent's economic loss.

The appellant submits that subsection 55(1), a generally-worded tax avoidance provision, applies to the loss purchase entered into by the respondent whereby it purchases tax losses from two corporations, which were not related to it, for a price that was approximately one-fifth of the amount of tax savings which arose from its use of those losses.

The respondent pleads, however, that for paragraph 55(1)(c) to apply the respondent, not the statute, must be responsible for the increase of the loss in issue. It pleads that the appellant is asking the Court to use subsection 55(1) of the Act to preclude the survival of a high adjusted cost base following a change in control. Amendments to the *Income Tax Act* to block such a result were enacted on January 15, 1987, adding subsection 249(4) and paragraph 111(4)(c),[3] but there were no such provisions in the Act at the time of the transaction in question.

---

[3]These amendments of 1987 are irrelevant to the case at bar as demonstrated by subsection 45(2) of the *Interpretation Act*, which reads:

> **45(2)** The amendment of an enactment shall not be deemed to be or to involve a declaration that the law under that enactment was or was considered by Parliament or other body or person by whom the enactment was enacted to have been different from the law as it is under the enactment as amended.

Interpretation of tax statutes

In interpreting paragraph 55(1)(c) of the Act, it is appropriate to begin the analysis with a discussion of some of the principles involved in the interpretation of tax statutes.

The interpretation of tax statutes is no longer dependant on predetermined assumptions which favour either the taxpayer or the government. In *Stubart Investments Limited v. The Queen*,[4] the Supreme Court of Canada stated that fiscal legislation is to be read in its entire context, having regard to the legislative purpose and scheme. Estey J. said the following:[5]

> ... Gradually, the role of the tax statute in the community changed, as we have seen, and the application of strict construction to it receded. Courts today apply to this statute the plain meaning rule, but in a substantive sense so that if a taxpayer is within the spirit of the charge, he may be held liable.

In *Corporation Notre-Dame de Bon-Secours v. Communauté Urbaine de Québec*,[6] Gonthier J. provided five rules of interpretation of taxing statutes (based on the seminal cases *Stubart*[7] and *The Queen v. Bronfman Trust*[8]):

1)The interpretation of tax legislation should follow the ordinary rules of interpretation;

2)A legislative provision should be given a strict or liberal interpretation depending on the purpose underlying it, and that purpose must be identified in light of the context of the statute, its objective and the legislative intent: this is the teleological approach;

3)The teleological approach will favour the taxpayer or the tax department depending solely on the legislative provision in question, and not on the existence of predetermined presumptions;

---

[4][1984] 1 S.C.R. 536.

[5][1984] 1 S.C.R. 536 at 578.

[6]95 DTC 5017 at 5023.

[7][1984] 1 S.C.R. 536.

[8]87 DTC 5059 (S.C.C.).

4)Substance should be given precedence over form to the extent that this is consistent with the wording and objective of the statute;

5)Only a reasonable doubt, not resolved by the ordinary rules of interpretation, will be settled by recourse to the residual presumption in favour of the taxpayer.

These rules of interpretation adopt a purposive approach, emphasizing the context of the statute, its objective and the legislative intent. While a tax provision must be construed in light of the purpose underlying it, the words of a provision must, however, be capable of supporting a proposed interpretation.

The abandonment of the traditional strict constructionist approach to tax statute in favour of a purposive approach has impacted on the courts' view of tax avoidance schemes. It is trite law that one of the principles that has governed the judicial response to tax enactments is that a taxpayer is entitled to arrange his affairs so as to attract the minimum amount of tax. This view was first articulated in the decision of the House of Lords in *IRC v. Duke of Westminster*:[9]

... Every man is entitled if he can to order his affairs so as that the tax attaching under the appropriate acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax.

While this principle has governed Canadian tax law, its scope has been restricted by both judicial doctrines and the enactment of anti-avoidance provisions in the *Income Tax Act*. Professor Ruth Sullivan in *Driedger on the Construction of Statutes*[10] notes the following:

There is no shortage of anti-avoidance tools available to Canadian judges. First, transactions that are merely a sham or formally ineffective may be set aside. Second, courts may pierce the corporate veil to prevent parties from taking advantage of inappropriate avoidance techniques. Third, although step by step transaction analysis and the bona fide business purpose test have not been adopted in Canada, the courts can rely on purposive analysis to accomplish much the same thing. Finally, there are statutory rules aimed at controlling or preventing avoidance. These are found not only in income tax legislation but also in other kinds of fiscal law. [footnotes omitted]

---

[9][1936] A.C. 1.

[10]3rd ed. (Toronto: Butterworths, 1994) at 409.

This Court, therefore, must take a purposive approach to the interpretation of paragraph 55(1)(c) and identify its objective and effect by examining the context of Subdivision c - Taxable Capital Gains and Allowable Capital Losses of Division B of the Act, which provides the scheme of capital gains and losses, and the language of the provision itself.

The purpose of paragraph 55(1)(c)[11]

Paragraph 55(1)(c) is a general anti-avoidance provision with a specific application to the disposition of capital property. It is intended to negate the effect of any transactions entered into by a taxpayer which may reasonably be considered to have artificially or unduly reduced the amount of a capital gain arising on the disposition of a capital property.

In enacting paragraph 55(1)(c), Parliament clearly recognized that, in certain circumstances, the application of the rules contained in Subdivision c - Taxable Capital Gains and Allowable Capital Losses, could lead to inappropriate results: artificial or undue creation or increase of losses or artificial reductions in gains from the disposition of property.

While the case at bar involves the proper interpretation to be given to paragraph 55(1)(c), the capital losses acquired by Nova through the Allarco and Petralgas transactions were made possible through the operation of several provisions in the Act.

It is admitted that Nova was not a party to any of the transactions which preceded its buying of the sole issued share of 842 from 841 for a purchase price of $1,237,500 on October 22, 1986. Nova, however, was in the market for precisely this

[11]Subsection 55(1) was repealed by 1988, c. 55, s. 33(1).

kind of "product", which I will later consider in the light of paragraph 55(1)(c) of the Act.

I ask, therefore, whether the Allarco and Petralgas transactions are of a kind which Parliament intended to capture under paragraph 55(1)(c) of the Act?

The provisions which facilitated the transfer of the unrealized capital loss in the Allarco and Petralgas transactions, namely paragraphs 85(4)(a), 40(2)(e) and 53(1)(f.1) of the Act, are provisions which were intended to prevent the triggering of unrealized losses by dispositions to related parties (paragraphs 85(4)(a) and 40(2)(e)) and relief to the taxpayer who has so disposed of such property (paragraph 53(1)(f.1)). Paragraph 53(1)(f.1) is the provision that operated, on the sale of the Allarco preferred shares from Carma to 842, to deny the $16,499,999 loss to Carma and to add the amount of the denied loss to the cost base of the Allarco preferred shares then held by 842. Similarly, on the sale of the Petralgas shares from AGCL to 976, paragraph 53(1)(f.1) operated to deny the loss of $25,425,000 to AGCL and to add the amount of the denied loss to the Petralgas shares then held by 976. Both 842 and 976 were second-tier subsidiaries of the corporations from which they obtained the loss shares, Carma and AGCL respectively. This had to be by design. If 842 and 976 had been first-tier subsidiaries of Carma and AGCL respectively, the loss on the transfer of the Allarco and the Petralgas shares would not have been added to 842's and 976's adjusted cost base of those shares, but rather would have been added to Carma's adjusted cost base of its shares of 842 and AGCL's adjusted cost base of its shares of 976 pursuant to paragraph 85(4)(b). As a result, Carma and AGCL would have realized the loss on the arm's length disposition of their shares of 842 and 976 respectively. Thus, if the arrangement was hopefully to work, without reference to paragraph 55(1)(c), it was necessary to set up and to dispose of the loss shares to second-tier subsidiaries.

The appellant argues that the scheme of the Act is intended to prohibit the transfer of losses between unrelated parties. The respondent agrees. The respondent states, however, that there are rollover provisions in the Act which dictate that, on transfers of property between related parties, the transferer does not realize any gain or loss and the transferee inherits the transferor's cost base of property. These are the provisions, says the respondent, that dictate the results of the transaction in this case.

This is true, but with a nuance. Once the rollovers had been achieved at the second-tier level by Carma, Nova willingly brought itself into the picture through the acquisition from 841 of the sole issued share of 842 which owned the loss shares of Allarco. Nova became in command of the loss by triggering at its call the liquidation of 842 and the timing of the future sale of the Allarco preferred shares to the Bank for $1.

Is this deviation of the rollover provisions permissible under paragraph 55(1)(c) of the Act?

The wording of paragraph 55(1)(c)

While the Supreme Court of Canada and this Court respectively held in *Mara* and *Husky* that subsections 245(1) and 245(2) had no application to similar avoidance transactions in those cases, the same conclusion is not necessarily reached when seeking to apply paragraph 55(1)(c). One must examine the specific wording of paragraph 55(1)(c) in order to determine its application and scope. It reads as follows:

55(1) For the purposes of this subdivision, where the result of one or more sales, exchanges, declarations of trust, or other transactions of any kind whatever is that a taxpayer has disposed of property under circumstances such that he may reasonably be considered to have artificially or unduly	**55(1)** Aux fins de la présente sous-section, lorsque les circonstances dans lesquelles ont été effectuées une ou plusieurs opérations de vente ou d'échange, ou autres transactions de quelque nature que ce soit, permettent de croire raisonnablement que le contribuable a disposé d'un bien de façon à artificiellement ou indûment
...	...
(c) increased the amount of his loss from the disposition,the taxpayer's gain or loss, as the	(c) augmenter le montant de sa perte résultant de la disposition,

case may be, from the disposition of the property shall be computed as if such reduction, creation or increase, as the case may be, had not occurred.

[Emphasis added]

le gain ou la perte du contribuable, selon le cas, résultant de la disposition du bien, est calculée comme si une telle réduction, perte ou augmentation, selon le cas, ne s'était pas produite.

[Je souligne]

Paragraph 55(1)(c) provides a results-driven test. The way in which that result can be reached is framed broadly, encompassing sales, exchanges and declarations of trust, "or other transactions of any kind whatever..." The intention of the taxpayer is irrelevant.[12]

All the circumstances must be looked at to appreciate if the taxpayer "may reasonably be considered to have..." ("permettent de croire raisonnablement que..." in the French version) artificially or unduly increased his loss. The standard to be applied is one of reasonable consideration. But it is clear that the proper approach to applying paragraph 55(1)(c) of the Act requires that one views the transactions as a whole rather than in isolation. It would be clearly misleading to examine Nova's actions in isolation from the series of transactions which led to the disputed result. This is so because each step was an essential part of the overall scheme: had any of the parties failed to go through with any one of the steps in the series of transactions, Nova would never have had the Allarco and Petralgas losses to claim. The "product" to be bought was arranged so as to fit the business purposes pursued by corporations such as Nova. The series of transactions would have had no value had Nova not taken the steps it did, for example in the Allarco situation, to acquire 842, to wind up its affairs, and appropriate itself of the loss shares, and then sell them at the market value of $1 to the Bank. Without Nova's own actions, the scheme first elaborated by Carma would never have come to fruition.

The resulting increase in the taxpayer "loss" must, however, have been achieved artificially or unduly. The meaning of the words "his loss" is in dispute. The appellant

---

[12] V. Krishna, *The Taxation of Capital Gains*, (Toronto: Butterworths, 1983) at 234.

claims that these words refer to the economic loss suffered by the respondent, namely the cost of capital spent to acquire the loss shares ($1,237,500 for the Allarco shares and $100,000 for the Petralgas shares) and not the loss it claimed ($16,500,000 and $25,425,000 respectively) since these losses were not Nova's losses but those of unrelated corporate entities.

I agree with the respondent that the words "his loss" must be read in the light of subparagraph 40(1)(b)(i) of the Act. The words "his loss... from the disposition..." are a defined term which corresponds to the arithmetic difference between the adjusted cost base to him before the disposition and the proceeds of disposition.

This loss must not, however, have been "artificially or unduly increased" by the taxpayer.

Nothing of the sort has happened, claims the respondent. Nova did not artificially influence any of these two figures. The proceeds of disposition of the Allarco and Petralgas shares were sold for a nominal amount of $1 which represented their true worth. The adjusted cost base of the shares was not determined by the respondent, but resulted from the operation of the Act.

The position of the respondent is correct, but does not answer the real question raised by the anti-avoidance provision of paragraph 55(1)(c). The adjusted cost base may have been obtained by operation of the Act. But, it was obtained contrary to the scheme and intent of the Act. When paragraph 53(1)(f.1) of the Act was introduced in 1977, the following Budget Date Comment was made:[13]

> The Minister has recognized that the present treatment of capital losses of a corporation from a disposition of property to a parent corporation or a corporation controlled by that parent under paragraph 40(2)(e) was unduly harsh. It is proposed that such losses be added to the adjusted cost base of the purchaser to whom the property has been transferred in a manner similar to that

[13]D.M. Sherman, *Income Tax Act and regulations, Department of Finance Technical notes: a consolidation of technical notes and other income tax commentary from the Department of Finance*, 7th ed. (Toronto: Carswell, 1995) at 300.

> provided for in the case of superficial losses. The purchaser will thus be able to realize the capital loss on a subsequent arm's length sale.
>
> [Emphasis added]

Nova profited from the rollover provisions as between related corporations by acquiring the sole issued share of 842, which owned the loss shares, and then dissolving the subsidiary. Had Nova been genuinely interested in the Allarco preferred shares themselves (which it was not), it would have bought them directly from 842 which could have claimed the capital loss. What Nova obtained "by operation of the Act" was obtained through a distortion of the Act. A distorted tax result ensues.

The words "unduly or artificially" do not cover, as claimed by Nova, only cases where the taxpayer takes steps to increase his adjusted cost base of the shares, for instance, by having the corporation declare a dividend which increased the adjusted cost base of the shares but had no other effect.[14] The words "unduly or artificially", viewed within the principles of statutory interpretation under *Corporation Notre-Dame de Bon-Secours*, cover also situations such as the present one, where action was taken in clear defiance of the scheme of the rollover provisions and contrary to normal business practice.[15]

In *Husky Oil Ltd., Canada v.*,[16] this Court upheld a similar avoidance transaction because it "flowed from the provisions of the Act". That might have been the right answer in that case, where the words "... that a person conferred a benefit on a taxpayer..." in subsection 245(2) of the Act were to be interpreted.

---

[14] *Industries S.L.M. Inc. v. Minister of National Revenue*, [1996] 2 C.T.C. 2572 (T.C.C.); *Daggett (R.H.) v. M.N.R.*, [1992] 2 C.T.C. 2764 (T.C.C.).

[15] *Fording Coal Ltd. v. R.*, [1996] 1 C.T.C. 230 (F.C.A.).

[16] [1995] 1 C.T.C. 460 at 464 (F.C.A.) where Pratte J.A., for the Court, said:

> The Tax refund obtained by the respondent was a benefit. No one denies that. But was that benefit conferred on the respondent by Brinco, Carma or another person? The respondent was either entitled or not to obtain the tax refund. If it was so entitled, that benefit was not conferred on the respondent by anyone but merely flowed from the provisions of the *Income Tax Act*...

"By operation of the Act" was also mentioned by this Court in *R. v. Mara Properties Ltd.*[17] where both the majority and minority judges of this Court found subsection 245(1) of the Act to be inapplicable because the loss arose by specific operation of the Act. We are left in limbo with regard to the legacy of those reasons for judgment, however, since the Supreme Court of Canada's decision, which reversed the majority opinion of this Court, is directed only to the "conclusion" reached by the Tax Court of Canada and the dissenting judge in the Court of Appeal.[18]

Paragraph 55(1)(c) is an anti-avoidance provision which is intended to play a role in the income tax system. To the extent that the words of the provision reasonably bear the meaning given to them in a particular situation, the anti-avoidance provision modifies the rules of the game set forth in the *Duke of Westminster* case.

My reasoning is not based on the economic loss of the respondent compared to its claimed fiscal loss. My proposition is that through a deviation of the rollover provisions, about which Nova is not an innocent bystander, the respondent may reasonably be considered to have unduly and artificially increased one of the two figures in the calculation of its fiscal loss, namely the adjusted cost base. The morality of these transactions does not concern us. Their reality, however, does, in the light of the *Income Tax Act*. Nova's action is well captured by the terms of paragraph 55(1)(c) of the Act.

---

[17][1996] 2 S.C.R. 161; [1996] 2 C.T.C. 54 (S.C.C.), which reversed the decision of this Court, 95 DTC 5168, [1995] 2 C.T.C. 86 (F.C.A.) and restored the decision of the Tax Court of Canada [1993] 2 C.T.C. 3189 (T.C.C.).

[18]*R. v. Mara Properties Ltd.*, [1996] 2 S.C.R. 161. The Supreme Court of Canada's decision reads:

> We agree with the conclusion reached by the Tax Court and McDonald J.A., the dissenting judge in the Court of Appeal. In our view, in the circumstances of this case, the property retained its character as inventory in the hands of the appellant.
>
> Accordingly, the appeal is allowed with costs throughout, the judgment of the Court of Appeal is set aside, and the judgment of the Tax Court is restored.

I would allow this appeal with costs throughout, I would set aside the decision of the Tax Court of Canada and I would dismiss the respondent's appeal thus confirming the reassessment of the Minister.

"Alice Desjardins"
J.A.