Case Name:

Mathew v. Canada

Between
Douglas H. Mathew, Steven M. Cook, Eugene Kaulius, Charles E. Beil, 347059 B.C. Ltd., John R. Owen, Amalio De Cotiis, William John Millar, NSFC Holdings Ltd., TFTI Holdings Limited, Ian H. Pitfield, The Estate of the Late Lorne A. Green, Innocenzo De Cotiis, Verlaan Investments Inc., Frank Mayer, Craig C. Sturrock, John N. Gregory, appellants, and Her Majesty the Queen, respondent

[2002] T.C.J. No. 222

[2002] A.C.I. no 222

99 C.R.R. (2d) 189

[2003] 1 C.T.C. 2045

2002 D.T.C. 1637

Court File Nos. 1999-464(IT)G, 1999-466(IT)G,

1999-467(IT)G, 1999-468(IT)G, 1999-469(IT)G,

1999-472(IT)G, 1999-473(IT)G, 1999-474(IT)G,

1999-475(IT)G, 1999-478(IT)G, 1999-479(IT)G,

1999-480(IT)G, 1999-481(IT)G, 1999-484(IT)G,

1999-486(IT)G, 1999-487(IT)G, 1999-488(IT)G

Tax Court of Canada
Vancouver, British Columbia and Ottawa, Ontario

Dussault T.C.J.

Heard: July 3-6, 9-13 and 23-25, 2001.
Judgment: May 3, 2002.

(507 paras.)

Income tax -- Partnerships -- Losses -- Restrictions -- Tax evasion and avoidance -- Interpretation of tax transactions according to substance and not form -- Avoidance, what constitutes -- Constitutional law -- Determination of validity of statutes or acts -- Civil rights -- Liberty -- Canadian Charter of Rights and Freedoms -- When rights arise.

Appeals by several individual and corporate taxpayers from the assessments of the Minister of National Revenue disallowing their deductions of partnership losses. The losses were allocated to the taxpayers as partners in SRMP Realty & Mortgage Partnership. The partnership was formed after the insolvency of Standard Trust Company and its subsequent winding-up. Standard held significant non-performing mortgages. The liquidator devised a plan to transfer the non-performing mortgages to an arm's length partnership. Through a series of transactions, a bundle of properties were transferred to a partnership, and interests in the partnership were sold to the taxpayers. The partnership sold a number of the properties in the portfolio, which resulted in a significant loss. The taxpayers deducted their share of the partnership's losses in their income tax statements. The Minister disallowed the deduction of the losses on the basis of the general anti-avoidance rule. The taxpayers challenged the applicability of the general anti-avoidance rule and its constitutionality. They emphasized the lengthy negotiations over the purchase price, the real estate expertise of several of the taxpayers and the extent of due diligence performed during the transactions as evidence of the commercial nature of the transactions.

HELD: Appeals dismissed. The tax losses were a key component of the transactions leading up to the purchase of the partnership interests by the taxpayers. The losses held by Standard would have been lost were it not for the use of the partnership vehicle. The taxpayers had no real expectation of profit from the transaction. The series of transactions were designed in contemplation of the final result. The transactions were avoidance transactions. There was a tax benefit to the taxpayers from the transactions. The transactions contemplated a permanent tax saving. They made Standard's tax losses a marketable commodity. The commercial objectives could have been attained by other means. There was a significant disparity between the tax benefit and the commercial benefit of the transactions. The transfer of losses from the partnership to the partners did not in itself constitute an abuse of the Act. However, the transactions had to be viewed as a whole. The transactions resulted in the transfer of one corporation's losses to other taxpayers, which was against the general policy of the Act. The general anti-avoidance rule did not infringe the taxpayers' section 7 Charter rights. The economic effects of the rule did not amount to a deprivation of liberty. The rule was constitutionally valid.

Statutes, Regulations and Rules Cited:

Canadian Charter of Rights and Freedoms, 1982, ss. 1, 2(d), 6, 7, 15, 26.
Canada Evidence Act, R.S.C. 1985, c. C-5.
Combines Investigation Act, s. 32(1)(c).
Constitution Act, 1982, s. 52, 52(1).
Criminal Code.
Excise Tax Act.
Federal Court Act, s. 57.
Income Tax Act, ss. 3, 4, 5, 6, 7, 8, 9, 18(13), 18(13)(c), 18(13)(d), 20(1)(c)(i), 37, 40(3), 97(1), 100(2), 111, 111(1), 111(3), 111(5), 111(7), 152(8), 245, 245(1), 245(2), 245(3), 245(3)(b), 245(4), 248(10).
Quebec Charter of Human Rights and Freedoms, s. 5.
Securities Act, R.S.B.C. 1996, c. 418.
Tax Court of Canada Rules (General Procedure), Rule 58, 58(1), 58(1)(b).
Unemployment Insurance Act, 1971, S.C. 1970-71-72, c. 48, s. 32.
Winding-up Act, R.S.C. c. W-11.

Kim Hansen, David J. Martin and Letitia Sears, for the appellants.
Luther P. Chambers and Robert Carvalho, for the respondent.

[Quicklaw note: A corrigendum was received from the Court May 15, 2002. The corrections have been made to the text and the corrigendum is appended to this document.]

JUDGMENT:-- The appeals [1999-464(IT)G, 1999-488(IT)G)] from the assessments made under the Income Tax Act for the 1993, 1994, 1995, 1996 and 1997 taxation years are dismissed with costs to the Respondent in accordance with the attached Reasons for Judgment.

However, the fees with respect to the preparation and the conduct of the hearing are limited to those that would be applicable to one appeal only.

The appeals [1999-466(IT)G] from the assessments made under the Income Tax Act for the 1993, 1994 and 1995 taxation years are dismissed with costs to the Respondent in accordance with the attached Reasons for Judgment.

However, the fees with respect to the preparation and the conduct of the hearing are limited to those that would be applicable to one appeal only.

The appeal [1999-467(IT)G, 1999-473(IT)G, 1999-480(IT)G, 1999-481(IT)G] from the assessment made under the Income Tax Act for the 1993 taxation year is dismissed with costs to the Respondent in accordance with the attached Reasons for Judgment.

However, the fees with respect to the preparation and the conduct of the hearing are limited to

those that would be applicable to one appeal only.

The appeals [1999-468(IT)G, 1999-479(IT)G, 1999-487(IT)G] from the assessments made under the Income Tax Act for the 1992 and 1993 taxation years are dismissed with costs to the Respondent in accordance with the attached Reasons for Judgment.

However, the fees with respect to the preparation and the conduct of the hearing are limited to those that would be applicable to one appeal only.

The appeals [1999-469(IT)G, 1999-484(IT)G] from the assessments made under the Income Tax Act for the 1994 and 1995 taxation years are dismissed with costs to the Respondent in accordance with the attached Reasons for Judgment.

However, the fees with respect to the preparation and the conduct of the hearing are limited to those that would be applicable to one appeal only.

The appeals [1999-472(IT)G] from the assessments made under the Income Tax Act for the 1990, 1991, 1992, 1993, 1994 and 1995 taxation years are dismissed with costs to the Respondent in accordance with the attached Reasons for Judgment.

However, the fees with respect to the preparation and the conduct of the hearing are limited to those that would be applicable to one appeal only.

The appeals [1999-474(IT)G] from the assessments made under the Income Tax Act for the 1991, 1992 and 1993 taxation years are dismissed with costs to the Respondent in accordance with the attached Reasons for Judgment.

However, the fees with respect to the preparation and the conduct of the hearing are limited to those that would be applicable to one appeal only.

The appeal [1999-475(IT)G, 1999-478(IT)G] from the assessment made under the Income Tax Act for the 1994 taxation year is dismissed with costs to the Respondent in accordance with the attached Reasons for Judgment.

However, the fees with respect to the preparation and the conduct of the hearing are limited to those that would be applicable to one appeal only.

The appeals [1999-486(IT)G] from the assessments made under the Income Tax Act for the 1990, 1991, 1992, 1993 and 1994 taxation years are dismissed with costs to the Respondent in accordance with the attached Reasons for Judgment.

However, the fees with respect to the preparation and the conduct of the hearing are limited to those that would be applicable to one appeal only.

REASONS FOR JUDGMENT

1 DUSSAULT T.C.J.:-- These appeals relate to losses allocated to the partners in the SRMP Realty & Mortgage Partnership ("SRMP") at that partnership's 1993 year-end, on October 1, 1993.

In computing their income for the 1993 taxation year the 14 individual Appellants[1] deducted their share of SRMP's losses. Because October 1, 1993 fell within the corporate Appellants' (347059 B.C. Ltd., NSFC Holdings Ltd., TFTI Holdings Limited and Verlaan Investments Inc.) 1994 taxation year, these Appellants deducted their share of the SRMP losses in their 1994 taxation year. In the case of a number of the Appellants their share of the SRMP losses exceeded their income in the year of the deduction. They therefore computed non-capital losses which they then carried back to prior taxation years or forward to future taxation years. The Minister of National Revenue (the "Minister") reassessed all of the Appellants, disallowing the deduction of the SRMP losses and, where applicable, the non-capital losses.

I ISSUES

2 Initially, the Minister disallowed the losses in question on a number of bases, one being the general anti-avoidance rule (the "GAAR") under section 245 of the Income Tax Act (the "Act"). The Appellants are challenging not only the applicability of the GAAR but also its constitutionality. Before the hearing of these appeals the Respondent abandoned the other bases of the assessments, deciding to proceed in respect of the GAAR only. Judge Beaubier of this Court issued an order on June 7, 2001 in relation to a motion heard on June 4, 2001, providing that the appeal would proceed in respect of only two issues. The order provided, inter alia, the following:

> The Respondent having abandoned all other issues in dispute between the parties and the Appellants consenting thereto, the hearing of these appeals will proceed respecting only the following two issues:
>
> (a) Whether the SRMP losses were properly denied under the General Anti-avoidance Rule ("GAAR") under section 245 of the Income Tax Act, and
> (b) Whether section 245 of the Income Tax Act is impermissibly vague and thus contrary to section 7 of the Canadian Charter of Rights and Freedoms (the "Charter") and/or the substantive requirements of the Rule of Law and hence of no force and effect under section 52 of the Constitution Act, 1982, as alleged by the Appellants.

3 Pursuant to section 57 of the Federal Court Act, Mr. David J. Martin, counsel for the Appellant John N. Gregory (1999-488(IT)G), served notice of a constitutional question on the Attorney General of Canada and the Attorney General of each province on January 31, 2000. As all the other appeals herein were heard together with the appeal of John N. Gregory, I take it that the notice requirement has been satisfied for each of them.

4 The Respondent further brought preliminary applications pursuant to Rule 58(1)(b) of the Tax

Court of Canada Rules (General Procedure) requesting that paragraphs or portions of paragraphs of each of the four corporate Appellants' Amended Notice of Appeal invoking section 7 of the Charter be struck out as disclosing no reasonable grounds for appeal. At the hearing, on July 3, 2001, counsel agreed to address this issue during final argument.

II ADMITTED FACTS

5 Prior to the hearing, the parties submitted the following Statement of Admitted Facts:

1. Standard Trust Company ("STC") carried on a business which included the lending of money on the security of mortgages on real property.
2. By May, 1991 STC was insolvent, and on May 2, 1991 Mr. Justice Houlden, of the Ontario Court (General Division) ordered STC to be wound up pursuant to the provisions of the Winding-up Act, R.S.C. c. W-11, and appointed Ernst & Young Inc. (E & Y) its liquidator. Thereafter Messrs. Bradeen and Drake, of E & Y, as liquidator of STC, were the directing minds of STC.
3. At the time the liquidation commenced, one-half of STC's total mortgage loan portfolio of approximately $1.6 billion was comprised of non-performing loans, which is to say loans upon which the payments of principal and interest were 90 days or more in arrears.
4. The task of E & Y as Liquidator, was to obtain the maximum realization possible on the assets of STC, and to that end, it was empowered, both by the Winding Up Act and by the Order of Houlden, J., to carry on the business of STC, insofar as was necessary for the beneficial winding up of the company.
5. E & Y accordingly devised a plan to transfer such nonperforming mortgages to a partnership that was to be formed between STC and a wholly-owned subsidiary of STC, i.e., a partnership with which STC, as a corporate entity, would not be dealing at arm's length, within the meaning of the Income Tax Act. STC would have a 99% partnership interest and its wholly-owned subsidiary a 1% partnership interest in that partnership.
6. E & Y accordingly caused the following transactions or events to take place:

    (a) On October 16, 1992, E & Y caused 1004568 to be incorporated.
    (b) On October 21, 1992, on E & Y's motion, the Ontario Court (General Division) approved the incorporation of a wholly-owned subsidiary of STC, the formation of two general partnerships, i.e.,

STIL I and STIL II, in which STC and its wholly-owned subsidiary were to be partners, and the transfer of the beneficial ownership of nonperforming mortgages contained in two portfolios prepared by E & Y to these partnerships.

(c) Standard and 1004568 entered into a partnership agreement dated October 23, 1992 to create the STIL II Partnership.

(d) On October 23, 1992, 1004568 borrowed $730,220 from STC and contributed $312,902 of that amount to STIL I and $417,318 to STIL II as a capital contribution for a 1% partnership interest in each of STIL I and STIL II.

(e) On October 23, 1992, STC transferred one of the said mortgage portfolios, ("the STIL II Mortgage Portfolio") to STIL II for $41,314,434 by way of STC's capital contribution in that amount for a 99% partnership interest in STIL II. The STIL II Mortgage Portfolio comprised 17 nonperforming mortgages, with 9 underlying real estate properties. Pursuant to subsection 97(1) of the Income Tax Act, STC was deemed to have disposed of these assets, and STIL II was deemed to have acquired them, at their fair market value of $33,262,000 broken down as follows:

Properties	Fair Market Value
99 Rideau	$2,000,000
Shurguard Oakville	1,170,000
Georgian Estates	11,370,000
Masonville Estates	9,600,000
Mount Baker Enterprises	1,000,000
Turner Crossing	1,211,000
23 Lesmill	5,700,000
Atherton	519,000
Shurguard Hamilton	692,000

Total	$33,262,000

(f) At the time of the said disposition STC's cost of these assets was $85,368,872, broken down as follows:

Properties	Cost
99 Rideau	$ 5,792,692
Shurguard Oakville	3,020,392
Georgian Estates	31,215,480
Masonville Estates	27,198,952
Mount Baker Enterprises	1,262,823
Turner Crossing	1,961,653
23 Lesmill	10,621,355
Atherton	1,270,768
Shurguard Hamilton	3,024,757

Total	$85,368,872

(g) By virtue of subsection 18(13) of the Income Tax Act, the cost for income tax purposes of the mortgages in the STIL II Mortgage Portfolio to STIL II was maintained at the historic cost of such assets to STC as set out in paragraph 6(f).

7. Between August, 1992 and January, 1993 E & Y contacted 38 prospective purchasers of STC's 99% interest in STIL I and STIL II, including OSFC Holdings Limited ("OSFC") (a company with which STC dealt at arm's length), and sold its interest in the STIL I partnership in December, 1992 to a third party not relevant to this appeal.
8. In January, 1993, OSFC started to negotiate with E & Y to acquire STC's said 99% interest in STIL II ("the STIL II Interest").
9. Negotiations were difficult between OSFC and E & Y leading up to the sale of Standard's STIL II partnership interest.
10. E & Y at first attempted to obtain $33,262,00 for its STIL II Interest, representing the fair market value of the STIL II Portfolio, as estimated by E & Y. However, OSFC made it known to E & Y that the STIL II Portfolio could, in OSFC's view, not be sold for what E & Y thought to be its fair market value. E & Y and OSFC therefore negotiated a price for STC's STIL II Interest, which was to be payable based on a formula of sharing the proceeds from the sale of the properties underlying the STIL II Portfolio over a period of several years.

11. The negotiations culminated in an extensive written agreement of purchase and sale, dated May 31, 1993, whereby STC sold and OSFC purchased STC's STIL II Interest ("the STIL II Purchase Agreement").
12. Pursuant to that agreement the purchase price payable by OSFC for the said 99% STIL II Interest consisted of the following components:

a)	Cash	$3,000,000
	5-year 7.5%, Promissory Note, repayable at any time	14,500,000
		$17,500,000
	Plus: An "Additional Payment" up to	5,000,000
		$22,500,000

b) "Earnout", depending on the proceeds from the sale of the properties underlying the mortgages, as follows:

ii) [if] the proceeds were less than $17,500,000, the earnout was NIL,
iii) if the proceeds were in excess of $17,500,000, but less than $32,434,751, the earnout was 91% of 99% of the difference between the amount up to $32,434,751 and $17,500,000,
iv) if the proceeds were in excess of $32,434,751, but less than $38,000,000, the earnout was equal to the sum of $13,454,716 and 50% of 99% of the difference between the amount up to $38,000,000 and $32,434,751, and
v) if the proceeds were in excess of $38,000,000, the earnout was equal to the sum of $16,209,514 and 25% of 99% of the proceeds in excess of $38,000,000.

c) The said note of $14,500,000 was payable out of the proceeds of the sale of the properties underlying the nonperforming mortgages in such a way that the promissory note was repaid in full when the proceeds reached $17,500,000.
d) Interest on the said promissory note was to be paid from the "Net

Cash Flow" from these properties, i.e. the net rent from them, less operating expenses. To the extent interest was not so paid, it was to be added to the principal amount of the note. No cash distribution to STIL II's partners was to be made until this note was fully paid.

e) The Additional Payment of $5,000,000 was adjustable, depending on what actual losses resulted from the disposition of these properties, and depended on whether such losses actually turned out to be deductible under the Income Tax Act. The Additional Payment was payable by OSFC to STC on April 30, 1999, and as security therefor OSFC was obligated to pay the following amounts into an escrow account:

a) $1,000,000 on May 31, 1994;
b) $1,000,000 on May 31, 1995;
c) $1,500,000 on May 31, 1996; and
d) $1,500,000 on May 31, 1997.

13. It was a requirement of the STIL II Purchase Agreement that STC and 1004568 Ontario Inc. enter into an "Amended and Restated Partnership Agreement" by the closing time of the STIL II Purchase Agreement. On June 22, 1993, 1004568 Ontario Inc. and STC entered into an Amended and Restated Partnership Agreement amending and restating the terms of the original STIL II Partnership Agreement with the result that what OSFC purchased from STC was the latter's STIL II Interest as constituted by that Amended and Restated Partnership Agreement.
14. Pursuant to the Amended and Restated Partnership Agreement STIL II's business was to be carried out in accordance with a "Business Plan" approved by the partners which E & Y (on behalf of STC) and OSFC expressly approved in writing on June 18, 1993. This Business Plan stated that it reflected the partners' current estimates of the likely outcome of dispositions of STIL II's assets based on the assumptions discussed in that Plan regarding the business climate in which STIL II must manage and realize on its assets.
15. The said Business Plan set out a "High Scenario" and a "Low Scenario" for the disposition of the said mortgages or the properties for which they were security between July 1993 and December, 1996. According to the "High Scenario", the gross sales proceeds for the 9 properties were projected at $39,820,200 and the net proceeds at $37,611,200, while according to the "Low Scenario", the gross sales proceeds for these nonperforming mortgages or properties were projected at $23,351,200 and the net

proceeds at $21,969,800.

16. The said Business Plan was agreed to by STC and OSFC on June 18, 1993.
17. Under the Amended and Restated Partnership Agreement regarding STIL II, STC was entitled to a management fee of $250,000 per annum, and 1004568 was entitled to a fee of $200,000 per annum (for an initial term of two years; these fees were thereafter to be determined by the STIL II Management Committee).
18. OSFC and TFTI entered into an agreement dated July 5, 1993 (the "SRMP Partnership Agreement") forming and entering into a general partnership to carry on business under the name "SRMP Realty & Mortgage Partnership" (the "SRMP Partnership" or "SRMP") to acquire and manage OSFC's partnership interest in the STIL II Partnership.
19. The capital of SRMP was divided into 35 class A Units and 15 class B Units. The class B Units were allocated as follows:

Class B Unitholder	No. of class B Units
OSFC	12.00
TFTI	2.00
NSFC	.50
Eugene Kaulius	.50

	15.00

20. TFTI, NSFC and Eugene Kaulius were issued their Class B Units for $1.00 per Class B Unit, and OSFC was issued its 12 Class B Units as part of its consideration for transferring its STIL II Interest to SRMP. OSFC was SRMP's managing partner and was authorized to raise capital for SRMP in order to purchase OSFC's STIL II interest by offering and selling Class A Units to other persons at the price stipulated in the "subscriptions" pursuant to which such persons subscribed for much [sic] Class A Units.
21. The SRMP Partnership Agreement confirmed OSFC's entitlement to the $250,000 per annum management fee to which STC was entitled under the Amended and Restated Partnership Agreement regarding STIL II, and entitled OSFC to $12,000 per annum as an administration fee and to an "Incentive Management Fee" equal to 75% of "Gross STIL II Receipts", i.e. essentially, revenue paid to SRMP by STIL II, excluding proceeds of

disposition of assets, less operating expenses (including interest on the promissory note of $14,500,000).

22. E & Y prepared a report (Liquidator's Report #22) dated June 22, 1993 and filed it with the Ontario Court of Justice (General Division) in support of an Order approving the transfer of Standard's interest in the STIL II Partnership to OSFC.
23. The transfer to OSFC of Standard's partnership interest in STIL II was approved by Mr. Justice Houlden in an Order dated June 25, 1993.
24. Standard and 1004568 intended to carry on, and they did in fact carry on, a business in common with respect to the Mortgages in the STIL II partnership with a view to profit.
25. OSFC approached a number of potential investors to participate as partners in SRMP Partnership, including the Appellants.
26. On July 7, 1993 OSFC sold its STIL II Interest to SRMP for a composite purchase price, consisting of:

(1) $3,850,000 in cash,
(2) the assumption of the $14,500,000 Promissory Note which OSFC was obligated to pay to STC under the STIL II Purchase Agreement,
(3) the assumption of the Earnout, i.e. the amounts which OSFC was obligated to pay to STC under the STIL II Purchase Agreement pursuant to the earnout formula therein contained,
(4) the assumption of the Additional Payment (of approximately $5,000,000) which OSFC had obligated itself to pay to STC under the STIL II Purchase Agreement,
(5) the "Excess SRMP Payment", i.e. an amount equal to the excess of a calculated amount as of October 22, 1998 or such later date, as specified in the STIL II Purchase Agreement, over the "Additional Payment", also as specified in the STIL II Purchase Agreement, and,
(6) the fair market value of 12 Class B Units in SRMP, to be satisfied by the issue of 12 Class B Units to OSFC.

27. Pursuant to the SRMP Purchase Agreement, OSFC entered into a deed of assignment dated July 5 [sic], 1993 assigning its partnership interest in the STIL II Partnership to the SRMP Partnership except for OSFC's right to perform certain services for the STIL II Partnership and to receive a fee therefor.
28. OSFC, SRMP Partnership and 1004568 entered into an agreement dated July 7, 1993 to confirm that OSFC had assigned to the SRMP Partnership and the SRMP Partnership had assumed from OSFC all of the rights and

obligations of OSFC under the STIL II Partnership except for OSFC's right to perform certain services for the STIL II Partnership and to receive a fee therefor.

29. On or about July 9, 1993 the Class A Unitholders described in Appendix "A" hereto subscribed for the stated number of Class A Units, or fractions thereof, of SRMP for a composite price of $110,000 per Class A Unit (aggregating to $3,850,000 for all 35 Class A Unitholders). In addition the Class A Unitholders had to agree to pay additional subscription proceeds to SRMP to fund their proportionate share of the "Additional Payment" which SRMP was obligated to pay to OSFC in respect thereof. As security for the payment of the Additional Payment, the subscribers for Class A Units in SRMP had to provide a letter of credit in the amount of $60,000 per Class A Unit and pay the following amounts on the following dates to a third party escrow agent for payment by OSFC of the Additional Payment:

(a)	April 30, 1994:	$28,571
(b)	April 30, 1995:	$28,571
(c)	April 30, 1996:	$42,857
(d)	April 30, 1997:	$25,701

		$125,700

or $4,399,500 in the aggregate for all 35 Class A Unitholders. If it should happen that the Additional Payment should exceed $125,700 per Class A Unit, OSFC had the right to request an increase in the security payments therefor.

30. Each Appellant that acquired Class A Units in SRMP tendered the following documents:

(a) a certified cheque in the amount of $110,000 per Class A Unit;=
(b) a letter of credit in the amount of $60,000 per Class A Unit;
(c) a Pledge Agreement;
(d) a direction with respect to cash distributions;
(e) an Escrow Agreement;
(f) acknowledgement, Postponement and Subordination Agreement;
(g) a Subscriber's Covenant Letter; and

(h) a power of attorney in favour of OSFC.

31. Net Cash Flow after payment of operating expenses from the operations of the STIL II Partnership, other than from the sale or other realization of the Mortgages or underlying properties, was to be applied as follows:

First:	$250,000 annual management fee to OSFC*
Second:	$200,000 annual administration fee to 1004568 Ontario Inc.*
Third:	to pay interest on the $14.5 million Promissory Note at the rate of 7.5%/annum
Fourth:	75% of remaining cash flow to OSFC as an incentive management fee
Fifth:	balance, 70% to Class A Units, 30% to Class B Units

* The amounts of these fees were subject to re-negotiation after two years.

32. Net Proceeds after payment of all selling costs from the sale or other realization of the STIL II Partnership Mortgages and/or underlying properties was to be applied as follows:

First:	$14.5 million applied 82.684% to STC in payment of the Promissory Note and 17.316% to fund to be held in escrow to secure payment of the Promissory Note
Second:	next $3 million (after discharge of the Promissory Note from funds is escrow) to Class A Units to be held on account of the required security deposits to fund payment of the Additional Amount
Third:	next $14.9 million allocated 91% to STC and 9% to STIL II Partnership of which 99% went to SRMP Partnership and 1% to 1004568 Ontario Inc. Of the amount allocated to SRMP Partnership, the first $850,000 [w]as to be allocated to the Class A Units with the balance to be allocated 70% to the Class A Units and 30% to the Class B Units.
Fourth:	balance allocated 50% to STC and 50% to STIL II Partnership of which 99%

went to SRMP Partnership and 1% to 1004568 Ontario Inc. Of the amount allocated to SRMP Partnership, 70% went to the Class A Units and 30% to the Class B Units.

33. OSFC and the SRMP Partnership entered into an agreement dated September 10, 1993 pursuant to which the SRMP partners assumed and agreed to perform OSFC's obligations under the STIL II Purchase Agreement and Amended and Restated STIL II Partnership Agreement.
34. As at September 30, 1993, as a result of the sale of some of the said properties and the write-down of the remaining properties to fair market value, the difference between STIL II's said cost of the properties of $85,368,872 and their sale price and fair market value, respectively, resulted in a loss to STIL II for tax purposes in excess of $52,000,000, 99% of which was allocated to SRMP, which SRMP then allocated to its partners in proportion to their respective unit holdings, the Appellants' shares thereof being those set out in Appendix "A" hereto.
35. The Appellants deducted their said share of the SRMP loss in computing their income for their 1993 or 1994 taxation years, depending on when their taxation year ended. Some of the Appellants, in addition to reducing their taxable income for those taxation years to NIL, also computed noncapital losses which they then carried forward to future taxation years or back to prior taxation years.
36. In reassessing the Appellants for their 1993 or 1994 taxation years, as the case may be, the Minister of National Revenue disallowed to said Appellants their share of the SRMP loss, with the result that the Appellants had taxable income in that year, rather than a noncapital loss which could be carried back or forward to other taxation years.
37. During its 1992 and 1993 fiscal periods, the STIL II Partnership carried on business with a reasonable expectation of profit.
38. During its 1993 fiscal period, the SRMP Partnership and its partners carried on business with a reasonable expectation of profit.
39. Apart from the properties comprising the STIL II Portfolio, neither STIL II nor SRMP ever acquired or sold any real property.

APPENDIX "A"

SRMP REALTY & MORTGAGE PARTNERSHIP

ANALYSIS OF CAPITAL ACCOUNTS

PARTNERS	# OF UNITS	OPENING BALANCE	CONTRIBUTION	WITHDRAWALS	NET INCOME (LOSS)	CLOSING BALANCE
CLASS 'A' UNITS						
TFTI Holdings Ltd	1.00	0	110,000	0	(1,047,689)	(937,689)
NSFC Holdings Ltd	1.00	0	110,000	0	(1,047,689)	(937,689)
Viam Properties Ltd	19.00	0	2,090,000	0	(19,906,100)	(17,816,100)
Amalio De Cotiis	0.33	0	36,667	0	(349,195)	(312,528)
Innocenzo De Cotiis	0.33	0	36,667	0	(349,195)	(312,528)
Michael De Cotiis	0.33	0	36,667	0	(349,195)	(312,528)
Frank B. Mayer	3.00	0	330,000	0	(3,143,068)	(2,813,068)
347059 BC Ltd and Verlaan Investments Inc.	3.00	0	330,000	0	(3,143,068)	(2,813,068)
Charles E. Beil	0.80	0	88,000	0	(838,152)	(750,152)
Steven M. Cook	0.70	0	77,000	0	(733,383)	(656,383)
A. Barrie Davidson	1.00	0	110,000	0	(1,047,689)	(937,689)
Lorne A. Green	0.40	0	44,000	0	(419,076)	(375,076)
John N. Gregory	0.50	0	55,000	0	(523,845)	(468,845)
Douglas H. Mathew	0.40	0	44,000	0	(419,076)	(375,076)
W. Jack Millar	0.50	0	55,000	0	(523,845)	(468,845)
Warren J. A. Mitchell	0.50	0	55,000	0	(523,845)	(468,845)
John R. Owen	0.40	0	44,000	0	(419,076)	(375,076)
Ian H. Pitfield	0.50	0	55,000	0	(523,845)	(468,845)
James H.G. Roche	0.50	0	55,000	0	(523,845)	(468,845)
Craig C. Sturrock	0.80	0	88,000	0	(838,152)	(750,152)
Total Class 'A'	35.00	0	3,850,001	0	(36,669,029)	(32,819,028)
CLASS 'B' UNITS						
OSFC Holdings Ltd	12.00	0	12	0	(12,572,274)	(12,572,262)
TFTI Holdings Ltd.	2.00	0	2	0	(2,095,379)	(2,095,377)
NSFC Holdings Ltd	0.50	0	1	0	(523,845)	(523,844)
Eugene Kaulius	0.50	0	1	0	(523,845)	(523,844)
Total Class 'B'	15.00	0	15	0	(15,715,342)	(15,715,327)
ROUNDING DIFFERENCES		0	0	0	(103)	(103)
TOTAL	50.00	0	3,850,016	0	(52,384,474)	(48,534,458)

6 Leaving aside for the moment the many details spelled out in this extensive Statement of Admitted Facts, one will appreciate that the losses claimed by the Appellants resulted in the end from six key transactions which are as follows:

1. The incorporation of 1004568 by STC. ("TRANSACTION 1")
2. The formation of the STIL II partnership between STC (99%) and 1004568 (1%). ("TRANSACTION 2")
3. The sale by STC of the non-performing mortgages to STIL II using subsection 18(13) of the Act. ("TRANSACTION 3")
4. The sale by STC of its partnership interest in STIL II (99%) to OSFC. ("TRANSACTION 4")
5. The formation of the SRMP partnership by OSFC and TFTI. ("TRANSACTION 5")
6. The sale by OSFC of 76% of its 99% interest in STIL II to the other SRMP partners, some of which are Appellants in the present case. ("TRANSACTION 6")

7 Throughout these Reasons for Judgment, the above transactions may occasionally be referred to by number.

8 Total losses claimed by the SRMP partners holding the 35 Class "A" as well as the 15 Class "B" Units amounted to $52,384,474 or $1,047,689 per unit. Appendix "A" to the Statement of Admitted Facts gives the details concerning each SRMP partner's participation in and the contribution to the partnership as well as the losses claimed by each. During evidence and in argument the $52,384,474 in losses was often rounded off to $50 million.

III REVIEW OF EVIDENCE

(A) GENERAL COMMENTS

9 Pursuant to Judge Beaubier's order dated June 7, 2001, the transcripts of Mr. Richard Bradeen's testimony before Judge Bowie of this Court in OSFC Holdings Ltd. v. The Queen (hereinafter OSFC (TCC)) 99 D.T.C. 1044, [1999] 3 C.T.C. 2649, were filed by consent of the parties to constitute Mr. Bradeen's evidence in the present appeals. Mr. Bradeen is a chartered accountant and was, during the relevant period and until 1997, a partner in the accounting firm Ernst & Young ("E & Y") in Toronto. In May of 1991 Mr. Bradeen, under the direction of Mr. William Drake the senior partner in charge of liquidation at E & Y, assumed responsibility for overseeing the liquidation of STC's mortgage loan portfolios. Mr. Bradeen's duties involved supervising the daily management of the assets, enforcing security rights, collecting on personal and corporate guarantees and selling the underlying assets with the overall purpose of maximizing the proceeds to the estate for the benefit of the creditors.

10 Seven witnesses testified for the Appellants.

11 Eugene Kaulius, in addition to explaining OSFC's involvement in the transactions, testified for himself and on behalf of NSFC Holdings Ltd. and TFTI Holdings Limited, companies ultimately controlled by Peter Thomas, who also controlled OSFC. Mr. Kaulius emphasized that Mr. Thomas is very experienced in real estate, having founded the Century 21 real estate firm in Canada. Mr. Kaulius is a chartered accountant by training and was, from 1992 until 1998, president of OSFC, NSFC, TFTI and Samoth Capital Corporation (Samoth), a public corporation of which Mr. Thomas was chairman during these years.

12 John Norman Gregory and Steven Mark Cook testified on behalf of the lawyers with the firm of Thorsteinssons who were partners in SRMP, including Mr. Gregory and Mr. Cook, themselves, Charles E. Beil, A. Barrie Davidson, Lorne A. Green, Douglas H. Mathew, W. Jack Millar, Warren J.A. Mitchell, John R. Owen, Ian H. Pitfield, James H.G. Roche and Craig C. Sturrock. Mr. Gregory specified, however, that Messrs. Davidson, Green and Roche are now deceased. He further stated that Mr. Millar departed the firm to form his own law firm a few years ago, and that Mr. Pitfield is now a judge in the Supreme Court of British Columbia. With the exception of Messrs. Roche and Davidson, these persons are all Appellants in these proceedings. Mr. Gregory further testified that he was fairly experienced in the real estate business at the time he acquired his half partnership interest in SRMP. His experience was acquired through training as well as through his personal experience in rental properties, both residential and commercial. He stated that he had never been involved in a syndicated partnership but was, as a lawyer, very familiar with real estate syndication. Mr. Cook testified that he was familiar with real estate through his training.

13 Michael De Cotiis testified on behalf of his two brothers, Amalio and Innocenzo De Cotiis. Messrs. De Cotiis are heavily involved in the real estate business and hold, among other companies and interests, shares of a company called Viam Properties Ltd., of which they are also directors. While Messrs. De Cotiis and Viam Properties Ltd. were partners in SRMP, only Innocenzo and Amalio De Cotiis are Appellants in the present proceedings. The hearing of the appeal of Michael De Cotiis (1999-482(IT)G) has been adjourned by order of Judge Beaubier dated June 7, 2001 and is to be heard in conjunction with the appeal of Viam Properties Ltd. (2000-5103(IT)G) at a later date. However, of the three brothers, Michael De Cotiis, was the one who was mainly involved in the investment in SRMP. Having a better knowledge of the English language, he was also in a better position to testify.

14 William Verlaan testified on behalf of Verlaan Investments Inc. and 347059 B.C. Ltd., real estate development companies of which he is president and shareholder and which are partners in SRMP. Having started in real estate in the 1960s, Mr. Verlaan is also greatly involved and has considerable experience in that business.

15 Frank Benjamin Mayer testified for himself. Mr. Mayer is an investment analyst who has been specializing in real estate for over 28 years.

16 Stewart Robertson also testified for the Appellants, having been involved in the STIL II

transactions in the course of his employment with OSFC. Although Mr. Robertson took part in the negotiations with E & Y, his role was principally to carry on the due diligence process and to look after the day-to-day management of the properties included in the STIL II Mortgage Portfolio (hereinafter the"Portfolio"). He would also provide information on those properties to the SRMP partners. At OSFC, Mr. Robertson reported to Mr. Kaulius.

17 Lastly, counsel for the Appellants read in as evidence excerpts from the examination for discovery of Mr. Turner, a senior appeals officer at the Canada Customs and Revenue Agency.

18 Counsel for the Respondent attempted to have Mr. Richard Charles Taylor, a chartered accountant and a chartered business valuator with the firm Low Rosen Taylor Soriano in Toronto, accepted as an expert and to have his report entered as evidence or, in the alternative, to have him testify on limited matters confined to market rates of return or the proper calculation of rates of return. Counsel for the Appellants challenged to the admissibility of Mr. Taylor's expert evidence primarily on the basis that a major part of his report consisted in findings of fact made by him in the OSFC (TCC) trial that did not fall within the area of his qualifications. Further to accept Mr. Taylor's testimony on limited matters of market rates of return or the proper calculation of rates of return would, according to counsel for the Appellants, allow him to engage in a completely different exercise than the one he was initially asked to undertake. By Order dated July 18, 2001, I refused to admit Mr. Taylor's evidence, essentially for the reasons advanced by counsel for the Appellants. The Reasons for Order were signed on July 30, 2001.

19 Read-ins from the examination for discovery of Douglas H. Mathew, Warren J.A. Mitchell, Ian H. Pitfield and Craig G. Sturrock were however entered as evidence for the Respondent. Transcripts of the examination for discovery of Steven M. Cook as well as transcripts of the testimony of Eugene Kaulius in the OSFC (TCC) case, supra, before Judge Bowie, were also adduced by the Respondent.

20 The documentary evidence consists of Exhibits 1 to 203 contained in volumes I to XV, of various other Exhibits numbered 204 to 209, of Exhibits A-1 to A-17 contained in the Appellant's Supplemental Book of Documents, and of various other documents numbered A-18 to A-21. In addition, counsel for the Respondent filed a Brandeis Brief consisting of documents on the legislative history of section 245 of the Act and on foreign tax legislation. The Brandeis Brief also contains numerous writings on the subject of tax avoidance.

21 During examination of the witnesses, counsel for the Appellants placed great emphasis on the underlying assets of the Portfolio, and more particularly on their target realisation value, in order to demonstrate the primary business purpose of the Appellants in becoming partners in SRMP. In cross-examination, counsel for the Respondent challenged their claim in that respect. Central to that question is Exhibit A-16 entitled "Summary of STIL II Assets", a document that would have been prepared and reviewed periodically by Mr. Robertson and provided by him from time to time to the Appellants. I do not wish to comment at this time on the pertinence or importance of that document.

However, for the sake of a better understanding of the evidence adduced by the parties, I have decided to reproduce it at this point. To further such understanding, I have also decided to offer thereafter a brief description of the properties listed in Exhibit A-16. The description of the properties as they were in early 1993 was provided in Mr. Gregory's testimony and to a greater extent in Mr. Robertson's testimony. Numerous comments were also provided by Mr. Kaulius.

22 Exhibit A-16 reads as follows:

SUMMARY OF STIL II ASSETS

Property Name	No. of Units	Number of Sq. Ft.	Annual Cash Flow	Minimum Net Sales Proceeds	Price per Unit on Cost	Cap. Rate on Cost	Appraisal Values	Date of Appraisal	Milborne Estimate of Value April/93	Target Realization Total	Target Sale Date	Offers on Hand	Sales Proceeds	Settlement Date
99 Rideau		21,270	(61,000)	500,265	$23.50/sqft		2,387,000	07/92		700,000	12/93			
23 Lesmill		71,230	(438,000)	247,630	$3.48/sqft		6,200,000	05/91		2,000,000	09/93			
Shurguard Oakville	766		150,000	1,021,500		15%	2,000,000	05/92		1,250,000	12/93			
Georgian Estates	258 165		270,000 470,000	Phase I 1,792,782 Phase II 2,690,909 Phase II 498,768 Phase III 997,536 5,979,995	$27,272	15% 11%	3,870,000 13,150,000	05/92	55,000	2,000,000 9,000,000	06/95			
Shurguard Hamilton	639		60,000	309,125		19%	1,600,000	05/92		500,000	06/96			
Masonville Estates	332		848,000	3,805,520 3,805,520	$22,891	11%	17,400,000	06/92	60,000	19,900,000	12/96			
Mt. Baker Enterprises		31,200	30,000	495,265	$20/sqft	6%	1,000,000	07/92		800,000	06/93			
Atherton Place	47		0	394,835	$8,500	sold	519,000	02/93		450,000	09/93	450,000		
Turner Crossing (75.7%)		14,943	110,000	940,315		12%	1,211,000	01/93		1,200,000	07/93	1,211,200		
Properties		170,495	$1,439,000	$17,500,000			$49,337,000			$37,800,000	09/93			

23 At the outset, it is worth noting that Mr. Robertson said the properties were not class "A" or "B" properties and many would not have been purchased but for the fact that they were part of a take-it-or-leave-it package deal presented by E & Y. The majority of the properties were located in Ontario.

24 The 99 Rideau property was located in the Byward Market area of Ottawa. It was at the time a three-storey building with a McDonald's restaurant and other tenants. This property had been designed as a hotel, a fact with which Samoth and Mr. Thomas were very familiar. However, the project had been stopped, as zoning and height regulations prevented the development of this project as designed. As the property sat, it was essentially "a hotel lobby without a hotel." However, Mr. Robertson said that OSFC and later SRMP had looked at potentially getting involved with a local developer to actually finish the hotel with five or seven storeys instead of 17, if the tenants, and particularly the McDonald's restaurant, would agree to having their leases bought out. However, McDonald's had a 99-year lease that was essentially prepaid. As Mr. Robertson described it, "it was a wild card."

25 The 23 Lesmill property was a very well-built office building in the Don Mills area of Toronto. However, it was quite problematic because it was substantially vacant and generating significant negative cash flow - some $438,000 - at the time. Mr. Robertson stated that the problem with the building was that it had been developed as an office condo, 26% of the units having been sold at that time. Therefore, what OSFC and later SRMP acquired was a mortgage on the remaining 74% of the property. As a result, they ended up being partners with small individual owner-occupiers, some of whom had no money to contribute capital if needed. The vacancy level was attributable to the rental market in the area in which the property was situated. According to Mr. Robertson, it was improbable that the property's net operating cash flow would improve in the near future. A sale by auction was contemplated early on in the process.

26 The Shurguard Oakville and Shurguard Hamilton properties were mini-storage properties in Oakville and in Hamilton. The one in Oakville was older but larger and had the advantage of a better net operating income. The one in Hamilton was newer and better built but had high property taxes and, as a result, a relatively small net operating income. Mr. Robertson stated that these properties were viewed as an opportunity to hold land with cash flow and wait until the market turned around, at which point either the properties could be sold outright to a builder or a joint venture could be entered into with a builder.

27 The Georgian Estates property was a large development in Barrie, Ontario. The constructions on the property were not well suited to a harsh environment, being of wood not concrete. Mr. Robertson described it as being a nine-acre site with three components. The first consisted of three student residence buildings with a total of 258 bedrooms, which generated significant cash flow eight months of the year. The second component consisted of two condominium buildings, each having 66 units. The third component was an L-shaped project with a 30,000 square foot strip mall on the ground floor and 34 residential condominiums on the second and third floors. It is worth noting that there was no cash flow from the strip mall because more than half of the property was vacant. While this property had several constructions flaws, E & Y had invested substantial amounts of money to correct deficiencies. Moreover, the net operating cash flow from some components of the property was good and there was opportunity to make it substantially better if the student vacancy factor was remedied. According to Mr. Robertson, the substantial potential cash flow from this property, as well as from the Masonville Estates, was one of the key elements of the whole Portfolio, since it would give OSFC and SRMP the "luxury of time on the entire Portfolio."

28 The Masonville Estates property was located in London, Ontario, close to the University of Western Ontario, and consisted of two residential building towers. This property was not particularly well built but was of new construction and most of the apartments had two bedrooms and two bathrooms, which was seen as an advantage, as it created privacy. As a result of its proximity to the University, most of the apartments were rented to students at very high rents. However, under its mode of operation at that time, the property was only rented eight months of the year, as students moved out for four months during the summer. Also, the building had some deferred maintenance to be done and there were some basic, fundamental flaws in its construction.

However, Mr. Robertson stated that, here again, E & Y had spent millions of dollars dealing with construction deficiencies, most of the work having been done by the time OSFC came into the project and the negotiations were completed. As it had been represented to OSFC that both the Masonville Estates and Georgian Estates either were or would shortly become registered condominiums, the Masonville Estates project was seen as beneficial, condominiums being at a premium as compared to apartment blocks. According to Mr. Robertson, whether OSFC, and later SRMP, was to sell Masonville Estates as individual condos or to sell the whole property to a condo retailer or syndicator, they expected to obtain a premium price, since it would already be in condo form. Moreover, the cash flow from the property was significant and a decrease in property taxes was expected from its registration as condominiums. Since the property had tenants at that time, there was very little risk to selling the condominium units, as long as the cash flow was covering debt service.

29 The Mount Baker and Atherton Place properties were both located in Winnipeg. Mount Baker was a small warehouse, which had experienced settling underneath it. As a result of the structural problems that entailed, only one half of the property was suitable for the storage of items of any significant weight. In addition the property had an access problem: the actual entrance was reached by crossing the neighbour's property via an easement. Access from the other side of the property would require construction across a culvert at a cost of between $75,000 and $100,000. Further, the borrower on the property was an irrational individual who was purporting to be both landlord and tenant and there was some question as to whether or not he could be removed so that increased rents could be charged. Atherton Place was a small apartment building with a long list of problems, most related to the fact that it was located in a dangerous neighbourhood. It is worth mentioning that there was an agreement of sale pending on Atherton Place at the time OSFC was negotiating the purchase of STC's 99% interest in the STIL II Partnership. It sold just prior to the closing between OSFC and STC, but for less than $450,000.

30 Turner Crossing was a shopping mall located in Regina. As may be seen from Exhibit A-16 (reproduced at paragraph 22 of these Reasons), there was an offer of $1,211,200 on this property at the time the transaction between STC and OSFC closed. However, the sale did not go through and the property was sold a year or two later to another purchaser.

31 Despite the extensive Statement of Admitted Facts, the evidence given at trial lasted almost nine days. In the following review of the evidence concerning the circumstances surrounding the key transactions mentioned in paragraph [6] of these Reasons for Judgment, I will concentrate on the admitted facts and the most important aspects of the evidence as emphasized by counsel for both parties prior to argument. Although this is done to avoid numerous repetitions, there will inevitably be some. If and when necessary, I will fill in what I consider to be important elements that may have been overlooked or, more simply, I will add details necessary for a better understanding of the facts.

(B) STC'S TRANSACTIONS (TRANSACTIONS 1, 2 AND 3)

32 The principal evidence regarding the purpose of STC's transactions, that is, the transactions involving the creation of 1004568 as a wholly owned subsidiary of STC, the formation of the STIL II partnership and the transfer of STC's portfolio mortgages to STIL II, was provided by means of the testimony given by Richard Bradeen in the OSFC (TCC) case, which was introduced in evidence through transcripts. Reference was also made to a number of exhibits adduced in evidence.

33 The Appellants' counsel emphasized in particular the following points.

34 Once appointed as liquidator of STC, E & Y's duty was to maximize the assets of STC for the benefit of its creditors. In an effort to speed up the liquidation process considering the difficulties the real estate markets were experiencing at that time, E & Y decided to package for sale one or more portfolios of mortgages with what they thought would be attractive characteristics. According to Mr. Bradeen, the creation of such portfolios was viewed at the time as a way to bring in partners with expertise in real estate in order to realize better net proceeds, as well as a way to create a marketing separation between STC and the assets to be sold. It was also viewed as a way to generate an additional payment through the tax benefit attached to the portfolios. The tax benefit from what ultimately became the Portfolio was considered to be 5/35 of the estimate of STC's proceeds on the Portfolio or $5 million on a Portfolio with a fair market value of $30 million to $35 million.

35 For the purposes of transactions involving the created portfolios, a non-arm's-length partnership was chosen as the appropriate vehicle. Liquidator's Report No. 13 (Exhibit 1, vol. I), which accompanied the motion for approval of STC's transactions presented to Houlden J., indicates the following to be the objectives of the transfer of the portfolio to a non-arm's-length partnership:

> PART III - STRATEGIC OBJECTIVES
>
> The following objectives of the Liquidator can be accomplished by the transfer of the Mortgages to the Partnership:
>
> (a) Enhanced Marketability
>
> The proposed transfer of Mortgages to the Partnerships has the potential to enhance the value and marketability of the Mortgages and the underlying real property, and may also enhance the marketability and value of Standard Trust's assets generally.
>
> To some extent, the enhanced marketability of the Mortgages may arise

simply from the separation of the Mortgages and underlying real property from the other assets of Standard Trust. The Liquidator intends to dispose of the assets of Standard Trust in an orderly manner and is prepared to wait out the market where appropriate. In spite of clearly stating this approach to potential purchasers of Standard Trust's assets, a perception persists in the marketplace that properties may be acquired on "fire sale" terms. Under the arrangements the Liquidator is proposing the Partnerships will become responsible for realizing on the Mortgages and the underlying real property, and this may emphasize to the market the nature of the realization process which is contemplated, and produce better recoveries.

(b) Additional Flexibility for Liquidator

The proposed transaction will also give the Liquidator greater flexibility in the realization process for Standard Trust's assets generally. In addition to being able to sell mortgage assets or parcels of real estate directly, the Liquidator would also have the option of selling some or all of Standard Trust's interest in the Partnerships. Accordingly, the range of realization methods at the Liquidator's disposal and the potential for maximizing the overall value of Standard Trust's assets would be increased under the proposed transaction.

If the Liquidator wishes to sell any of Standard Trust's interest in the Partnerships, such sale would be subject to this Court's approval. In addition, since the Liquidator's objective is to enhance the marketability of Standard Trust's assets and not to isolate them from the supervision of the Court, the Liquidator will cause the Partnerships to seek this Court's approval of any proposed transaction in respect of the Mortgages or the underlying real property in any circumstances where such approval would have been required had the Mortgages not been transferred to the Partnerships.

(c) Protection of Standard Trust's Estate

The Liquidator, through Standard Trust's ownership of the Subsidiary, will cause the Partnerships to continue the process of realizing maximum value from the Mortgages. To this end, the Partnerships may sell Mortgages or

> foreclose, commence power of sale proceedings, or obtain quit claims in respect of the underlying real property from mortgagors in such a manner as is deemed appropriate by the Subsidiary. All of the foregoing realization procedures are of course presently at the disposal of the Liquidator. No flexibility in the realization process will be sacrificed by the transfer of the Mortgages to the Partnerships.
>
> The recoveries from the Mortgages will continue to be available to Standard Trust and its creditors through distributions from the Partnerships and dividends from the Subsidiary, both of which will be controlled by Standard Trust. However, to ensure that any claims relating to the Mortgages are subject to the Court's supervision to the same extent as at present, the Liquidator requests that the order of this Court dated July 19, 1991 requiring leave of this Court in any proceedings against Standard Trust or the Liquidator be varied so that such leave would also be required on the same terms, so long as Standard Trust retains its ownership interest in the Partnerships, for any proceedings against the Partnerships.
>
> In the event that the Liquidator subsequently determines that the marketability of the Mortgages and the underlying real property is not enhanced by the separation of these assets from Standard Trust's other assets, the Liquidator could cause the Partnerships to be dissolved, and the Mortgages returned to Standard Trust without cost (apart from the costs of the transfer itself). Accordingly, apart from the transaction costs involved, Standard Trust would not put any funds at risk by engaging in the proposed transaction, and would have the option of undoing the transaction in its entirety if we subsequently determine that this is appropriate. The Liquidator does not anticipate that overall expenses will be higher by engaging in the proposed transaction.

36 To the above, Mr. Bradeen added in his testimony that the partnership vehicle was found to be a good way of bringing in partners with real estate expertise to help with the disposition of the assets and with the management process, as real estate people are familiar with the partnership vehicle. Using a partnership was also viewed as an advantage because there was no capital tax. According to Mr. Bradeen, a partnership also seemed fairly good from the perspective of providing very detailed supervision and keeping a "hand in" in terms of overseeing the eventual disposition of the assets. Flexibility in terms of selling the units of the Portfolio as opposed to the underlying assets was also mentioned. Finally, the partnership structure was useful for tax purposes, allowing the transfer of losses, which would bring some additional value to the estate.

37 Counsel finally emphasized that the Appellants were not involved in STC's transactions, which transactions did not originate with the Appellants, their advisors or anyone connected with the Appellants.

38 Counsel for the Respondent emphasized the following points.

39 E & Y had sold a number of STC's non-performing mortgages to various purchasers for cash, either at a substantial discount or as part of a package including performing mortgages. In Exhibit 106 (vol. VIII), there is a detailed list of nine transactions by which E & Y sold a total of 4195 STC mortgages between June 24, 1991 and June 24, 1994. These transactions were confirmed by Mr. Bradeen during cross-examination in the OSFC (TCC) case. However, with respect to what ultimately became the STIL I and STIL II Portfolios, a non-arm's-length partnership was resorted to instead of doing a simple cash sale at a discount. Part of the reason why E & Y opted for this vehicle was that it would result in an increased purchase price for the portfolio by virtue of the tax benefit accruing to the purchasers. As stated by Mr. Bradeen, "we thought that we would receive a better, a better price, an enhanced deal by packaging the assets in this manner." Further, Mr. Bradeen admitted that the chances were slim that they would have gotten the price they got from OSFC had there been no tax benefit in the package. The importance of this tax objective is illustrated by Exhibit 77 (vol. VI), which is a copy of Draft 3 of the Real Estate Portfolio Transaction Term Sheet (E & Y) dated July 24, 1992, a document setting out the steps that were to be followed in transferring STC's losses on the mortgages to outside investors by utilizing subsection 18(13) of the Act. The transfer of the losses to a non-arm's-length partnership was admitted to be essential to the completion of the scheme laid out in that document. Interestingly enough, the selection of mortgages for the portfolio that was to be transferred to the contemplated STIL II was based in part on "sizable losses," as indicated in Exhibit 91 (vol. VI), which is a copy of a memo to file from Mr. Bradeen, Allan Mark and Glen Shear of E & Y regarding updated appraisals for STIL I dated December 3, 1992. Part of this document provides as follows:

> ... The selection of the mortgages transferred into STIL I on October 23, 1992 was based on a number of factors considered favorable to the marketing of the 99% partnership interest in STIL I. These factors included low environmental risks associated with the properties, sizable losses, and current positive net operating income or potential asset appreciation.

40 While this paragraph applied specifically to STIL I, Mr. Bradeen admitted that similar considerations applied to STIL II. As a matter of fact, the very same statement specifically relating to STIL II appears in Exhibit 108 (vol. VIII), which is an undated copy of a document entitled Review of Proposed Transaction.

41 With respect to Houlden J.'s knowledge of the purpose of the creation of STIL II, counsel for the Respondent emphasized that while Houlden J. had been given Liquidator's Report No. 13 (Exhibit 1, vol. I), he had not been given Exhibit 110 (vol. VIII), which is an undated copy of the

draft liquidator's report. Contrary to Liquidator's Report No. 13, the draft report clearly indicated the tax losses were an object of the transactions. This document reads in part as follows:

> The Mortgages have an aggregate cost base for tax purposes of approximately $195 million. The partnership purchasing the Mortgages under the Proposal will acquire this tax base and will be able to realize tax losses in connection with its ownership and sale of the Mortgages and the Real Estate.

42 Counsel for the Respondent acknowledged that Liquidator's Report No. 22 (Exhibit 9, vol. I), which was also given to Houlden J. for the purpose of obtaining approval of the sale of STC's 99% interest in STIL II to OSFC, includes, at page 7, a mention of the tax aspect of the transactions in the form of the following statement with respect to the purchase price:

> an additional payment calculated on the basis of partnership losses allocated to OSFC as set out in section 2.07 of the Purchase Agreement up to a maximum of $5,000,000.

43 However, counsel for the Respondent emphasized that, apart from this reference, there is no real indication that Houlden J. was informed about the tax component of the STC transactions. In particular, Mr. Bradeen did not know for certain whether the tax aspects of the transactions were explained to the Court and he did not know whether the possibility that the transactions might be attacked by Revenue Canada as avoidance transactions was discussed with the Court. I might add here that Mr. Bradeen admitted that he was not present before Houlden J. but said he believed, from his discussions with counsel and Mr. Drake, his superior, that the mechanics of the transactions were explained to him.

44 It is worth mentioning that while the Appellants' counsel put great emphasis on Liquidator's Report No. 22 and the reference therein to an additional payment for tax losses, this document, dated June 22, 1993, was not presented to Houlden J. at the time the STC transactions occurred, that is, in October 1992. It is only when E & Y sought the Court's approval with respect to the transfer of STC's interest in STIL II to OSFC (in June 1993) that the document was submitted to him. Apart from the mention of the additional payment in the report, there is no indication that Houlden J. was informed at that time of the tax component of the STC transactions.

(C) OSFC'S TRANSACTION (TRANSACTION 4)

45 With respect to OSFC's purchase of STC's 99% interest in STIL II, counsel referred mainly to the testimony of Messrs. Kaulius and Robertson, as well as to the transcript of the testimony of Mr. Bradeen in the OSFC (TCC) case. Several exhibits adduced in evidence were also referred to.

46 Counsel for the Appellants emphasized in particular the following points.

47 As stated in paragraph 7 of the Statement of Admitted Facts, between August of 1992 and

January of 1993, E & Y contacted prospective purchasers of STC's 99% interest in STIL II, including OSFC. As stated in paragraph 8 of the Statement of Admitted Facts, negotiations between E & Y and OSFC started in January of 1993. On March 5, 1993, OSFC wrote a first letter of intent (Exhibit 14, vol. I) in order to have the properties "tied up" before they invested further in the project. The negotiations continued until the conclusion of the final purchase agreement dated May 31, 1993 (Exhibit 15, vol. II). I would add here that in fact the closing finally took place on June 29, 1993.

48 The negotiations between E & Y and OSFC began in January 1993 and lasted until the end of June 1993; they were described by both parties as having been very difficult. Mr. Bradeen said they were "a very difficult set of negotiations", "very difficult and acrimonious" and "somewhat hostile." Mr. Kaulius called them "very challenging." Indeed, the deal almost fell apart at the end of May, as OSFC did not agree with the deal as a whole. In counsel's view, the whole negotiation process shows that it was "very much a negotiated business deal," as opposed to "a normal tax avoidance transaction, where everything is pre-structured in advance and these transactions proceed like clockwork."

49 From E & Y's point of view as indicated in the above-mentioned Liquidator's Reports Nos. 13 and 22, OSFC's expertise in real estate made it an attractive purchaser of the STIL II interest. From OSFC's point of view, the focus was to limit its "downside risk" by ensuring that the fixed payment obligation toward STC would be minimized and that OSFC's managerial control over the management and exploitation of the Portfolio would be maximized, as would the potential upside return available to OSFC once the "net sales proceeds" realized from the Portfolio exceeded certain thresholds.

50 Great emphasis was placed on the evidence of the steps taken by OSFC to ensure the attainment of these objectives. These steps included the extensive due diligence with respect to the properties underlying the Portfolio that was done by OSFC through Messrs. Robertson and Kaulius, which resulted in the preparation of similarly extensive due diligence binders (Exhibits 63, 64, 65 and 66, vols. IV, V and VI). The evidence reveals that, as stated by the Appellants' counsel:

> ... The due diligence process was more than a full-time job during the period in which OSFC was negotiating with E&Y and required OSFC to incur substantial out-of-pocket costs. The due diligence included:
>
> (a) examination of the pertinent mortgage terms and conditions;
> (b) review of previous lender conduct;
> (c) ascertainment of the strength of the security/charges in place;
> (d) reviewing the tenant role and analyzing the terms of the prevailing leases;
> (e) verifying receipt of the rent roll as represented by STC;
> (f) site visits;

(g) examining local market conditions;
(h) undertaking structural analysis of the buildings;
(i) procuring environmental risk assessments for the properties.

51 As a result of a number of deficiencies identified during the above-mentioned due diligence process, OSFC negotiated several significant concessions from E & Y. These concessions included the reduction of the fixed consideration payable from the $20 million first proposed in the letter of intent dated March 5, 1993 to $17.5 million, the contribution by STC to STIL II of $834,000 to compensate for outstanding construction and repair commitments and of $473,000 to cover adjustments for property taxes and tenant deposits relating to the Portfolio, as well as an extension beyond five years of the contemplated sale horizon for the Portfolio.

52 Mr. Kaulius was positive that the Portfolio was presented to OSFC as an indivisible package, which E & Y would not break up. It was a take-it-as-is-or-leave-it proposition. According to Mr. Bradeen, on the other hand, E & Y was willing to sell the STIL II Portfolio to a third-party purchaser without any of the tax attributes attached to it. However, it was, in Mr. Kaulius, and Mr. Robertson's view, unlikely that they could have obtained at that time the price they assessed as being the fair market value of the properties. It was as a result of the foregoing that the purchase price was negotiated, which was to be payable on the basis of a formula of sharing the proceeds from the sale of the properties underlying the Portfolio over a period of several years. Since interest was payable on the promissory note that was a component of the purchase price, OSFC negotiated a full right of prepayment in respect thereof. It was OSFC's intention to satisfy its obligations under the promissory note as soon as possible in order to minimize its financial exposure and to immediately improve cash flow by eliminating the significant interest amount otherwise payable on that note.

53 Counsel for the Appellants also reiterated that Liquidator's Report No. 22 (Exhibit 9, vol. I), which was presented to Houlden J. for the purposes of the approval of the transfer of STC's 99% interest in STIL II to OSFC, indicated that the additional payment for the tax losses was a component of the purchase price. Counsel reminded the Court that Mr. Bradeen had stated that he believed the mechanics of the transactions were explained to Houlden J. when E & Y sought authorization for the transfer. Counsel for the Appellants submitted that Houlden J.'s approval of the transactions certainly goes to show the bona fides of those transactions.

54 As a result of this transfer, and as stated in paragraph 13 of the Statement of Admitted Facts, STC and 1004568 entered into an Amended and Restated Partnership Agreement on June 22, 1993 (Exhibit 19, vol. III). Pursuant to this Agreement STIL II's business was to be carried on in accordance with a business plan approved by the partners (Exhibit 18, vol. II). However, it was stressed that neither OSFC nor, later, the Appellants placed any great reliance on that business plan as a realistic projection of the net proceeds to be realized, as OSFC's plan was very different from that negotiated with E & Y. In fact, Mr. Kaulius explained that the business plan was prepared in the course of negotiations between OSFC and E & Y and that OSFC's focus in the negotiations was

on securing control over managerial decisions with respect to the Portfolio. The low scenario, as it was called, was intended to allow OSFC flexibility should it, for some specific reason, want to sell any one asset at any given time. As Mr. Robertson explained, OSFC focused on being able to sell the Lesmill property as soon as possible by auction. Such flexibility was also said to be ensured by the "put option" that enabled OSFC on the one hand to compel STC either to acquiesce in a proposed sale of a particular property to a third-party or to purchase the property from STIL II on identical terms, and on the other hand, to retain any property within the Portfolio by matching whatever third-party offer STC wished to accept. The numbers arrived at in the business plan were also explained by the fact that at the time of the negotiations, OSFC was still attempting to obtain a better aggregate purchase price from STC and thus advocated the lowest possible values for the properties underlying the Portfolio for the purpose of establishing the earn-out. E & Y conversely advocated the highest possible values.

55 Counsel for the Respondent emphasized the following points.

56 When first approached by Jonathan Baker of E & Y in January of 1993, Mr. Kaulius was given the available overview information regarding the Portfolio. Mr. Kaulius stated that this information package included a description of the properties and indicated the kind of properties they were, the cash flows E & Y thought they generated and what their upsides were. The existence of a partnership and how the tax losses would be transferred to OSFC were also indicated. Mr. Kaulius' impression from the outset was that the properties were low quality. In his own words, "these were not A properties, they weren't even B properties." From his discussions with Mr. Baker, Mr. Kaulius felt that "they were not very good properties." Mr. Kaulius moreover described some of them as "dogs" and pressed E & Y to remove them from the Portfolio, which E & Y did not agree to do, as the transaction, as mentioned before, was presented at the outset and throughout as a take-it-or-leave-it proposition. It is because OSFC did not agree with E & Y's appraised value of about $33,000,000 that Mr. Kaulius came up with the earn-out formula as a way to "bridge the difference" between that appraised value and the fixed amount of $20 million agreed to in the March 5, 1993 letter of intent (Exhibit 14, vol. 1). However, that fixed amount was subsequently reduced to $17.5 million as a result of the due diligence process because the properties turned out to be of even lower quality than had been originally thought. Counsel further emphasized that OSFC's first concern in this transaction was to protect itself, that is, to try to get a low enough price to be able to get its money back. As was said by Mr. Kaulius in particular, "the upside would look after itself."

57 Mr. Kaulius also admitted that OSFC did not try to negotiate away the tax losses, which were an attractive part of the deal. The payment for the losses was based on 10[cents] on the dollar, which OSFC accepted from the outset. I might add here that from Mr. Kaulius' testimony it is clear that payment for the losses would only have been made if those losses were ultimately available, otherwise nothing would have been paid.

58 It was also stressed by counsel for the Respondent that Liquidator's Report No. 22 (Exhibit 9,

vol. 1) referred to above does not identify the transfer of the losses as an objective pursued by E & Y. In fact, E & Y's objectives in that regard are stated in the Liquidator's Report in terms of the benefits to STC. That document reads in part as follows (at pages 12-14):

1. BENEFITS TO STC

(a) Financial Benefits

On the basis of the same pattern of asset dispositions, the sale of STC's partnership interest will result in a higher yield to the estate compared to the results that will be obtained (i) if STC retained its partnership interest (referred to in the table below as "Status Quo"), or (ii) the results that would have been obtained if STC had sold the Mortgages directly instead of transferring them to STIL II.

The proposed transaction: (i) will result in STC receiving cash proceeds sooner by way of cash payable on closing; and (ii) may result in STC receiving cash proceeds sooner by way of amounts payable under the Note and any additional payment, than would otherwise be the case on the basis of the same assumed pattern of asset dispositions.

Using the market assumptions set out in the most recent STC business plan and assuming the most probable course of management action by STIL II, the proposed transaction will generate the following net cash flows to STC: [Footnote omitted.]

	Status Quo	Proposed Transaction	Incremental Benefit ($ million)
Total amount received	$31.7	$35.3	$3.6
Net Present Value @ 12%	$27.7	$30.7	$3.0

Note: These financial projections are included for purposes of illustration only. Actual results may vary materially. [Footnote omitted.]

The total estimated net cash flow to STC from the OSFC transaction is $35.3 million. This amount includes the deposit ($500,000), cash on closing ($2,500,000), the Note ($14,500,000), the additional payment (a maximum of $5,000,000), the earn-out ($13,300,000) and interest and management fees payable to the Subsidiary (totalling $1,400,000), less capital expenditure funding and enforcement costs ($1,400,000). Incremental benefits to STC from the proposed transaction could arise by virtue of the additional payment over the next five years and the early repayment of the Note out of net sales proceeds from the sales of the Mortgages and underlying properties.

(b) Real Estate Expertise

As discussed in Part V, OSFC will provide day-to-day management services to STIL II. The partnership will therefore benefit from OSFC's and Mr. Thomas' real estate and management expertise.

(c) Limitation of Market Risk

The minimum payment STC will receive from OSFC is $17,500,000. This establishes a market floor with respect to the Mortgages and protects STC in the event of further significant declines of the real estate markets in the provinces where the properties subject to the Mortgages are located.

(d) Earn-Out

The earn-out will allow STC to participate indirectly to a significant degree in any future profits realized by OSFC if the Mortgages or underlying properties are ultimately sold in a more favourable market.

(D) SRMP'S TRANSACTIONS (TRANSACTIONS 5 AND 6)

59 With respect to OSFC's syndication of its 99% interest in STIL II by the creation of SRMP and the sale of Class A Units, counsel referred most particularly to the testimony of Messrs. Kaulius, Gregory, Cook, De Cotiis, Verlaan and Mayer. Counsel also referred to numerous exhibits.

60 The Appellants' counsel emphasized the following points.

61 According to Messrs. Kaulius and Robertson, OSFC solicited potential third-party investors, including the Appellants, to participate in the venture in order to reduce the risk involved and to fund the acquisition of its 99% interest in STIL II. Mr. Kaulius said that OSFC intended almost from the start to syndicate its interest, because it was a very large transaction. As stated in paragraph 18 of the Statement of Admitted Facts, OSFC and TFTI thus entered into an agreement (Exhibit 35, vol. III) dated July 5, 1993 (the "SRMP Partnership Agreement") to form a general partnership to carry on business under the name SRMP and to acquire and manage OSFC's partnership interest in the STIL II partnership. As stated in paragraph 19 of the Statement of Admitted Facts, the capital of SRMP was divided into 35 Class A units and 15 Class B units, with 14.50 of the latter being allocated to Mr. Thomas's private companies (OSFC, TFTI and NSFC), and the remaining .50 unit being allocated to Mr. Kaulius.

62 I would add here that, as stated in paragraph 27 of the Statement of Admitted Facts, OSFC signed a deed of assignment dated July 7,1993 assigning its partnership interest in the STIL II Partnership to SRMP except for OSFC's right to perform certain services for the STIL II Partnership and to receive a fee therefor (Exhibit 36, vol. III). As stated in paragraph 26 of the Statement of Admitted Facts, on July 7, 1993, OSFC sold its STIL II interest to SRMP for a stipulated composite purchase price that included in particular $3,850,000 in cash (Exhibit 40, vol. III). As stated in paragraph 28 of the Statement of Admitted Facts, the above was confirmed in an agreement between OSFC, SRMP and 1004568 dated July 7, 1993 (Exhibit 37, vol. III).

63 As stated in paragraph 29 of the Statement of Admitted Facts, on or about July 9, 1993, the Class A unitholders described in Appendix "A" thereto subscribed for the stated number of Class A units, or fractions thereof, of SRMP for a composite price of $110,000 per Class A unit (aggregating $3,850,000 for all 35 Class A unitholders). The Class A unitholders also undertook the additional obligations described in paragraph 29 of the Statement of Admitted Facts, namely, funding of their proportionate share of the "Additional Payment". To that end, each Class A unitholder had to provide the documents mentioned in paragraph 30 of the Statement of Admitted Facts.

64 As a result of both STIL II and SRMP being general partnerships, each SRMP partner assumed and agreed to perform OSFC's obligations under the STIL II Purchase Agreement and the Amended and Restated STIL II Partnership Agreement as provided in paragraph 33 of the Statement of Admitted Facts. Each SRMP partner, whether a Class A or a Class B unitholder, was

thus jointly and severally liable with respect to any liabilities of SRMP and STIL II, including the $14,500,000 promissory note and any other debt incurred. They all shared the risks associated with a general partnership.

65 Counsel for the Appellants reviewed the allocation of the net operating cash flow from STIL II by reference to a graphic depiction of the allocation (Schedule A to the Appellants' Written Argument). This allocation is also detailed in paragraph 31 of the Statement of Admitted Facts. In summary, the net operating cash flow of STIL II was allocated as follows:

1. $250,000 was to be paid to OSFC as an annual management fee;
2. $200,000 was to be paid to 1004568 as an annual administration fee;
3. of the remainder, 1% was allocated to 1004568 and 99% to SRMP.

Of the 99% allocated to SRMP, the following further allocations were made:

1. payment of the interest on the promissory note was to be made;
2. $12,000 was to be paid to OSFC as an administration fee;
3. 75% of the remaining net annual cash flow was to be paid to OSFC as an incentive fee;
4. of the remaining 25%, 70% was to be paid to the Class A units and 30% to the Class B units.

66 Counsel for the Appellants also reviewed the allocation of the proceeds by reference to a graphic depiction of the allocation (Schedule B to the Appellants' Written Argument). This allocation is also detailed in paragraph 32 of the Statement of Admitted Facts. In summary, the Portfolio proceeds were allocated as follows:

1. 1% was to be paid to 1004568;
2. 99% was to be paid to SRMP.

Of the 99% allocated to SRMP, the following further allocations were made:

1. Of the first $14,355,000 (being 99% of $14,500,000), 82.684% was to be paid to STC on the promissory note and 17.316% was to be held in escrow to secure future payments due under the promissory note. Pursuant to the SRMP Partnership Agreement the entire $14,355,000 was to be paid to STC in respect of the promissory note.
2. Of the next $3,000,000 allocated to SRMP (between $14,355,000 and $17,355,000), 100% was to be paid to the Class A units. However, pursuant to the SRMP Partnership Agreement these funds were to be directed into escrow and applied to satisfy the Class A Unitholders' obligation to provide security deposits in respect of their contingent obligation to fund the additional payment.

3. Of the next $9,444,443 (between $17,355,001 and $26,799,444), 91% was to be paid to STC in respect of its earn-out and 9% to SRMP. However, the entire amount allocated to SRMP - a maximum of $850,000 - was allocated to the Class A Units, the holders of which pursuant to the SRMP Partnership Agreement, directed these funds into escrow to satisfy the obligation to provide security deposits in respect of their contingent obligation to fund the additional payment.
4. Of the next $5,307,394 (between $26,799,445 and $32,106,839), 91% was to be paid to STC in respect of its earn-out and 9% to SRMP. The 9% allocated to SRMP was further allocated 70% to the Class A units and 30% to the Class B units.
5. Of the next $5,513,160 (between $32,106,840 and $37,620,000), 50% was allocated to STC in respect of its earn-out and 50% to SRMP. The 50% allocated to SRMP was further allocated 70% to the Class A units and 30% to the Class B units.
6. Any Portfolio proceeds above $37,620,000 were allocated 25% to STC in respect of its earn-out and 75% to SRMP. The 75% allocated to SRMP was further allocated 70% to the Class A units and 30% to the Class B units.[2]

67 Messrs. Gregory, De Cotiis, Verlaan and Mayer were positive that at no time were any of the Appellants given an opportunity to purchase the Portfolio, the underlying properties (or any portion thereof) or any of the tax attributes associated with the Portfolio in any manner other than as an acquisition of an interest in SRMP. Counsel for the Appellants noted that Mr. De Cotiis and Mr. Verlaan attempted to buy up the Georgian Estates and Masonville Estates properties and that Mr. De Cotiis even made a bid on the Lesmill property when it was auctioned but he was unsuccessful.

68 The varying degrees of individual due diligence done by the Appellants were explained. While some of the Appellants inspected one or more of the properties underlying the Portfolio, all relied to some extent on the extensive due diligence done by Messrs. Robertson and Kaulius for OSFC. The Appellants were afforded access to the due diligence binders completed by OSFC. Some among them, in particular Mr. Gregory and Mr. Cook, testified that they reviewed with Messrs. Kaulius and/or Robertson the contents of the Summary of STIL II Assets (Exhibit A-16). In fact, as regards the Thorsteinssons partners, Messrs. Gregory and Cook were in constant contact with Mr. Robertson during the due diligence process. The other Thorsteinssons partners relied on Messrs. Gregory and Cook to consider and evaluate the information presented by OSFC.

69 Based on their own due diligence and on their reliance on Mr. Kaulius' and Mr. Robertson's due diligence, the Appellants believed that the aggregate net proceeds of $37,800,000 from the disposition of the properties comprising the Portfolio arrived at in the Summary of STIL II Assets (Exhibit A-16) was a reasonably attainable target. Counsel for the Appellants emphasized, based on the examination for discovery of Mr. David Turner, that the Revenue Canada auditor, Mr. Thomas Heinz Buschhausen, had indicated that there was nothing unreasonable in thinking that the potential

realization value of these properties would be in excess of $35 million or even $37 million. Mr. Turner did not disagree with the statement. Based on this assumption and on the allocation of cash flows and proceeds set out above, Mr. Gregory, when acquiring his interest in SRMP, forecast a return of between 50% and 100% on invested capital. His reconstructed calculations are summarized in Exhibit A-18 and show a projected return over three years of $67,572/$110,000 or about 61%. In fact, Mr. Gregory admitted that the return should have been computed over a period of 31/2 years, which would have given an annual rate of return of 17.5%.

70 For his part, without making a precise calculation, Mr. Cook expected "better than a market rate of return" from his investment. Mr. Kaulius expected "better than 15%." Mr. Kaulius added that this rate was the threshold return, inclusive of fees, expected by OSFC, in order for it to be interested in the transaction. Other partners, in particular Messrs. De Cotiis, Verlaan and Mayer, believed that the aggregate net proceeds would exceed $40 million or even $50 million. Both Messrs. De Cotiis and Verlaan said they expected to double the money they invested. During cross-examination, Mr. Robertson moreover stated that the return anticipated by OSFC exceeded the return forecast by Mr. Gregory and other Appellants. He was referred to calculations he made in 1998 based on actual cash flow as of December 31, 1997 as well as net actual proceeds received plus an estimate of the value of the properties still in inventory. Given that an amount representing the estimated value of the remaining properties is added to the net actual proceeds, the calculations detailed in Exhibits 69 and 70 (vol. VI) result in total net cash flow and proceeds of $6,317,192 for the SRMP partners, which translates into a 32.82% annual cash-on-cash return on the Class A unitholders' cash investment of $3,850,000.

71 The Appellants were confident they would achieve their expectations, given the very conservative valuations of the Georgian Estates and Masonville Estates. These properties alone would produce sufficient proceeds to extinguish the promissory note. In support of this view, the Appellants noted that the valuations of these properties were well below construction costs for comparable properties, ignoring the cost of land, and represented only a fraction of the amount originally lent by STC.

72 A number of the Appellants also believed that the properties within the Portfolio would increase in value as the real estate market experienced its usual cycle. Moreover, the Appellants drew comfort from the idea that a quick disposition of the Lesmill property would stop a negative cash flow of some $500,000 and thus increase the net cash flow from the Portfolio as a whole to an amount that would be more than sufficient to cover the interest payable to STC on the promissory note. The sale proceeds could also be used to reduce the outstanding amount of the promissory note. Accordingly, it was thought that upon the expected sale of the Lesmill property, SRMP would have an expanded time frame, if necessary, in which to maximize the net proceeds from the Portfolio.

73 Great emphasis was also placed on the fact that unlike the extensive work done on the real estate aspects of the transactions, the negotiations and the due diligence on the issue of the preservation, for tax purposes, of STC's historical cost of the Portfolio were superficial. In this

regard, E & Y simply provided OSFC with copies of the orders of Mr. Justice Houlden and supporting documentation relating to the formation of STIL II as well as a representation/warranty as to the amounts owing with respect to the Portfolio. In addition, it was emphasized that the additional payment in respect of the tax attributes of the Portfolio was contingent, that is, payable only if the resulting losses were available to the SRMP partners. Moreover, it was stressed that the Appellants could have no entitlement to have allocated to them any losses by STIL II/SRMP without first becoming Class A or B unitholders in SRMP and assuming all of the risks and benefits associated with being a member of that general partnership.

74 Besides, while the Appellants all stated that the tax benefit was important, great emphasis was placed on the fact that the benefit obtained was merely a deferral. In fact, the adjusted cost base of the Appellants' partnership interests had to be reduced by the amount of the losses allocated, and was therefore driven down to a negative value. Eventually a capital gain would result from the disposition of each Appellant's partnership interest on termination of the partnership or otherwise. For that reason, it was stated that the exact value of the tax benefit was difficult to ascertain. Some Appellants insisted that the product obtained by multiplying the applicable tax rate by the amount of SRMP losses deducted does not represent the value of the tax benefit since it ignores the recapture of the tax benefit through the realization of the resultant negative adjusted cost base in the form of a capital gain as well as the outlay of $125,700 for the additional payment.

75 A calculation prepared by Mr. Cook entitled Value of Tax Deferred per Class A unit was adduced as evidence (Exhibit A-21). This calculation is based on several assumptions, being in part the following: it was assumed that SRMP losses allocated in 1993 to the Class A SRMP partners were fully utilized against income otherwise subject to tax in the 1993 taxation year, and that each unitholder had paid the full amount of the additional payment of $125,700 per unit. It was further assumed that a termination event would occur in year 6, resulting in a recapture in that year due to the negative adjusted cost base. The calculation is based lastly on a tax rate of 45%, an applicable capital gains inclusion rate of 75% for the 1993 taxation year, and an applicable discount rate of 6% per annum, which was the prescribed rate of interest payable on tax arrears as at April 1994. Based on these assumptions, Mr. Cook arrived at an initial tax saving in the amount of $471,460 per Class A unit, reduced by the additional payment of $125,700 and by the recapture amount of $219,364, resulting in a deferral of $126,396.

76 Based on an exchange of correspondence between counsel, the Appellants' counsel further stressed that each Appellant stated his primary purpose in becoming a member of the SRMP Partnership to be, in common with the other partners therein, to acquire and manage the 99% partnership interest previously held by OSFC in the STIL II Partnership and to realize a profit from the administration and sale of the mortgages or the underlying properties held by the STIL II Partnership, and that each also said he had a further purpose, which was to obtain a tax benefit from his proportionate share of the SRMP Partnership losses.

77 Counsel for the Appellants further emphasized that OSFC was the managing partner of

SRMP, in addition to the role it played as manager of STIL II, and as such, carried out direct, active and substantial management of the properties underlying the Portfolio and otherwise managed both STIL II and SRMP under the terms of the relevant agreements. The Appellants were confident that OSFC had the necessary expertise and acumen to manage the Portfolio. OSFC's management of the Portfolio and underlying properties included rental property renovation, tenant substitution and redevelopment of certain properties for resale. Counsel emphasized, based mainly on the testimony of Mr. Robertson but also to some extent on the testimony of Messrs. Gregory, Cook and Mayer, that as a result of OSFC's efforts, the following results were obtained in respect of the properties within the Portfolio.

78 The 99 Rideau property was the subject of a number of redevelopment proposals and offers for sale. It is still held for the benefit of those Appellants who were partners in the Crerar Properties Limited Partnership ("Crerar"), a sister partnership that was formed in 2000 by the partners in SRMP (with the exception of OSFC, related companies and the now deceased SRMP partners). The purpose of the formation of Crerar was to enhance the partners' return on the remaining Portfolio properties by purchasing STC's remaining entitlements under the earn-out for a stipulated amount as well as its contingent entitlement to receive the additional payment, and by securing termination of the OSFC management contract.

79 The net annual cash flow from the operations of the Shurguard Oakville property was increased from $150,000 in 1993 to over $650,000 in 2000. It is still owned by the Appellants who are partners in Crerar.

80 The Shurguard Hamilton Property was sold in 1995 for an amount in excess of the targeted net sale proceeds.

81 The Georgian Estates Property was substantially improved through a renovation/redevelopment project in order to ensure that a "quality product" was marketed to third-party purchasers. The various components of this property were either retained in STIL II or sold by either STIL II or Crerar in 2001. The net proceeds realized from the sale of these assets were in excess of $12.2 million.

82 As indicated in Exhibit A-16, (reproduced at paragraph 22 of these Reasons), while there was an offer on hand in May of 1993 for the Turner Crossing property, it did not lead to a transaction. The property was subsequently sold in 1994 for net proceeds in excess of $1,061,000.

83 The Atherton Place property was sold prior to the closing of the purchase by OSFC of STC's 99% interest in STIL II.

84 The Lesmill property represented a particular challenge to the STIL II and SRMP partners in light of the significant negative cash flow associated with its ownership in 1993. A strategy was developed by OSFC to sell this property by auction as soon as possible for net proceeds slightly over $2 million. As a result of this sale, the net operating cash flow from the partnership increased

by $600,000 per year. I would add here that Mr. Gregory explained that this figure is arrived at by adding both the $438,000 gained by the elimination of the negative cash flow from the property and the $150,000 reduction in costs for servicing the debt of $14.5 million, such debt being reduced by the $2 million proceed from the sale.

85 The Masonville Estates property was located in London, Ontario, which was harder hit than other areas by the real estate downturn. While it was originally anticipated that individual units would be sold on the retail market, that changed due to the economic conditions. Instead, this project was sold en bloc for $14,900,000 in 1995 as a result of an unsolicited offer from a third-party developer. I would add here that, according to Mr. Robertson, the total amount received in cash, was received with interest, over a period of one year ending in May 1995. While the sale proceeds received from this project were significantly less than had been targeted, they did allow SRMP to eliminate the amount it owed STC under the promissory note. The sale of the property at that time also saved SRMP from absorbing the negative cash flow associated with the relocation of students during the summer months and also from incurring any "marketing" costs associated with a syndication of the property. However, not all of the SRMP partners were happy with the sale of the property en bloc or with the amount of net proceeds received.

86 The Mount Baker property was sold in 1993.

87 As a result of the efforts of OSFC, the net proceeds realized by STIL II from the disposition of the Portfolio prior to November 2000 were $30 million and the properties on hand at that time had an estimated fair market value of $8 million.

88 Counsel for the Respondent emphasized several elements that indicate the SRMP transactions were not undertaken primarily with profit in mind, either from OSFC's or from the SRMP Class A partners' point of view. In this respect, counsel also noted contradictions in the testimony of the various witnesses and the fact that the Appellants' purported expectations of profit were not supported by the written evidence.

89 With respect to the contradictions in the testimony, counsel for the Respondent noted that Mr. Kaulius had testified that the syndication by OSFC of its interest in STIL II was contemplated because the Portfolio was too large for OSFC alone, while Mr. Robertson stated that OSFC could have handled the transaction by itself, without the assistance of anyone, but syndication was Mr. Thomas's usual way of doing business. Further, while Mr. Kaulius testified at trial that OSFC could have used all the tax losses itself over several years, at his examination for discovery, he had stated that one of the reasons for the syndication of OSFC's interest in STIL II was that OSFC could not have used the entire $50 million in losses. Finally, according to Mr. Robertson's testimony, OSFC could not have used the entire $50-odd million in tax losses at any point.

90 As indicated in paragraphs 18 and 19 of the Statement of Admitted Facts, the syndication was done through the creation of the SRMP partnership between OSFC and TFTI. That partnership's capital was divided into 35 Class A units and 15 Class B units. Pursuant to article 3.06 of the SRMP

Partnership Agreement (Exhibit 35, vol. III), each Class A unit was entitled to one vote and each Class B unit was entitled to three votes. Moreover, in article 3.06, the Thorsteinssons partners agreed to vote as a block. Article 8.04 of the same agreement provides that, as a result of the syndication, 30% of all SRMP's income and losses were to be allocated to the Class B units and 70% to the Class A units of SRMP.

91 Pursuant to Liquidator's Report No. 22 (Exhibit 9, vol. I), under heading 3, "Operation of the Partnership," in Part V, OSFC was required to "act in accordance with a business plan approved by the partners and ... be under the general direction the partnership's management committee." In his testimony, Mr. Robertson stated that OSFC took this document seriously. The business plan referred to (Exhibit 18, vol. II) set out a realization plan for the properties in the Portfolio, along with a range of projected gross and net sales proceeds. However, none of the Appellants who were Class A partners in SRMP made or attempted to make calculations of their expected returns from SRMP on the basis of those actual projections. They knew that they could expect only minimal returns from STIL II's net operating cash flow, and that significant profits from the real estate could only come from its upside, that is, from net sales proceeds exceeding about $33 million. At the time they purchased their Class A units, the extent of that upside was not known to them: they hoped that the real estate market would turn upward from its depressed state, but it could not be predicted when this might occur. Nevertheless, calculations made by Mr. Gregory (Exhibit A-18) were based on the figures in the Summary of STIL II Assets (Exhibit A-16), which are different from those in the business plan. Furthermore, while Mr. Cook stated that OSFC's actions had to come within the business plan, Mr. Kaulius said that Exhibit A-16 was never given to STC as it was an internal document.

92 While the Appellants' evidence with regard to their expectation of profit is largely based on Exhibit A-16, counsel for the Respondent submitted that the evidence concerning this document is confusing and contradictory.

93 First of all, Exhibit A-16 bears no date. Mr. Cook testified that it was sent to the Class A unitholders by Mr. Robertson with his memorandum dated September 9, 1993 (Exhibit 49, vol. IV), that is, well after the SRMP purchase transaction closed in June of 1993. However, in re-examination by the Appellants' counsel, Mr. Robertson stated that Exhibit A-16 was in fact the duplicate of a document that was originally prepared in the course of the due diligence process. I would add here that Mr. Robertson said the document was initially created probably in March or April 1993 and that its content had been discussed with the SRMP partners. Mr. Robertson nonetheless thought that he had sent the actual Exhibit A-16 document with the aforementioned memorandum on September 9, 1993 and that this memorandum would have been one of the first sent to the investors. According to him, he did not send any memorandums to anyone before the closing. Further, while Mr. Cook said that he had seen a similar document previously, in May or June 1993, neither he nor any of the other Appellants could produce a copy of any such document.

94 The target realization total figure in Exhibit A-16 is stated and was considered by many

witnesses to be the net proceeds of sale. Based on selling costs of $2,209,000 in the "high scenario" in the business plan (Exhibit 18), counsel for the Respondent emphasized that the gross proceeds would have had to be in excess of $40 million if net proceeds of that order were to be realized and that no projections were made that contemplated a sale of the properties at $40,000,000. However, I must add that during cross-examination, Mr. Cook stated that the focus was on the net projections, which would take into account the selling costs. Also, Mr. Verlaan stated that no one at OSFC ever provided him with anything in writing that showed net proceeds over $37,000,000. In the view of counsel for the Appellants, the reference to $37,000,000 during Mr. Verlaan's cross-examination should be construed as a reference to the $37,800,000 indicated in Exhibit A-16 and not as an acknowledgment that he had never received Exhibit A-16. For the Respondent's counsel, it is not clear whether Mr. Verlaan's statement should be construed as indicating that he never saw Exhibit A-16 or rather as showing that he acknowledged that the $37.8 million target in Exhibit A-16 was not supported by other documentation provided by OSFC. As for Mr. De Cotiis, while he said that he had seen a spreadsheet similar to Exhibit A-16 in early 1993 "with all the properties and different things," he could not say whether it was the same as Exhibit A-16.

95 Counsel for the Respondent also emphasized the fact that while Exhibit A-16 is based on a unit-by-unit sale of the Masonville condos, Mr. Robertson stated there had been a debate in early 1993 whether to sell Masonville en bloc or unit-by-unit. Since the STIL II management committee first met on September 30, 1993, no decision on the matter of whether to sell Masonville en bloc or unit-by-unit was made until that date because the management committee had to agree on that point. I would add here that Mr. Robertson stated that given the premium in the order of $10 000 a unit for a condo, it was the unit-by-unit mode of sale that was presented to the investors in SRMP. Mr. Robertson further acknowledged that it would have taken up to three or four years to sell all of the Masonville property unit-by-unit as condos so as to maximize its value.

96 Moreover, counsel for the Respondent emphasized that the evidence was also contradictory as to whether the amounts shown in Exhibit A-16 were actually net amounts. In his testimony, Mr. Kaulius was positive that the target realization total of $37,800,000 in this document was a net amount, that is, sale prices less any direct selling costs such as commissions and legal fees. However, on this point, Mr. Mayer could not recall whether the figures were gross or net. While earlier, during his examination for discovery, he had stated that he considered the proceed to be "de minimis", he testified that "not all these sums would be coming back to the investor, of course."

97 With respect particularly to the Atherton Place and Turner Crossing properties, Mr. Kaulius stated that, as may be concluded from the figures reproduced under the heading "Property Realizations" at page 4 of a memorandum to Mr. Gregory from Mr. Robertson dated April 9, 1996 (Exhibit 57, vol. IV), the figures in the target realization total column in Exhibit A-16 were gross figures, while Mr. Robertson stated that the figure given for Turner Crossing in Exhibit A-16 was net. I would add here that Mr. Robertson said that, back in 1993, the figures in Exhibit A-16 were only projections of what were thought to be net realizable values. However, as Mr. Robertson explained later in his testimony, the net figure in this particular case was equal to the gross figure,

the only costs being the legal fees, which were borne by 1004568 out of its $200,000 annual administration fee.

98 Counsel for the Respondent stated that with regard particularly to the Georgian Estates, both Mr. Kaulius and Mr. Robertson asserted that the condominium unit price of $55,000 shown in Exhibit A-16 was a net price, even though the appraisal values (page 2384, Exhibit 95, vol. VII), Mr. Hunter Milborne's estimates (in Exhibit 66, vol. VI) and OSFC's own due diligence binder for Georgian Estates (Exhibit 65, vol. V, and Exhibit 66, vol. VI) all show projected gross selling prices of $50,000 per unit. Further, Mr. Robertson acknowledged in his testimony that an investor looking at the Milborne Estimate column in Exhibit A-16, having read the Milborne market study in the due diligence binder (Exhibit 66, vol. VI), and seeing $50,000 gross per unit would not know that the $55,000 figure given in Exhibit A-16 was net, unless that investor asked. Counsel for the Appellants however noted that Mr. Kaulius said that the $50,000 in the Milborne report was also referred to more as a teaser reflecting the lowest price of a unit. According to him, the average gross price would thus be situated between $50,000 as the lowest price and $70,000-$80,000 as the highest price. The average net price would then be determined from those gross numbers and not be based on $50,000.

99 Moreover, referring to the STIL II projection (Exhibit 95, vol. VII, page 2397) counsel for the Respondent pointed out that a condo value of $55,000 per unit is indicated for Masonville Estates and that 13.0% is then subtracted for selling costs. As the condo value of $60,000 per unit indicated in Exhibit A-16 was said to be net, Mr. Robertson acknowledged that on that basis the gross price would have had to be $68,695 per condo unit. However, he said that he had no documentation demonstrating how he arrived at a value of $60,000 net.

100 Counsel for the Respondent also noted that Mr. Kaulius said he did not represent to the investors that they would in fact realize the target of $37.8 million shown in Exhibit A-16. Rather, he said that he would have given them some sort of range and that, with respect to a Portfolio like this, the range could easily reflect a variation of 30%, maybe even more. Furthermore, Mr. Kaulius said that when OSFC had finished its due diligence on the properties he thought that $32-odd million in net sales was attainable but that the properties would need "a lot of sprucing up." In fact, no more than $32 million in net proceeds has been realized to date. However, the sister partnership, Crerar, still holds some $8 million worth of properties.

101 Counsel for the Respondent also referred to Exhibit 50 (vol. IV), which is a memorandum from Mr. Robertson to Mr. Gregory dated January 17, 1994. Under the heading "Summary", at page 4, this document states the following:

> As you are aware, our initial projections targeted total realizations on this portfolio ranging from $25 to $37 million. Any of you who have misplaced your copy of those projections should contact Andrea Donnison to obtain another copy. We welcome your comments and suggestions as you follow the progress of

> the portfolio. At $28 million in total net sales proceeds from the portfolio, SRMP will make a profit. We expect to meet and exceed this number if the property market holds up. At $33 million STIL II goes from 9% split with STC to a 50% split. We are now targeting this $33 million level as our goal. We may be able to reach this level with some market improvement.

102 According to Mr. Gregory, the $33 million target referred to therein was a new target set in 1994, being a decrease of almost $5 million from the net target realization of $37,800,000 given in Exhibit A-16, which decrease resulted from the sale of the Masonville Estates property for about $5 million less than had been anticipated. The $37,800,000 target realization total in Exhibit A-16 was, again according to Mr. Gregory, the high end of the range referred to in the above-quoted memorandum. However, Mr. Robertson testified that his reference to the target of $33 million in that same memorandum was a reference to the earn-out formula. He thought that by working hard STIL II could obtain more than $33 million for the properties, maybe $38 million. He said he wanted to use that higher number but Mr. Kaulius, being more cautious and conservative, had made him use the $33 million figure in case the market fell apart. However, in re-examination, Mr. Robertson stated that that memorandum was sent following the letter of intent to purchase the Masonville property for some $4.9 million less than was first contemplated. Nevertheless, counsel for the Respondent emphasized, while Mr. Robertson testified that the memorandum of January 17, 1994, was an important document, he could not recall what the initial projections of between $25 million and $37 million referred to therein looked like. No evidence was adduced with respect to those initial projections.

103 Counsel for the Respondent also pointed out that if the $37.8 million realization total in Exhibit A-16 is a gross rather than a net amount, and total selling costs are assumed to be $2,209,000, half of which were to be borne by SRMP, Mr. Gregory's total return of $67,572 (Exhibit A-18) would be reduced to $45,703 or about 41.5% instead of 61% on a Class A unit investment of $110,000, or to 11.9% instead of 17.5% per annum over 31/2 years. Reference was made to the testimony of Mr. Kaulius in this regard. I must add here that Mr. Kaulius only agreed that the arithmetic was right without admitting that the basic assumption about gross receipts was correct. Counsel for the Respondent also pointed out that whereas Mr. Gregory's calculations produce a total net pre-tax profit of $67,572 over 31/2 years, or 17.5% per annum, Mr. Cook had calculated a total return of between $55,000 and $60,000.

104 Counsel for the Respondent referred as well to Exhibit A-20, which is a calculation prepared by Mr. Cook at the time of the trial and which is based on the same assumptions as those relied on by Mr. Gregory in preparing Exhibit A-18, except it ignores the cash flow - which would have been minimal to Class A unitholders. According to this calculation, the SRMP Class A partners could expect to recover their outlay of $110,000 per Class A unit once the proceeds from the sale of the properties reached about $28,000,000. Although the investment would have begun to become profitable from that point, counsel pointed out that Mr. Cook acknowledged that profits would be significant only at the $32-33 million net proceeds level since at that point the earn-out formula

moved from a 9% share to a 50% share for SRMP.

105 Counsel for the Respondent referred to other elements as indicating that the Appellants' expectation of profit was not necessarily what it was made out to be.

106 Counsel emphasized that, while Mr. Kaulius stated that OSFC looked to the cash flow after payment of all the fees to pay the interest on the promissory note and that substantial cash flow was expected, in his testimony in the OSFC (TCC) case he had said that OSFC did not know in the spring of 1993 what the cash flow would be for the next five years. As a matter of fact, Mr. Kaulius said that the $1.439 million projected cash flow referred to in Exhibit A-16 was only "a look ahead for one year." Further, while Mr. Kaulius stated that OSFC, TFTI and NSFC had throughout the due diligence process made a number of forecasts as to the profits that they expected to realize or that they required from the STIL II and SRMP transactions, the forecasts were continuously changing during that process. He stated that most of that type of forecasting stopped once they got into the syndication process. However, no documents evidencing any such forecasts were adduced in evidence. Mr. Kaulius also stated that OSFC did not calculate an expected percentage return and that its main concern was the elimination of the $14.5 million promissory note.

107 Mr. Kaulius stated as well that OSFC usually expected an annual rate of return on the cash invested in a venture like STIL II of 15% or more, depending on the risks involved and that the syndication was considered as a means to attain this threshold. Moreover, he stated that this benchmark of 15% would include the $250,000 management fee, the incentive fee of 75% of net cash flow, the $12,000 administration fee and the $850,000 obtained from the Class A SRMP partners on syndication, which all represented returns to OSFC. However, it was admitted that there were a number of risks involved in the STIL II venture, which would push OSFC's required rate of return from its SRMP investment beyond the 15% threshold rate. The risks acknowledged by Mr. Kaulius included the size of the Portfolio, OSFC's inexperience in the Ontario real estate market, the absence of representations and warranties by STC, the purchase of debt rather than real estate, the construction defects in some of the properties, the difficulty of knowing what the fair market value of the properties was and the fact that this was a very risky venture given the partners' joint and several liability on the $14.5 million promissory note. There was also the risk that the market might turn downward, rather than upward. However, Mr. Kaulius stated that in fact they proceeded "to minimize these risks." As for Mr. Robertson, he stated that the risk entailed by the $14.5 million debt alone would cause OSFC to look for an annual rate of return in excess of a 15% per annum, "hoping to get up into the twenties." In fact, Mr. Kaulius stated that OSFC made more than 15% return on its investment of $3 million. Indeed, while OSFC had paid $3,000,000 cash to STC, it received $3,850,000 cash from the Class A unitholders ($110,000 per Class A unit) as a result of the syndication.

108 In addition, Mr. Kaulius stated that OSFC profited from the operating cash flow because it got the major part of it as a result of the fees, including the incentive fee and the payment for the sale of about 76% of the tax losses. On the other hand, the return from the cash flow was negligible

for the Class A partners. Consequently, the expectation of profit of the Class A partners depended on the upside for the real estate, that is, on sharing substantially in the net proceeds from the properties. However, the way the earn-out was structured, it could not be expected that appreciable profits would be made until the net proceeds went well above about $33,000,000. It was also pointed out by counsel for the Respondent that, according to the evidence, the Class A partners were well aware of being exposed to unlimited liability as general partners and concerned by the fact that they were jointly and severally liable on the promissory note of $14.5 million payable to STC. It is clear from the testimonies that their main concern, given that the real estate market might drop further, was to cover their downside through the repayment of the promissory note.

109 Furthermore, counsel for the Respondent pointed out that Mr. Kaulius recognized that through the syndication OSFC had sold approximately 76% of its 99% interest in STIL II to the other SRMP partners and hence 76% of the $50-odd million in tax losses, for which it was rewarded. Mr. Kaulius also recognized that the tax losses were presented from the outset as one of the reasons why the deal was interesting to potential investors, although, according to him, the focus was on the real estate.

110 Counsel for the Respondent further emphasized that, as may be seen from the copy of a letter from E & Y to Mr. Thomas dated June 2, 1993 (Exhibit 102, vol. VIII), the Thorsteinssons partners had been involved in the deal since the letter of intent stage, that is, at least since March 5, 1993.

111 In this respect, it is worth referring to Exhibit 98 (vol. VII), which is a copy of a letter from Peter Thomas to E & Y dated May 31, 1993 that was sent as an attempt to renegotiate several clauses of the final deal. On the fourth page of the letter, Mr. Thomas proposed an amendment regarding the sharing of the proceeds and explained his proposal as follows:

> Following receipt of the documentation late Wednesday, the senior partners at Thorsteinssons reviewed the entire package. Their position is that in order to satisfy G.A.A.R. and the expectation of profits, the break even point on realization of these mortgages must be reduced and there must be a greater incentive for OSFC to realize a share of the profits on the mortgages.

112 From both STC's and OSFC's perspective, as presented by Mr. Bradeen and Mr. Kaulius, this comment was explained as being a last minute negotiation tactic. Moreover, Mr. Gregory denied that such legal advice might have been given by one of the Thorsteinssons partners. While he admitted in cross-examination that, as an investor, he had certainly discussed the GAAR with Mr. Robertson, he stated that he did not express any concern regarding the reduction of the break-even point on the realization of the mortgages.

113 With respect to the tax savings, counsel emphasized that the Appellants testified that such savings that would accrue to them due to the SRMP losses were an attractive and important consideration. Counsel referred to the extensive evidence, both documentary and oral, on what the Appellants' tax savings were from their SRMP loss allocations.

114 In cross-examination of most of the witnesses, counsel for the Respondent presented a calculation of the Appellants' approximate tax savings based on a rough formula. Even though tax rates vary, depending on the amount of taxable income, the amounts of the tax savings to the Appellants could be approximated by the application of an average corporate tax rate of 45.5% and an average individual tax rate of 43.3% to the Appellants' share of the SRMP loss. Counsel remarked that Mr. Cook used a 45% tax rate for himself in his calculation of the tax savings (Exhibit A-21). Based on this rough formula, the approximate gross tax savings for a corporate partner would have been $476,698 per Class A unit, and for an individual partner, $453,649 per Class A unit. According to counsel for the Respondent, comparing these results with the commercial return of $67,572 per unit calculated by Mr. Gregory (Exhibit A-18), the approximate gross tax savings are more than 7 times higher than the commercial return in the case of corporate Class A unitholders and 6.7 times higher in the case of an individual Class A unitholder.

115 Counsel emphasized that even if the $125,700 that had to be paid with respect to each Class A unit for the tax losses is deducted from the gross tax savings, the net tax savings for each corporate Class A unit ($350,974) would remain 5.19 times higher than Mr. Gregory's commercial return, while the net tax savings for each individual Class A unit ($327,935) would be 4.9 times higher than Mr. Gregory's commercial return.

116 In the case of Class B unitholders (except OSFC), because they did not have to pay for their tax losses nor for the acquisition of their Class B units (apart from their $1.00 contribution), counsel for the Respondent submitted, their net tax savings would have been equal to their gross tax savings and thus amount to $476,698 per Class B unit in the case of a corporate partner and to $453,649 per Class B unit in the case of an individual Class B unitholder.

117 Then, referring to Mr. Cook's calculation of the tax savings (Exhibit A-21), counsel for the Respondent noted that Mr. Cook based his calculation on a number of simplified assumptions. The most significant of these was that a "termination event" would occur within 6 years after 1993 in the form of the completion of the implementation of the business plan or the death of a partner, which would result, according to Mr. Cook's calculations, in a net deferral benefit of $126,396.

118 However, counsel pointed out that, after conceding that his total expected tax benefit from the transaction was "a very attractive part of it", Mr. Cook agreed that there was no "sunset date" in the SRMP Partnership Agreement, that is, no date on which it would automatically be terminated, and that, subject to the partnership's continuing to carry on business, it was entirely within the remaining partners' power to keep the partnership alive by leaving as little as one property in it. Counsel further emphasized that indeed article 2.07 of the SRMP Partnership Agreement (Exhibit 35, vol. III) provides that the term of the partnership shall be indefinite and that it shall be terminated only in accordance with the provisions of article 10.

Article 10.01 provides as follows:

> 10.01 Events Giving Rise to Dissolution

> The Partnership shall be dissolved on the earliest of the following:
>
> (a) 180 days following the bankruptcy of OSFC, unless OSFC is replaced within such 180 day period; or
> (b) the passage of a Partners Special Resolution approving the dissolution and winding-up of the Partnership provided that no such Partners Special Resolution may be voted on or passed prior to December 31, 2100.

119 Thus, to the extent that OSFC did not go bankrupt or, if it did, as long as it was replaced within 180 days, the SRMP Partnership could not end prior to December 31, 2100. Moreover, counsel emphasized that, as a matter of law, even if 1004568 was for some reason to cease being a partner in STIL II, this would not mean the end of that partnership's existence.

120 On the question of the eventual termination of the partnership, it is also worth referring to a copy of a memorandum from Mr. Robertson to Mr. Gregory dated April 9, 1996 (Exhibit 57, vol. IV). Under the heading "Property Acquisitions", this document reads in part as follows:

> The question before us now is whether the letters of credit should be gradually released as we realize proceeds from property sales, prior to the acquisition of another property. As originally planned we wish to continue the business of this partnership. Therefore, a property acquisition should occur prior to the sale of the last property in the portfolio.
>
> [Emphasis added.]

121 A copy of another memorandum from Mr. Robertson to Mr. Gregory dated December 17, 1997 (Exhibit 208), is also relevant. In the last paragraph under the heading "Property Realizations", that memorandum states the following:

> The final consideration is the partnership can never be wound up, or the tax consequences to the partners would be unacceptable. Therefore, much of this value will remain in the partnership.

IV INCOME TAX ISSUE (THE GAAR)

(A) PRELIMINARY COMMENTS

1. Ruling in J.N. Gregory Appeal (1999-488(IT)G)

122 It is worth noting that by Notice of Motion filed pursuant to section 58 of the Tax Court of Canada Rules (General Procedure), the Appellant John N. Gregory sought a determination of the constitutional validity of section 245 of the Act as a preliminary question of law. Associate Chief Judge Bowman heard the motion on March 6, 2000 and granted the requested order on March 17, 2000 in Gregory v. The Queen (hereinafter Gregory(TCC)), 2000 D.T.C. 2027. His order was however reversed by the Federal Court of Appeal on October 11, 2000 in The Queen v. Gregory (hereinafter Gregory(FCA)), 2000 D.T.C. 6561. As the Federal Court's judgment provides some indications regarding the analysis of the Charter issue, it may be of some assistance to refer to the parties' arguments, as well as to the reasons of both courts.

123 Subsections 58(1) and (2) of the Rules provide as follows:

> 58. (1) A party may apply to the Court,
> (a) for the determination, before hearing, of a question of law raised by a pleading in a proceeding where the determination of the question may dispose of all or part of the proceeding, substantially shorten the hearing or result in a substantial saving of costs,
> or
> (b) to strike out a pleading because it discloses no reasonable grounds for appeal or for opposing the appeal,
>
> and the Court may grant judgment accordingly.
>
> (2) No evidence is admissible on an application, (a) under paragraph (1)(a), except with leave of the Court or on consent of the parties, or (b) under paragraph (1)(b).

124 In support of his motion, the Appellant Gregory argued that the GAAR is unconstitutional on the face of it since its application requires an analysis in two steps that contradict each other. As a result, he submitted, the GAAR's constitutionality is a pure question of law, the determination of which does not require factual evidence. He further distinguished between adjudicative and legislative facts, contending that only the latter would be required in order to determine the Charter issue.

125 The Respondent, however, argued that in order to establish that a particular piece of legislation violates section 7 of the Charter a person must at minimum demonstrate that he is affected by that legislation, for the courts will not decide hypothetical questions. Since at the time of the motion there were non-GAAR issues raised in relation to the transactions in issue, the Respondent submitted that a determination of the question stated in the Appellant's motion would be hypothetical. The Respondent further submitted that a determination of the question whether the GAAR breaches section 7 of the Charter requires a determination that the GAAR violates one or more of the rights enumerated in that section. Contending that it is not immediately apparent how the GAAR could deprive anyone of any of those rights (to life, liberty and security of the person), the Respondent argued that whether it could or could not must surely be established by evidence led by the person who is challenging its constitutional validity. As a result, the Respondent concluded, the determination of the question stated by the Appellant would require extensive evidence in the form of legislative and adjudicative facts. That being so, the Respondent submitted that it was not a determination subject to section 58 of the Rules.

126 Judge Bowman granted the Appellant's motion for the following reasons, set out in paragraph 17:

> Counsel for the appellant stated that he does not intend to adduce any adjudicative facts of the type that were considered necessary in Danson or MacKay. His contention is that section 245 is unconstitutional on its face and no further evidence is necessary. He is not alleging any unconstitutional effects on the appellant or on any class of persons that would require the adducing of evidence. His position is that the legislation is impermissibly vague and is therefore contrary to the substantive requirements of the rule of law and in violation of section 7 of the Charter. For this counsel for the appellant contends that no evidence is required. That is the manner in which he chooses to frame the appellant's challenge to the legislation and it is not the court's place (or the Crown's) to tell the appellant how to present his case. Nor, in my view, should procedural roadblocks be put in the way of a citizen's attempt to invoke the supreme law of this country.

127 Judge Bowman ruled in paragraph 20, that "[t]he constitutionality of section 245 is a separate and discrete issue of law that can be determined without reference to any of the other facts that are in issue in this appeal."

128 However, the Federal Court of Appeal accepted the Respondent's argument. Noël J.A. delivered reasons for judgment in which Rothstein J.A. concurred, while Létourneau J.A. gave separate reasons.

129 Noël J.A. relied on Ontario v. Canadian Pacific Ltd. (hereinafter Ontario v. C.P.), [1995] 2 S.C.R. 1031, a decision in which the Supreme Court of Canada, at page 1090, stated that "[i]f

judicial interpretation is possible, then an impugned law is not vague." Noël J.A. concluded, at paragraphs 6 and 7 of his reasons:

> It follows that before embarking on an analysis as to whether section 245 is on the face of it impermissibly vague, the Tax Court had to first attempt to apply section 245 to the particular facts in issue in the appeal before it; in the words of the Supreme Court, if the impugned provision can be applied to the relevant facts, it "is obviously not vague". It is only after attempting to exercise this interpretative function without success that the Court can turn to the broader question raised by the respondent.
>
> Without the relevant adjudicative facts, the question as framed by the respondent is therefore not one which can be adjudicated upon on a preliminary basis. This is sufficient to dispose of the appeal and we refrain from expressing any view on the other grounds advanced by our colleague for allowing the appeal.

130 Létourneau J.A. came to the same conclusion although for different reasons. In paragraph 8 of his reasons, he relied on Blencoe v. British Columbia (Human Rights Commission), [2000] 2 S.C.R. 307 in stating that:

> the question to be addressed in section 7 challenges is not whether the alleged fact can engage section 7 of the Charter, but whether the respondent's section 7 rights were actually engaged in the circumstances of the case. Here there are, beyond a mere assertion that they will, no evidence whatsoever as to how, why and when the rights to life, liberty and security of the respondent are engaged by the potential application of section 245. I say potential application because it is possible that the liability of the taxpayer in these proceedings be determined by the Tax Court adjudicating upon the non-GAAR issues, thereby making it unnecessary to rule on the constitutionality of GAAR.

131 He then stated, in paragraphs 9 and 11:

> It is trite law that a section 7 challenge proceeds in two steps. First, there has to be evidence that a citizen is deprived of his section 7 rights. Second, evidence has to be adduced that this was done in a manner that was not in accordance with the principles of fundamental justice: Blencoe, supra, R. v. Beare, [1988] 2 S.C.R. 387, at page 401....
>
> To accept this position without evidence that the respondent's section 7 rights are engaged elevates freedom from vagueness "to the stature of a constitutionally protected section 7 right", something which cannot be done: see Blencoe, supra,

at paragraph 97.

132 He thus agreed with Noël J.A. in reversing Judge Bowman's order.

133 Some guidance may be taken from the foregoing. Noël J.A., relying on Ontario v. C. P., supra, concluded in paragraph 6 of his reasons that "[i]t is only after attempting to exercise this interpretative function without success that the Court can turn to the broader question raised by the Respondent." The corollary to this seems to be that to the extent that the Court is successful in its attempt to interpret section 245, the Charter issue may be disregarded. What is less clear is what constitutes interpretation as contemplated by the Supreme Court of Canada in Ontario v. C. P., supra. It was argued that if the interpretation requires the Court to exercise discretion that is too broad, then the Court will have failed to exercise its interpretative function. Further, that inconsistencies in the existing section 245 jurisprudence support such a conclusion. In any event, it follows from the Federal Court of Appeal's decision that I must first proceed with an analysis of the GAAR before turning to the Charter issue.

2. Federal Court of Appeal Decision in OSFC

134 After the hearing in the present appeals, the Federal Court of Appeal rendered its decision dismissing OSFC's appeal from the jugment of Judge Bowie of this Court on the basis that the GAAR provisions were applicable in the circumstances. The judgment rendered on September 11, 2001 is reported as OSFC Holdings Ltd. v. Canada (hereinafter OSFC(FCA)) 2001 D.T.C. 5471. Counsel in the present appeals were then given the opportunity to present supplementary written submissions in light of the Federal Court of Appeal's findings, which they did. These submissions will be dealt with separately following the presentation of the initial arguments for both sides at the hearing.

(B) INCOME TAX ACT PROVISIONS

135 Subsection 18(13) of the Act as applicable at the relevant time read as follows:

> (13) Superficial loss - Subject to subsection 138(5.2) and notwithstanding any other provision of this Act, where a taxpayer
>
> (a) who was a resident of Canada at any time in a taxation year and whose ordinary business during that year included the lending of money, or
> (b) who at any time in the year carried on a business of lending money in Canada
>
> has sustained a loss on a disposition of property used or held in that business that

is a share, or a loan, bond, debenture, mortgage, note, agreement of sale or any other indebtedness, other than a property that is a capital property of the taxpayer, no amount shall be deducted in computing the income of the taxpayer from that business for the year in respect of the loss where

(c) during the period commencing 30 days before and ending 30 days after the disposition, the taxpayer or a person or partnership that does not deal at arm's length with the taxpayer acquired or agreed to acquire the same or identical property (in this subsection referred to as the "substituted property"), and

(d) at the end of the period described in paragraph (c), the taxpayer, person or partnership, as the case may be, owned or had a right to acquire the substituted property,

and any such loss shall be added in computing the cost to the taxpayer, person or partnership, as the case may be, of the substituted property.

Subsections 245(1) to 245(4) of the Act read as follows:

245. [General anti-avoidance rule]

(1) Definitions. In this section and in subsection 152(1.11),

"tax benefit" means a reduction, avoidance or deferral of tax or other amount payable under this Act or an increase in a refund of tax or other amount under this Act;

"tax consequences" to a person means the amount of income, taxable income, or taxable income earned in Canada of, tax or other amount payable by, or refundable to the person under this Act, or any other amount that is relevant for the purposes of computing that amount;

"transaction" includes an arrangement or event.

(2) General anti-avoidance provision. Where a transaction is an avoidance transaction, the tax consequences to a person shall be determined as is reasonable

in the circumstances in order to deny a tax benefit that, but for this section, would result, directly or indirectly, from that transaction or from a series of transactions that includes that transaction.

(3) Avoidance transaction. An avoidance transaction means any transaction

(a) that, but for this section, would result, directly or indirectly, 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 tax benefit; or

(b) that is part of a series of transactions, which series, but for this section, would result, directly or indirectly, 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 tax benefit.

(4) Provision not applicable. For greater certainty, subsection (2) does not apply to a transaction where it may reasonably be considered that the transaction would not result directly or indirectly in a misuse of the provisions of this Act or an abuse having regard to the provisions of this Act, other than this section, read as a whole.

Subsection 248(10) of the Act reads as follows:

(10) Series of transactions. For the purposes of this Act, where there is a reference to a series of transactions or events, the series shall be deemed to include any related transactions or events completed in contemplation of the series.

(C) ARGUMENTS

1. Initial Submissions

136 Counsel for the Appellant's submission is best expressed in the following statement: in cases where there is a real and substantial commercial transaction that underlies the impugned transactions, the GAAR should not be applied to set aside any tax efficiencies associated with those. In counsel's view, this interpretation would be consistent with the stated legislative purpose of the GAAR, which was to legislatively implement a "business purpose" test similar to the business purpose test found in the United States but rejected in Canada by the Supreme Court in Stubart Investments Limited v. The Queen, [1984] 1 S.C.R. 536. It is counsel's contention that in recent decisions of United States Court of Appeals, namely: IES Industries, Inc. and Alliant Energy Corporation v. United States, U.S.Ct.App. (8th Circuit) (File Nos. 00-1221 and 00-1535, June 14, 2001) and UPS v. Commissioner of IRS, U.S.Ct.App., (11th Circuit) (File No. 00-12720, June 20,

2001), this "business purpose" test is satisfied if there is a real business, regardless of the income tax implications that flow from the transactions. This interpretation would, in counsel's view, limit the issue in many GAAR cases to the sufficiency of the commercial activity carried on and the connection of the sought-after tax benefit to that activity, which, he submitted, are palpable and tangible concepts with which the courts are comfortable. Counsel submitted that in the present appeals, since the preserved historical cost of the Portfolio represented a tax-planning efficiency associated with a real and substantial real estate business in the form of the Portfolio, the GAAR cannot apply under this proposed interpretation.

137 Counsel further submitted that this interpretation is consistent with two distinct approaches taken by this Court in recent GAAR cases. Based on the first approach, exemplified by Rousseau-Houle v. The Queen, 2001 D.T.C. 250 (English version: [2001] T.C.J. No. 169 (Q.L.)), the very recent Donohue Forest Products Inc. v. The Queen, 2001 D.T.C. 823, and Fredette v. The Queen, 2001 D.T.C. 621, as well as the secondary reasons in Canadian Pacific Limited v. The Queen (hereinafter Canadian Pacific (TCC)), 2000 D.T.C. 2428, Jabs Construction Limited v. The Queen, 99 D.T.C. 729, and Geransky v. The Queen, 2001 D.T.C. 243, counsel stated that there is no misuse of the provisions of the Act or abuse having regard to the provisions of the Act read as a whole if the taxpayer has implemented a bona fide commercial arrangement but has chosen to do so by using the most advantageous tax alternative provided for in the Act. Referring to the second approach, exemplified by Husky Oil Limited v. The Queen, 99 D.T.C. 308, Canadian Pacific (TCC), supra, and Geransky, supra, counsel stated that so long as the overall arrangement has a bona fide commercial objective, there will not be an avoidance transaction simply because the commercial objective is met in a tax-efficient manner.

138 Counsel for the Respondent rejected the Appellants' contention that where there is an overarching commercial transaction section 245 is not engaged. He submitted that the proper approach was to engage in a disciplined analysis, like that set out by Judge Bowie in OSFC (TCC), supra, and subsequently in Duncan et al. v. The Queen, 2001 D.T.C. 96 (T.C.C.). In OSFC (TCC), Judge Bowie formulated the following four-step analysis at paragraph 37:

> I must answer the following questions in relation to the application of GAAR:
>
> 1. But for the application of section 245, would the incorporation of 1004568, the formation of STIL II, and the sale by Standard of its interest in STIL II to the Appellant, or any of those transactions, have resulted in a tax benefit?
> 2. If the answer to the first question is yes, may the transaction, or transactions, reasonably be considered to have been undertaken or arranged primarily for bona fide purposes other than to obtain the tax benefit?
> 3. If the answer to the first question is yes, and the answer to the second

question is no, did the transaction, or transactions, result, directly or indirectly in a misuse of the provisions of the Act, or an abuse of the provisions of the Act read as a whole?

4. If the first question is answered yes, the second no, and the third yes, then which of the remedies set out in subsection 245(5) is appropriate?

139 The presentation of counsel's detailed arguments will generally follow Judge Bowie's analysis in OSFC (TCC), supra, which analysis was approved by the Federal Court of Appeal in dismissing OSFC Holdings Ltd.'s appeal in the same case OSFC (FCA), supra.

(a) Tax benefit (Subsection 245(1))

140 Counsel for the Appellants did not dispute that the Appellants obtained a tax benefit within the meaning of subsection 245(1) as a result of the transactions in issue, though they argued that the said benefit was limited in scope, contending that it was a mere deferral. Nevertheless, in light of the broad definition of "tax benefit" reproduced above, counsel for the Respondent submitted that there can be no doubt that the transactions resulted in a tax benefit. The question relating to the value of the benefit will be addressed as part of the submissions regarding primary purpose under subsection 245(3) of the Act.

141 In order for subsection 245(2) to apply, the tax benefit has to result from an avoidance transaction or a series of transactions that include such a transaction. It must therefore be determined whether all or any of the transactions in issue may be considered as avoidance transactions or as a series of such transactions within the meaning of section 245.

(b) Tax benefit as a result of an avoidance transaction or a series of transactions that includes an avoidance transaction (subsections 245(2) and (3))

(i) Avoidance transactions and series of transactions in general

142 Relying on the reasons delivered by this Court in a number of cases, namely Husky Oil, supra, Canadian Pacific (TCC), supra, Jabs Construction, supra, and Geransky, supra, counsel for the Appellants contended that the GAAR should not apply where a real and substantial business underlies the impugned transactions. To support his contention, he relied particularly on the following part of Judge Bonner's Reasons for Judgment in Canadian Pacific (TCC), supra, at paragraph 15:

> The transactions which the Respondent says constitute the series were, when viewed objectively, inextricably linked as elements of a process primarily intended to produce the borrowed capital which the Appellant required for business purposes. The capital was produced and it was so used. No transaction

> forming part of the series can be viewed as having been arranged for a purpose which differs from the overall purpose of the series. The evidence simply does not support the Respondent's position. Accordingly none of the transactions on which the Respondent relies was an avoidance transaction within the meaning of s. 245(3).

143 In light of the foregoing, counsel submitted that in the present appeals all the transactions were in furtherance of a single commercial purpose, namely, the disposition of the Portfolio by the SRMP partners. As a result, counsel submitted, none of the transactions in question may be considered as avoidance transactions.

144 Counsel for the Appellants further submitted that the only relevant transaction was the acquisition by the Appellants of their partnership interests in SRMP. Indeed, in counsel's view, transactions in which the Appellants did not participate may not be considered as avoidance transactions and are not relevant to the present appeals.

145 In counsel's view, for a transaction to be an avoidance transaction, two requirements must be met. First, there must be a determination by the Court that the particular transaction, or a series of transactions that includes the particular transaction, "would result, directly or indirectly, in a tax benefit." If the first requirement is met, there must then be a determination by the Court that the particular transaction cannot "reasonably be considered to have been undertaken or arranged primarily for bona fide purposes other than to obtain the tax benefit", either from the particular transaction or from the series. The second requirement being a purpose test, it is counsel's contention that it is the primary purpose of the person undertaking or arranging the particular transaction that must be assessed in determining whether that purpose was to obtain the tax benefit.

146 It is counsel's contention that the word "obtain" is reflexive as it requires that the tax benefit be obtained by the person whose purpose is being assessed. Accordingly, counsel's position is that only transactions undertaken or arranged by the taxpayer to obtain the tax benefit for himself are relevant. On this basis, counsel contended that the only relevant transaction in the present appeals is the Appellants' acquisition of their partnership interest in SRMP. In his view, consideration of previous transactions in a series is only relevant as a factor in objectively determining whether the transaction in which the taxpayer participated was undertaken primarily for a bona fide purpose other than to obtain a tax benefit.

147 Moreover, counsel submitted that transactions undertaken by a third party without identifying the Appellants or without their having knowledge thereof cannot form part of a series of transactions which results in a tax benefit for them. In counsel's view, the applicable test is that set forth in Craven v. White, Commissioners of Inland Revenue v. Bowater Property Developments Ltd., Baylis v. Gregory (hereinafter Craven v. White) (1988), 62 TC 151 (H.L.). As a result, for there to be a series, there must be a direct connection or link between transactions such that all the transactions in the series must have been preordained, in effect forming a single composite

transaction. Further, counsel submitted that there must be reasonable evidence that, at the time of the first step, there was an identified target as regards the final steps and that the transaction would be completed in such a manner as to attain that final target.

148 In any event, counsel submitted, the upstream transactions were not avoidance transactions within the meaning of subsection 245(3). In fact, his contention is that STC's sole objective in arranging the upstream transactions was to package the business comprising the Portfolio in such a way as to maximize its proceeds on the sale of the business rather than to obtain a tax benefit. In his view, this is evidenced by the fact that STC would have sold the Portfolio directly had it received proceeds comparable to those it sought for the package.

149 For his part, counsel for the Respondent submitted that the analysis of whether a transaction or a series of transactions is an avoidance transaction or a series of such transactions requires the ascertainment of the taxpayer's primary purpose. In his view, this ascertainment involves in the first instance the determination of a threshold question, being whether the transaction or the series was commercially motivated. If this question is answered in the negative, that ends the inquiry as by definition, such a transaction could not have been entered into for any purpose other than to obtain a tax benefit. However, if the threshold question is answered positively, a further question then arises: whether the transaction or series was entered into primarily to obtain the tax benefit.

150 In counsel's view, the threshold question should not be construed to be the same as the carrying-on-of-a-business or the reasonable-expectation-of-profit tests that the Act otherwise contemplates, since those tests do not involve a quantitative analysis of the expectation of profit. In counsel's view, the test set forth in subsection 245(3) does involve such a quantitative analysis, the threshold question being whether the quantum of the profit that could reasonably be expected from the transaction would have been sufficient to induce a profit-minded businessman to enter into it. Conversely, the further question involves, in his view, a simple comparison of the profit that could reasonably be expected from the transaction with the tax benefit it entails. It is counsel's contention that if the quantum of the tax benefit significantly outweighs the expected non-tax benefit, the inference will arise that the transaction cannot be considered to have been undertaken primarily for a purpose other than to obtain that tax benefit.

151 Moreover, it is counsel's position that the words "unless the transaction may reasonably be considered to have been undertaken or arranged primarily for bona fide purposes other than to obtain the tax benefit" require that the analysis be conducted by reference to objective standards and facts, and not merely on the basis of what the actor says his intention was in entering into the transaction.

152 Counsel for the Respondent further submitted that the meaning of the terms "to obtain the tax benefit" in subsection 245(3) is not as narrow as counsel for the Appellants suggested. It is counsel's contention that the definition of "to obtain" does not require that the procurement thereby referred to must necessarily be for the benefit of the author of the transactions. He further referred to this

Court's reasoning in OSFC (TCC), supra, in submitting that subsections 245(2) and 245(3) of the Act are carefully worded to ensure that they do not apply only to those situations in which the tax benefit is enjoyed by the author of the transactions. Furthermore, counsel contended that the provisions in both subsections 245(2) and 245(3) stating that the tax benefit may result indirectly from a transaction or series of transactions clearly indicate that the recipient of the tax benefit need not be the author of the transactions because an indirect result need not have an immediate connection with a transaction or event that is said to cause the result indirectly.

153 Moreover, counsel for the Respondent submitted that there may be several possible tests for determining what type of transactions constitute a series of transactions, one such test being the "binding commitment test" developed in Craven v. White, supra, a case relied on by the Appellants' counsel. In the opinion of counsel for the Respondent, while it may be appropriate to adopt this restrictive "binding commitment" test in pre-GAAR situations or with respect to other areas of the Act that deal with a series of transactions, there is no justification for adopting that test for the purposes of paragraph 245(3)(b). In counsel's view, other tests, such as the "mutual interdependence" test and the "end result" test, are more appropriate. Pursuant to the "mutual interdependence" test, two or more transactions constitute a series if the transactions are so interdependent that the results of one transaction would be meaningless in the absence of the completion of the other transaction or transactions. According to the "end result" test, which is closely related to the "substance over form" doctrine, two or more transactions constitute a series if they are in substance component parts of a single transaction, which component parts were intended from the outset to serve the purpose of reaching the ultimate result. In counsel's view, it follows from the wording of paragraph 245(3)(b) that, so far as a series of transactions is concerned, that paragraph is clearly result-rather than purpose-oriented, and it would therefore be better construed in the light of one of those tests.

154 According to counsel for the Respondent, STC's transactions and OSFC's transaction were clearly mutually interdependent, as this Court found in OSFC (TCC), supra, for without OSFC's transaction, the preceding three would not have proceeded nor have made sense, and in the absence of STC's transactions, OSFC's transaction would not have taken place. On the basis that the evidence clearly shows that the syndication of a portion of OSFC's partnership interest in STIL II to the Appellants was contemplated at the time OSFC entered into the transaction, counsel submitted that the SRMP transactions as well as the previous transactions thereto were also mutually interdependent. Likewise, it is counsel's position that the "end result" test would lead one to a similar conclusion, since the sole raison d'être of STC's transactions was to transfer STC's tax losses to an arm's length person, such as OSFC and the Appellants.

155 However, it is counsel's contention that, should the Court find that paragraph 245(3)(b) requires that the receiver of the tax benefit that results from a series of transactions have participated in at least one of the transactions constituting the series, subsection 248(10) expands the concept of a series to encompass transactions carried out in contemplation of the series. Relying on Black's Law Dictionary, 6th ed., (St. Paul, Minn. West Publishing Co., 1990), page 318, counsel

submitted that "contemplation" includes the consideration of an act or series of acts with the intention of doing or adopting them. As a result, a transaction carried out in contemplation of a series would, in his view, include a transaction that is carried out after the transactions constituting the series occur, as well as a transaction planned or carried out in advance of the series. Accordingly, it is his contention that SRMP's transactions would be part of the series, and whether or not they were avoidance transactions is irrelevant.

156 In any event, counsel for the Respondent contended, should the Court apply the Craven v. White, supra, "binding commitment test", subsection 245(2) would still be applicable in the instant case. In his view, even if one assumes that the series of transactions in the present case is limited to STC's transactions, this truncated series still resulted, albeit indirectly, in tax benefits to OSFC and to the Appellants. As a result, it is counsel's contention that whether or not OSFC's transaction and SRMP's transactions were avoidance transactions is irrelevant.

(ii) SRMP's transactions in particular

157 Relying on The Oxford English Dictionary and on Husky Oil, supra, Canadian Pacific (TCC), supra, Jabs Construction, supra, and Geransky, supra, counsel for the Appellants submitted that the word "primarily" puts the emphasis on the root transaction. It is thus counsel's contention that the real estate acquisition is paramount and predominant, being the essence of all the transactions; it is the essential and main transaction. As such, the real estate acquisition is in counsel's view the primary purpose for the Appellants' acquisition of their SRMP partnership interests.

158 To support his contention that the essential nature of the Appellants' purchase of their SRMP interest was the acquisition of a substantial real estate portfolio, counsel relied on the evidence adduced at trial. He emphasized that extensive due diligence relating to the potential risks and returns associated with the Portfolio was undertaken at great cost in terms of both time and money before any deal was secured, whereas essentially no due diligence was done in respect of the tax aspects. He also emphasized that the Appellants jointly and severally took on significant other risks, including an obligation under the promissory note, all of which arose in respect of the real estate business only. Further, the ongoing commitment of time and human resources related exclusively to the management and realization of the assets underlying the Portfolio, while the tax benefit had no capital, time or resource commitment associated with it. According to counsel, this is evidenced by the fact that the additional payment was contingent, being due only if the losses were available to the Appellants. On the other hand, the risks and rewards of the real estate Portfolio were the Appellants' regardless of the tax result. Counsel emphasized lastly that the tax benefit did not arise in isolation, nor was it contrived, artificial or unrelated to the business being acquired. On the contrary, the losses arose from the very properties acquired by the Appellants. From the Appellants' perspective, the acquisition of the SRMP partnership interests was thus an economic package comprised of the real estate business with the historical tax attributes attached thereto.

159 In contrast, counsel for the Respondent's position is that the SRMP transactions are not ones that a prudent, profit-minded businessman would have entered into, and that the only reasonable explanation with respect to the Appellants' acquisition of their SRMP partnership interest was the tax benefit stemming therefrom. According to counsel, the SRMP transactions were consequently avoidance transactions within the meaning of subsection 245(3).

160 In support of that conclusion, counsel emphasized that the structure the Appellants bought into, did not, as the evidence reveals, allow them to make any profits from the sale of the properties for proceeds of between $17,500,000 and about $28,000,000. Further, counsel noted that the structure would not allow the Appellants any appreciable profits until the net proceeds of sale were well in excess of $33 million. As a result, counsel contended, it is apparent that the guaranteed purchase price of $17,500,000 was designed merely to limit the Appellants' downside and not to enable them to make profits.

161 Moreover, counsel for the Respondent submitted that the evidence shows that the net proceeds of sale figure of about $33,000,000 was regarded by both STC and OSFC, and also by the Appellants, as being more speculative than the realization of net proceeds below that threshold. This is, in counsel's view, demonstrated by STC's willingness to give up 50% or more of the upside once the net proceeds exceeded about $33,000,000. It is also demonstrated, according to him, by the failure of most of the Appellants to calculate or to pay attention to expected rates of return. In counsel's view, an informed investor, serious about making an investment from which substantial profits are expected, will of necessity have to quantify the return anticipated by him. Otherwise, he will be unable to make an informed decision about whether substantial profits may be expected and thus to make that investment in preference to an alternative one.

162 Counsel for the Respondent further emphasized that the business plan according to which the properties were to be disposed of provides for a "high scenario" - "low scenario" range of projected net sales, and that only a business loss could be expected from the "low scenario" net proceeds. Moreover, in his view, the evidence indicates that the "high scenario" net proceeds were extremely speculative. He contended that the "high scenario" proceeds depended on a dramatic upturn in the depressed real estate market of that time, which was not a certainty unless one were prepared to keep the Portfolio for an indeterminate number of years. Considering the pressing need to eliminate the $14.5 million promissory note as soon as possible, and the Appellants' desire to recover their investment as quickly as possible, counsel submitted that the disposition of several properties had to occur in the relatively short term. As a result, those properties could not wait for a turnaround in the real estate market. In counsel's opinion, the Appellants' expected profits, being based on $37,800,000 in net proceeds, were not reasonable. To support his contention, counsel emphasized the previously noted confusing and contradictory evidence concerning Exhibit A-16. In counsel's opinion, that entire document, and particularly its alleged listing of target realizations as net proceeds, is utterly lacking in credibility. In his view, it is totally unsupported by any other documentation or even by the Appellants' own testimony as to how the alleged net sales proceeds, and net unit prices where applicable, were arrived at. Moreover, counsel submitted that Exhibit

A-16 was put forward by the Appellants at a late stage to bolster their claim that in 1993 they made their investment decision based on the information contained in that document.

163 In any event, counsel emphasized that, should the Court accept that the $37,800,000 target realization was a reasonable expectation in the circumstances, the 17.5% annual return calculated by Mr. Gregory (Exhibit A-18) is a pre-tax return. In counsel's view, however, a profit-motivated businessman, faced with joint and several liability on a promissory note of $14.5 million and with unlimited liability as a partner in a general partnership, not to mention other serious investment-specific risks, would expect an annual after-tax rate of return in excess of 20%. Moreover, if the $37.8 million total target realization were gross, as counsel submitted, the annual pre-tax rate of return would be less than 12%. In counsel's opinion, from a purely commercial perspective, all the Class A unitholders cared about was getting out from under their heavy debt liability and recouping their money as swiftly as possibly. In his view, making a profit from the upside of the real estate was uncertain, speculative and strictly secondary.

164 Counsel for the Respondent therefore submitted that the Appellants' investment in SRMP lacked the minimum ingredients normally associated with an investment of this type. According to him, investors do not normally invest blindly, in amounts sometimes in excess of their own net worth, without some other inducement. In his opinion, that inducement was the immediate tax savings associated with the investment.

165 Moreover, counsel submitted that, while it is not disputed that STIL II and SRMP were partnerships and thus their activities were carried on with a view to profit, this acknowledgement is not inconsistent with his position that the Appellants' investment would not have been made had there not been the tax benefits. In counsel's view, a determination that the primary purpose of a transaction was to realize a commercial return rather than to obtain a tax benefit requires the court to find that the transactions were carried out with a view to profit and that there were quantifiable expected returns.

166 Alternatively, should the Court find that the transactions in issue were such as a prudent, profit-minded investor would enter into, counsel submitted that quantitatively weighing the expected commercial benefits against the expected tax benefits clearly indicates that the primary purpose of the transactions was to obtain the tax benefits.

167 In fact, in counsel's opinion, the tax benefit to the Class A unitholders, after deducting the amounts payable for the losses, was roughly 5 times greater, and the tax benefit to the Class B unitholders was approximately 7 times greater, than the commercial benefit that could be expected, assuming that Mr. Gregory's calculations contained in Exhibit A-18 and based on Exhibit A-16 are accurate. While this comparison assumes an absolute tax benefit, rather than a mere deferral, counsel submitted that there is no certainty, or even a strong likelihood, of the occurrence of recapture of the tax benefit on an eventual disposition. As emphasized in the review of the evidence, there are several indications that the Appellants did not intend that any termination event occur.

168 Moreover, counsel submitted, if the target realization total of $37.8 million in Exhibit A-16 was a gross figure, with roughly $2 million in selling costs associated with the disposition of the Portfolio, the expected commercial benefit would further decline by about $20,000 per Class A unit. The commercial benefit would of course decline even more with projected sales proceeds of approximately $33 million.

(c) Avoidance transaction which results in a misuse of the provisions of the Act, or in an abuse of the provisions of the Act read as a whole (Subsection 245(4))

(i) Scope of subsection 245 (4) of the Act

169 As is clear from its wording, subsection 245(4) is a legislative screen. In cases where it may reasonably be considered that the transaction would not result directly or indirectly in a misuse of the provisions of the Act or an abuse having regard to the provisions of the Act, other than section 245, read as a whole, it excludes from the ambit of the GAAR a transaction that would otherwise be an avoidance transaction.

170 Counsel for the Appellants contended that while the taxpayer bears the onus of proof regarding factual matters which underlie the determination of the existence of a "tax benefit" and an "avoidance transaction," the burden should lie on the Minister to positively demonstrate to the satisfaction of the Court either (a) that the avoidance transaction misuses a particular provision of the Act, the manner in which the misuse is determined and the nature of the misuse, or (b) that the avoidance transaction abuses an identifiable scheme within the Act, the manner in which the abuse is determined, the nature of the abuse and why one particular scheme, rather than any other relevant scheme, should be used in determining whether there has been an abuse. To support his contention, counsel relied on Minister of National Revenue v. Pillsbury Holdings Ltd., 64 D.T.C. 5184 (Ex. Ct.) as authority for the proposition that the taxpayer usually bears the onus of proof with respect to factual matters that are within his knowledge. Since the determination whether an impugned transaction constitutes a misuse or an abuse is not based on factual matters that are within the knowledge of the taxpayer, it is counsel's position that the onus in this respect should lie on the Minister. Counsel further submitted that the foregoing was explicitly recognized by Judge Archambault in Donohue, supra, at paragraph 78, where he stated:

> I do not believe that the respondent has succeeded in showing that, in law, the ABIL deducted by DSF resulted in such a misuse.

171 With respect to a case of alleged misuse, counsel for the Appellants submitted that the Minister must demonstrate that a provision of the Act has been used, the permitted uses of that provision and the manner in which the taxpayer's use of the provision is outside of, and offends, those permitted uses.

172 With respect to a case of alleged abuse, counsel submitted that the Minister must identify a relevant scheme dealing with the subject matter in question. It is also counsel's opinion that the Minister must explain the scheme and how it is relevant to the avoidance transaction and further demonstrate the manner in which the scheme has been abused. If the Minister succeeds at this stage, it remains open to the taxpayer to demonstrate that an equally compelling scheme of the Act has been respected. According to counsel, such a demonstration should exclude the application of the GAAR to the particular transaction. In support of this last contention, he submitted that it is open to a taxpayer to structure a transaction or investment so as to choose among co-existing schemes in the Act. As an example, counsel suggested that a taxpayer can choose to operate a business as a sole proprietor, to incorporate his business, to operate as a partnership or to carry on business through a commercial trust, and that each of these options is governed by a different scheme. In counsel's view, there cannot be misuse or abuse simply by virtue of the scheme chosen. To conclude otherwise would mean that under the GAAR a taxpayer is not free to choose among different alternatives in order to plan a commercial transaction in such way as to minimize tax. In counsel's opinion, that proposition has traditionally been rejected at common law, was rejected by the Department of Finance in the drafting of the GAAR and has specifically been rejected by the courts in interpreting the GAAR. Reference was made to the Supreme Court of Canada's judgment in Shell Canada Ltd. v. Canada ("Shell"), [1999] 3 S.C.R. 622, in which it is said at paragraph 46:

> Inquiring into the "economic realities" of a particular situation, instead of simply applying clear and unambiguous provisions of the Act to the taxpayer's legal transactions, has an unfortunate practical effect. This approach wrongly invites a rule that where there are two ways to structure a transaction with the same economic effect, the court must have regard only to the one without tax advantages. With respect, this approach fails to give appropriate weight to the jurisprudence of this Court providing that, in the absence of a specific statutory bar to the contrary, taxpayers are entitled to structure their affairs in a manner that reduces the tax payable: Stubart, supra, at p. 540, per Wilson J., and at p. 557, per Estey J.; Hickman Motors Ltd. v. Canada, [1997] 2 S.C.R. 336, at para. 8, per McLachlin J.; Duha, supra, at para. 88, per Iacobucci J.; Neuman, supra, at para. 63, per Iacobucci J.

173 Counsel noted that the same principle was recognized by the Department of Finance in the April 1988 Explanatory Notes to Draft Legislation and Regulations Relating to Income Tax Reform, where it is stated at page 348:

> ... It is recognized that tax planning - arranging one's affairs so as to attract the least amount of tax - is a legitimate and accepted part of Canadian tax law....

174 Moreover, counsel for the Appellants submitted that Judge Bowman confirmed in Geransky, supra, that the GAAR is not meant to limit a taxpayer's choices. At paragraphs 42 and 43, he said:

> Simply put, using the specific provisions of the Income Tax Act in the course of a commercial transaction, and applying them in accordance with their terms is not a misuse or an abuse. The Income Tax Act is a statute that is remarkable for its specificity and replete with anti-avoidance provisions designed to counteract specific perceived abuses. Where a taxpayer applies those provisions and manages to avoid the pitfalls the Minister cannot say Because you have avoided the shoals and traps of the Act and have not carried out your commercial transaction in a manner that maximizes your tax, I will use GAAR to fill in any gaps not covered by the multitude of specific anti-avoidance provisions.
>
> That is not what GAAR is all about.

175 Similar comments can also be found in Jabs Construction, supra, at paragraph 48, in Fredette, supra, at paragraph 76 and in Rousseau-Houle, supra at paragraph 50.

176 Conversely, counsel for the Respondent submitted that the misuse or abuse provisions in subsection 245(4) must be construed in the light of the doctrine of "abuse of rights", on which they are based. While counsel recognized that the "abuse of rights" doctrine is foreign to the common law, he submitted that this does not mean that Parliament cannot make it law in Canada by legislative prescription, which it evidently did for the purposes of the GAAR. That doctrine, in counsel's view, has its origin in the principle that a right cannot be exercised in such a way as to harm the enjoyment of the rights of others, and has been further developed and applied in European contract, corporate and tax law to signify that one cannot use a right, such as one given by statute, for a purpose for which it was not intended. Put in common-law language, this would mean, in counsel's view, that a right conferred by a statute must be exercised in accordance with the object and spirit of the statutory provisions.

177 In counsel's opinion, it results from the foregoing that subsection 245(4) in effect explicitly recognizes that the object and spirit of the provisions of the Act must be ascertained in order to determine whether any particular provisions of the Act read as a whole have been used to attain or to frustrate the economic and other results contemplated by them. It is counsel's opinion that this constitutes a fundamental departure from the tenet of statutory interpretation according to which the object and spirit of a provision of the Act is irrelevant where the words employed in that provision are clear and may technically fit the description of a particular transaction. Accordingly, counsel submitted that such pre-GAAR cases, as Canada v. Antosko, [1994] 2 S.C.R. 312, Friesen v. Canada, [1995] 3 S.C.R. 103, and Shell, supra, relied upon by the Appellants are of no assistance when applying the GAAR.

(ii) Misuse of subsection 18(13) of the Act

178 According to counsel for the Appellants, subsection 18(13) is one of a number of "loss deferral" provisions in the Act, the effect of which is to deny the immediate recognition of losses

otherwise realized on the transfer of property to a non-arm's-length party, including a partnership, and to carry over the historical tax attributes of the transferred property to the transferee. In counsel's words, subsection 18(13) mandates a "rollover" at historical cost and is an explicit provision in which Parliament expressly contemplates the transfer of mortgages from a corporate entity to a partnership.

179 According to counsel, subsection 18(13) had in the present case precisely the effect intended by Parliament, that is, the losses otherwise sustained by STC on the transfer of the mortgages were added to the cost of the mortgages in the hands of STIL II.

180 Counsel for the Appellants submitted that it is difficult to conceive how a specific provision of the Act, such as subsection 18(13), standing alone, can be misused, since any such misuse would imply that subsection 18(13) has a defined purpose not expressed in the plain words of the provision. In his view, the provision simply directs a certain result if specified criteria are met. In so stating, counsel relied on the reasons for judgment of Judge Bowman (as he then was) of this Court in Continental Bank of Canada and Continental Bank Leasing Corporation v. The Queen, 94 D.T.C. 1858 ("Continental Bank") (affirmed [1998] 2 S.C.R. 358 and [1998] 2 S.C.R. 298), at p. 1872:

> What, then, is the "object and spirit" of subsection 97(2)? I am not sure what its spirit, if any, is, - spirits tend to be somewhat elusive - but its object seems rather straightforward. It is to permit a taxpayer to transfer assets to a partnership in return for a partnership interest without triggering the immediate tax result that such a transfer would normally entail ....
>
> That, then, is the object and spirit of subsection 97(2), nothing more or less. I do not see how a taxpayer who avails itself of that provision, with both its advantages and potential disadvantages, can be said to have acted in contravention of its object and spirit.

181 Counsel also relied on the reasons for judgment delivered by McLachlin J. (as she then was) of the Supreme Court of Canada, in Shell, supra, at paragraph 40:

> Second, it is well established in this Court's tax jurisprudence that a searching inquiry for either the "economic realities" of a particular transaction or the general object and spirit of the provision at issue can never supplant a court's duty to apply an unambiguous provision of the Act to a taxpayer's transaction. Where the provision at issue is clear and unambiguous, its terms must simply be applied: Continental Bank, supra, at para. 51, per Bastarache J.; Tennant, [1996] 1 S.C.R. 305, supra, at para. 16, per Iacobucci J.; Canada v. Antosko, [1994] 2 S.C.R. 312, at pp. 326-27 and 330, per Iacobucci J.; Friesen v. Canada, [1995] 3 S.C.R. 103 at para. 11, per Major J; Alberta (Treasury Branches) v. M.N.R., [1996] 1 S.C.R. 963, at para. 15, per Cory J.

182 On the basis of the foregoing, counsel contended that the words of subsection 18(13) could not more clearly demonstrate that Parliament contemplated a transfer of mortgages to a partnership and the subsequent introduction of arm's length members to that partnership. In counsel's view, not only does subsection 18(13) explicitly refer to a transfer to a partnership, but it also contains within it a limitation of the acquisition of an interest in the partnership by an arm's length party. Counsel emphasized that by virtue of paragraphs 18(13)(c) and (d) subsection 18(13) can apply only if the transferor of the mortgages or a non-arm's-length party owns the same or identical property within 30 days before or after the transfer. In his view, the corollary of this is that if an arm's length party acquires the partnership interests within that time frame, the rule will not apply. Counsel further contended that Parliament has contemplated the case of arm's length parties and provided a "bright-line" rule mandating different results depending on when an arm's length party acquires the property. In his view the "bright-line" rule has been respected in the present appeals.

183 Further contending that a provision cannot be misused when it performs as intended or as contemplated by Parliament, counsel submitted that there was no abuse of subsection 18(13) in the transactions in issue since subsection 18(13) operated in the manner contemplated by Parliament.

184 Counsel for the Respondent, on the other hand, submitted that it is evident from subsection 18(13) that it was enacted as a "stop-loss provision", the object of which is to prevent taxpayers who are in the money-lending business from artificially realizing losses on assets which have declined in market value by transferring those assets to a person with whom they do not deal at arm's length, while maintaining control of the assets through the non-arm's-length nature of their relationship. In his opinion, subsection 18(13)'s purpose is not to effect the transfer of unrealized losses from a taxpayer who has no income against which to offset those losses to a taxpayer that does have such income. On the contrary, the transfer of superficial losses to the transferee is merely a consequential rule allowing the superficial loss to be utilized by the transferee rather than being lost altogether. Accordingly, it is counsel's position that if one uses subsection 18(13) to transfer losses to an arm's length party, one is using it for a purpose for which it is not intended and is therefore misusing it.

185 In that regard, counsel relied on this Court's reasons for judgment in OSFC (TCC), supra, particularly at paragraph 54, where Judge Bowie stated:

> ... Subsection 18(13) was enacted as a stop-loss provision, the object of which is to prevent taxpayers who are in the money-lending business from artificially realizing losses on assets which have declined in market value by transferring them to a person with whom they do not deal at arm's length, while maintaining control of the assets through the non-arm's length nature of their relationship with the transferee. The use of that provision to effect the transfer of unrealized losses from a taxpayer who has no income against which to offset those losses to a taxpayer which does have such income is clearly a misuse.

186 Counsel also relied on the Department of Finance's April 1988 Explanatory Notes to Draft

Legislation and Regulations Relating to Income Tax Reform which deal with the new subsection 18(13) and which provide as follows at pages 30 and 31:

> New subsection 18(13) introduces a superficial loss rule that denies such losses sustained by a taxpayer whose ordinary business includes the lending of money. This rule is similar to the superficial loss rule in paragraph 54(i) relating to capital properties. A superficial loss under subsection 18(13) is a loss realized by the taxpayer on the sale or transfer of a property that is a share or a loan, bond, debenture, mortgage, note, hypothec, agreement of sale or any other indebtedness that was not a capital property of the taxpayer where the same or identical property (referred to as the "substituted property") is acquired by the taxpayer or a non-arm's length person or partnership during the period commencing 30 days before and ending 30 days after the sale or transfer and that substituted property is held by the taxpayer or the person or partnership at the end of that period. Any loss that is a superficial loss is added in computing the cost of the substituted property to the taxpayer or the person or partnership who owns the property 30 days after the sale or transfer....

187 Counsel also referred on this point to Edward A. Heakes, "New Rules, Old Chestnuts, and Emerging Jurisprudence: The Stop-Loss Rules", Canadian Tax Foundation, Conference Report, 1995, p. 34:1, in which the author analyzes a number of stop-loss provisions and the amendments proposed.

188 According to counsel, to limit the determination of the purpose of a provision to the words used therein is to deny the very purpose of subsection 245(4) and thus to deny the meaning and applicability of the GAAR as a whole.

189 Counsel for the Respondent did acknowledge that subsection 18(13) of the Act was amended in 1998 so as to no longer provide that losses realized on the transfer of property from a financial institution to a non-arm's-length entity will be added to the cost of the property to that entity, and so as to in effect "suspend" these losses in the hands of the transferor. He submitted, however, that the amendment is entirely irrelevant to the issue in the present case, since the GAAR operated to deny the legal result - that is, the tax benefit to the arm's length transferee of the property - of subsection 18(13) as applicable at the relevant time.

(iii) Abuse of the provisions of the Act read as a whole

190 Counsel for the Appellants submitted that the applicable scheme of the Act is the one that deals with partnerships and the allocation of a partnership's income or losses to the partners at the partnership's year-end, without regard to whether they were partners throughout the partnership's fiscal period. In counsel's view, there is no rule of general application limiting the allocation of income or losses from a partnership so as to take into account changes of partners during a partnership's fiscal year or limiting losses not financed by partners. Nor is there, in his view, any

general rule requiring that the property be held beyond the fiscal year-end of the partnership to avoid the transfer of losses to new partners. Moreover, counsel submitted that there is nothing in the Act that prevents a person from becoming a member of a partnership and benefiting or suffering from the tax consequences of events that occurred prior to that person becoming a partner. Indeed, it is counsel's position that the scheme of the Act, including subsection 18(13), expressly contemplates this.

191 In counsel's view, once the choice to proceed by way of a partnership was made by STC, subsection 18(13) governed the move from the corporate scheme to the partnership scheme and dictated the tax consequences. From that point forward, the tax consequences to the partners of STIL II were governed by the partnership scheme, which has been adhered to in every way. Furthermore, counsel submitted that although STC recognized the tax advantages of using a partnership structure, it chose that structure for non-tax purposes namely, attracting purchasers for the Portfolio and maximizing the value of its estate. Relying on Continental Bank, supra, counsel contended that the fact that this choice was made in contemplation of a sale of the partnership does not affect its validity. In counsel's view, since Parliament has contemplated and facilitated the move from the corporate scheme of the Act to the scheme of the Act dealing with partnerships, there can be no abuse of the Act when the comprehensive scheme dealing with partnerships applies precisely as Parliament intended.

192 It is counsel's further contention that there is no general rule or scheme of the Act in which losses not funded by a taxpayer may not be utilized by that taxpayer. In his view, a taxpayer is entitled to use losses legally acquired unless there is an express prohibition of such use. Counsel submitted, for instance, that in the corporate context, in the absence of section 111, it would be open to any taxpayer to acquire control of a corporation and utilize its accumulated losses. In his view, by enacting section 111, Parliament has legislated a restriction on the unbridled use of corporate losses. Counsel submitted that it is only if control of a corporation has been acquired by an unrelated party that the use of the non-capital losses is restricted for that unrelated party. If there is no acquisition of control, counsel submitted, the use of the losses remains unrestricted, even in the absence of a specific enabling rule.

193 It is counsel's further contention that no general scheme for losses may be inferred from the narrow limitation in section 111. In his view, an exception does not define a scheme and the Supreme Court of Canada has explicitly warned against extrapolating and finding a general scheme of the Act based only on anti-avoidance rules that apply in specific circumstances. In this regard, counsel referred to Neuman v. M.N.R., [1998] 1 S.C.R. 770, a decision in which Iacobucci J. stated, at paragraph 35:

> ... I wish to make some observations to place the present debate into its proper perspective. First, s. 56(2) strives to prevent tax avoidance through income splitting; however, it is a specific tax avoidance provision and not a general provision against income splitting. In fact, "there is no general scheme to prevent

> income splitting" in the ITA (V. Krishna and J. A. Van Duzer, "Corporate Share Capital Structures and Income Splitting: McClurg v. Canada" (1992-93), 21 Can. Bus. L.J. 335, at p. 367). Section 56(2) can only operate to prevent income splitting where the four preconditions to its application are specifically met.

194 Counsel further submitted that in his recent decision in Donohue, supra, Judge Archambault of this Court refused to find any general scheme of the Act despite the Minister's general thesis regarding such a scheme.

195 In counsel's view, the fact that there is no counterpart to section 111 with respect to the use of losses sustained by a partnership or trust that were not funded by a partner or a beneficiary does not signify that Parliament has not addressed the issue. Rather, it is counsel's position that the schemes of the Act dealing with partnerships and trusts simply use a different mechanism.

196 According to counsel, the mechanism used in the scheme of the Act dealing with partnerships is the computation of the adjusted cost base of the partnership interest. Contributions to the partnership by a partner and any income allocated to the partner increase the adjusted cost base of that partner's partnership interest. Withdrawals by a partner and losses allocated to the partner reduce the adjusted cost base of the partnership interest. Hence, any losses not funded by the partner will cause the adjusted cost base to become negative. Under subsections 40(3) and 100(2), that negative adjusted cost base will be taxed to the partner as a capital gain on disposition of the partnership interest. Accordingly, it is counsel's position that, since the losses allocated to the Appellants will eventually be recaptured upon disposition of the Appellants' partnership interest in SRMP, the result is in accordance with the mechanism that Parliament has chosen to employ for the purpose of recognizing and accounting for losses from a partnership.

197 Furthermore, counsel warned the Court of the "obvious danger of a broad application of the misuse or abuse doctrine", which judicially "amends" the Act for the particular taxpayer. Counsel submitted that the GAAR is not and should not be construed as an instrument of legislation in the hands of the administration or, for that matter, the courts. Otherwise, in counsel's opinion, the GAAR becomes a "roving and arbitrary ex post facto technical amendment of which the taxpayer has no notice."

198 Having observed that Parliament did amend subsection 18(13) some time after the transactions under review, counsel submitted that, through these amendments, Parliament chose to fundamentally alter its policy regarding the recognition of losses. As a result of the amendments, counsel submitted, the central approach of all the loss deferral rules in the Act shifted from the carry-forward of the historical tax attributes to the "suspension" of the losses in the hands of the original holder.

199 In counsel's view, until that fundamental change, the policy was to move the denied loss to the non-arm's-length transferee for ultimate recognition by the transferee. After the change, the loss remained with the transferor. On the basis of the foregoing, it is counsel's submission that the result

brought about by former subsection 18(13) in the case at bar was wholly consistent with the policy in place at that time, and the subsequent amendments suggest that the use of former subsection 18(13) in the present case was not contrary to the scheme of the Act as it was prior to those amendments. On this point, counsel referred to paragraph 66 of Judge Archambault's reasons in Fredette, supra:

> ... If Parliament believed there was reason to change its tax policy with respect to this tax benefit, it was open to it to do so. And it did so in 1995 for the fiscal periods commencing after 1994. Consequently, it cannot be concluded that the one-year carry-over resulted in a misuse of, or an abuse having regard to, the provisions of the Act read as a whole during the relevant period.

200 Finally, counsel submitted that the comprehensive nature of the amendments illustrates the danger of judicial "amendment" of the Act using the GAAR. A broad construction of the test of abuse would, in counsel's view, result in a lack of certainty for taxpayers and place upon the courts or the Minister the role of Parliament. Counsel remarked that this is what the Supreme Court of Canada cautioned the courts against in Shell, supra, where McLachlin J., as she then was, stated at paragraph 43:

> ... The Act is a complex statute through which Parliament seeks to balance a myriad of principles. This Court has consistently held that courts must therefore be cautious before finding within the clear provisions of the Act an unexpressed legislative intention: Canderel Ltd. v. Canada, [1998] 1 S.C.R. 147, at para. 41, per Iacobucci J.; Royal Bank of Canada v. Sparrow Electric Corp., [1997] 1 S.C.R. 411, at para. 112, per Iacobucci J.; Antosko, supra, at p. 328, per Iacobucci J. Finding unexpressed legislative intentions under the guise of purposive interpretation runs the risk of upsetting the balance Parliament has attempted to strike in the Act.

201 Counsel for the Respondent, on the other hand, submitted that the relevant scheme of the Act in the case at bar lies in the basic rules for the computation of income provided in Division B, and in the rules for the computation of taxable income provided in Division C, pursuant to which rules income and taxable income must be computed separately for each taxpayer.

202 Counsel emphasized a number of provisions in support of his contention. With respect to the rules for the computation of income, he noted first that section 3 requires the determination of "a taxpayer['s]" income from various sources and "the taxpayer's" taxable capital gains. He then observed that section 4 requires the determination of "a taxpayer's" income or loss for a taxation year separately for each source of that income. He then remarked that Subdivision (a) of Division B (sections 5-8) provides rules for the computation of "a taxpayer's" income for a taxation year from an office or employment, while Subdivision (b) of Division B (sections 9-37) contains rules for the computation of "a taxpayer's" income for a taxation year from a business or property. With respect

to the rules for the computation of taxable income, counsel mentioned subsection 111(1), which provides that "[f]or the purpose of computing the taxable income of a taxpayer for a taxation year" a taxpayer may deduct such amounts as he may claim for "the taxpayer's" non-capital losses, net capital losses and other defined losses incurred in prior and subsequent taxation years. He further emphasized that subsections 111(3)-(7) impose limitations on the deductibility of such losses in certain circumstances, including where control of a corporation has been acquired during a year.

203 In counsel's view, it is clear from these provisions that income and taxable income must be computed separately for each taxpayer, by source, and that there is no computation of income for several taxpayers together, that is, there is no sharing with other taxpayers of income earned by a taxpayer and of losses incurred by him.

204 Counsel further submitted that the Act's policy of not permitting the sharing with other taxpayers of income earned by a particular taxpayer has been recognized judicially in Mersey Docks and Harbour Board v. Lucas (1883), 8 A.C. 891 (H.L) and Woodward's Pension Society v. Minister of National Revenue, 59 D.T.C. 1253 (Ex. Ct.); affd. 62 D.T.C. 1002. In particular, counsel referred to the following excerpt from the reasons for judgment of Thorson P. of the Exchequer Court at pp. 1260-1261:

> The other specific submission was that the appellant was entitled to exemption under the section by reason of the fact that it was impossible for it to keep or distribute its profit but must pay it to the pension trustees and that, consequently, the appellant did not own it. In support of this contention counsel relied strongly on the decision of the Supreme Court of Canada in Minister of National Revenue v. St. Catharines Flying Training School Limited, [1955] S.C.R. 738 [55 D.T.C. 1145]. There it was held by Locke J., who delivered the judgment of the Court, that the respondent in that case had no income liable to taxation since the surplus held by it was, in effect, held in trust for the Crown. In my opinion, that finding has no application to the facts in the present case and is certainly not an authority for the submission that the appellant was exempt from tax under section 62(1)(i). It would be unrealistic and fanciful to hold that the appellant had no income in the year ending January 31, 1953. In its own statement of revenue and expenditure for the year, Exhibit E8, shows its income. The fact that it was required to pay over its surplus funds to the pension trustees cannot possibly nullify the fact that the appellant had an income. The income was earned by it as the result of its own operation in dealing with its own property. How can it then be said that it did not own its income? The fact that a person must devote his property to a particular purpose cannot alter the fact that when he acquired the property it was his.

205 Counsel further emphasized that his position is supported by Judge Bowie's reliance on the reasons for judgment in Canada v. Duha Printers (Western) Ltd., [1996] 3 F.C. 78 (F.C.A.),

reversed on other grounds by Duha Printers (Western) Limited v. Canada, (hereinafter Duha Printers (SCC)) [1998] 1 S.C.R. 795, for the proposition that the Act does not, except where it specifically so authorizes, allow the transfer of losses from one person to another. In counsel's view, since STIL II's losses from the Portfolio were not incurred by it in carrying on its business, but were incurred instead by STC, the scheme of the Act that is relevant in the present case is that which deals with the transfer of losses between corporations, rather than that dealing with partnership losses.

2. Supplementary Submissions

206 Counsel, both for the Appellant and the Respondent, have provided the Court with supplementary written submissions concerning the recent decision of the Federal Court of Appeal in OSFC (FCA), supra.

207 Counsel for the Appellants submitted that the very inconsistency that they assert makes section 245 unconstitutional was acknowledged to exist by Rothstein J.A., speaking for the majority of the Court in OSFC (FCA), when he stated at paragraph 63:

> ... 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.

208 Counsel for the Appellants further submitted that Rothstein J.A. dealt with the dilemma by arbitrarily overriding the words Parliament used based on a subjective perception of policy and that he may have dealt with the dilemma differently if he had had the benefit of the Appellants' counsel's argument here regarding the unconstitutionality of section 245. Therefore, it is open to this Court to find that the provision is unenforceable despite the Federal Court of Appeal's decision.

209 Counsel for the Appellants referred the Court to the recent Supreme Court of Canada decision in Ludco Enterprises Ltd. v. Canada, 2001 SCC 62, in which Iacobucci J. stated at paragraph 38:

> Furthermore, when interpreting the Income Tax Act courts must be mindful of their role as distinct from that of Parliament. In the absence of clear statutory language, judicial innovation is undesirable ....

210 Counsel for the Appellants contended that Iacobucci J.'s analysis cannot co-exist with the approach taken by the Federal Court of Appeal in overriding, based on a subjective perception of policy, the words used by Parliament.

211 Counsel for the Appellants submitted that the conclusion of the majority of the Federal Court

of Appeal in OSFC (FCA), supra, that there was no misuse of subsection 18(13) and no abuse of the partnership scheme cannot co-exist with their conclusion that there was an abuse of the corporate loss scheme. The argument of counsel for the Appellants is that there can be no abuse of the corporate loss regime of which subsection 18(13) forms a part when the provision has been used in precisely the manner contemplated by Parliament.

212 Counsel for the Appellants also submitted that the Federal Court of Appeal's conclusion that there was no abuse of the partnership scheme supports their position that there has been no abuse of the Act read as a whole. Taxpayers are entitled to structure substantive commercial transactions by choosing among alternative business vehicles. In this case, the Appellants chose to utilize a partnership scheme specifically provided for in subsection 18(13), and thus there is no abuse of the Act read as a whole.

213 Counsel for the Appellants stated that the Federal Court of Appeal's decision in OSFC (FCA), supra, implies that section 245 can prohibit a taxpayer from choosing among co-existing schemes in the Act in structuring a commercial transaction. It is submitted that this implication is inconsistent with the views expressed in the recent Supreme Court of Canada decision in Singleton v. Canada, 2001 SCC 61, where the Court endorsed a taxpayer's right to advantageously order his affairs. Further, counsel stated that in Ludco, supra, the Supreme Court of Canada confirmed that it is not for the courts to in effect legislate to cure defects in the Act. In counsel's view this indicates that the Supreme Court of Canada would adopt a narrower approach to the interpretation of section 245 than that taken by the Federal Court of Appeal in OSFC (FCA), supra.

214 Counsel for the Appellants also submitted that there was a lack of evidence before the Federal Court of Appeal in OSFC (FCA), supra, which led that Court to draw an incorrect inference that there was no substantial commercial purpose behind the transactions. In the present proceedings, there was an abundance of evidence presented concerning the legitimate and substantial commercial nature of the real estate acquisitions at the core of the impugned transactions. Counsel for the Appellants referred again to the hard negotiations over the purchase price, the real estate expertise of several of the Appellants, the extent of the due diligence done prior to the acquisition, the expert real estate management after the acquisition, the bona fides of the Appellants' commercial expectations, the commercial risk of liability on the promissory note, the unlimited liability in the context of a volatile commercial real estate market and the scheme for the distribution of the net proceeds as between OSFC and SRMP as evidence of the substantial commercial nature of the impugned transactions.

215 Counsel for the Respondent rejected the Appellant's contention that the Reasons for Judgment of the majority of the Federal Court of Appeal in OSFC (FCA), supra, lend support to a finding that section 245 is unconstitutional. Counsel rejected the Appellants' contention that Rothstein J.A. found section 245 meaningless and in order to apply it had to override the words of Parliament. On the contrary, he submitted, when Rothstein J.A. speaks of an analysis of the GAAR that would be meaningless, he is referring to an interpretation that would confine the analysis under

subsection 245(4) to the words used by Parliament in a particular provision rather than considering that provision's object and spirit or the policy behind it.

216 Counsel submitted that the fact that the Federal Court of Appeal found it possible to apply subsection 245(4) in OSFC (FCA), supra, was in effect a determination that the provision is not unconstitutional. In support of this submission, he referred the Court to the Supreme Court of Canada's decision in Ontario v. C. P., supra, in which Gonthier J. stated at paragraph 79:

> ... In a situation, such as the instant case, where a court has interpreted a legislative provision, and then has determined that the challenging party's own fact situation falls squarely within the scope of the provision, then that provision is obviously not vague. There is no need to consider hypothetical fact situations, since it is clear that the law provides the basis for legal debate and thereby satisfies the requirements of s. 7 of the Charter.

217 Counsel for the Respondent also rejected the Appellant's contention that the Federal Court of Appeal found an abuse of the corporate loss scheme in OSFC (FCA), supra. Rather, in counsel's view, the Federal Court of Appeal found that the transactions in question violated the general policy of the Act against the transfer of losses from one corporation to another. More particularly, it is submitted that the Federal Court of Appeal found a general overarching policy against loss trading that overrides specific provisions of the Act and the policy otherwise applicable in a non-tax-avoidance context. Therefore the attempt to find an inconsistency between, on the one hand, the Federal Court of Appeal's finding that the taxpayer complied with the letter and policy of subsection 18(13) and the partnership rules and, on the other hand, this overarching policy is misplaced. Further, counsel for the Respondent submitted that the Federal Court of Appeal's findings regarding the policies of the Act are binding on this Court.

218 Counsel for the Respondent also rejected the Appellants' contention that the alternate business vehicle argument was not advanced before the Federal Court of Appeal in OSFC (FCA), supra, stating that the Appellant in that case alleged that a compelling and valid business scheme had been chosen and adhered to. Nevertheless, according to counsel, the Federal Court of Appeal, in the face of the legal and commercial validity of the transactions comprised in the scheme, found that they contravened the policy in the Act against loss trading.

219 Counsel for the Respondent rejected the assertion that the Federal Court of Appeal found that section 245 operated to prohibit a taxpayer from structuring a commercial transaction by choosing among co-existing schemes in the Act. According to counsel for the Respondent, the Court found that section 245 simply deprives a taxpayer of the benefit of transactions that contravene the policy of the Act read as a whole.

220 Counsel for the Respondent stated that neither Ludco, supra, nor Singleton, supra, is relevant to the interpretation of section 245. The relevant transactions in Ludco, supra, took place prior to the enactment of section 245. In Singleton, supra, they took place after the enactment. However, neither

decision considered the application of section 245 of the Act.

221 Counsel for the Respondent submitted that the Federal Court of Appeal's finding that the transactions in OSFC (FCA), supra, abused the policy against loss trading among corporations is based on the basic premise that, as a matter of the Act's general policy, losses cannot be transferred among taxpayers, regardless of whether the taxpayers are individuals or corporations. There is, therefore, no valid reason for this Court not to apply the Federal Court of Appeal's decision to the final two transactions involved in these appeals and find that they too contravened the general policy against loss trading.

222 Counsel for the Respondents noted that the majority of the Federal Court of Appeal found that subsection 248(10) broadened the meaning of the expression "series of transactions" contained in subsection 245(3) such that, as long as the parties to a transaction took into account the common law series of transactions (Transactions 1, 2 and 3) in deciding to complete a later transaction, that transaction would form part of the series. In fact, the Federal Court of Appeal found that the first four transactions formed a series. Therefore, counsel submitted, Transactions 5 and 6 form part of the series because the Appellants took the first four transactions into account when entering into the later transactions. Counsel also referred to the opinion expressed by Létourneau J.A., speaking for himself only, that Transaction 4 (OSFC's purchase of its 99% interest in STIL II) was part of the series because it satisfied both the "mutual interdependence" test and the "end result" test. Although noting that this approach best expresses the law regarding the meaning of "series of transactions" in paragraph 245(3)(b) of the Act, counsel stated that, for the purpose of the disposition of the present appeals, the opinion of the majority must govern.

223 Counsel for the Respondent submitted that the majority of the Federal Court of Appeal found it necessary to inquire into whether Transaction 4 was an avoidance transaction purely for convenience' sake so that it could express an opinion as to whether any of the transactions in the series resulted in a misuse or abuse under subsection 245(4). Counsel stated that under no circumstances can the majority's opinion be taken as establishing that all transactions in a series must be found to be avoidance transactions before the series may be said to result in a tax benefit. In counsel's view, since Transactions 1 through 4 have been found to be avoidance transactions by the Federal Court of Appeal, then, so long as this Court finds that Transactions 1 through 6 constitute a series from which a tax benefit resulted, it is not necessary to find that the final two transactions are also avoidance transactions. Regardless, it was submitted, referring to the "threshold question" and the "second question" in the Respondent's initial submissions, that the evidence in the present appeals overwhelmingly supports a conclusion that the final two transactions are avoidance transactions.

224 Counsel for the Respondent further submitted that the evidence in OSFC (FCA), supra, supports the conclusion that Transactions 5 and 6, that is, the Appellants' transactions involved in the present appeals, were undertaken solely to obtain the tax benefit. Counsel disagreed with the Appellants' contention that the Federal Court of Appeal did not have before it extensive evidence of

the substantial commercial nature of the core transactions and that, as a result, it drew a poorly informed inference as to the fundamentals of the transactions, which lead to the grossly inaccurate impression that the real estate portfolio was mere window dressing.

225 Counsel for the Respondent noted that although the majority of the Federal Court of Appeal found that a simple comparison between the estimated tax benefit and the estimated business earnings may not be determinative, especially where the estimates of each are close, the Court stated that a potential tax benefit vastly greater than the estimated business earnings would strongly suggest a primary tax purpose. In fact, in arriving at that conclusion, the majority of the Federal Court of Appeal compared the potential tax benefit of $52 million with earnings of about $6 million before selling costs under the earn-out formula and about $1 million in projected operating income. The Court then stated that its conclusion was supported by the manner in which the sale by OSFC of its interest in STIL II was effected, by the money OSFC received in return and by the sharing of the proceeds and income received from STIL II amongst the SRMP partners. In the present appeals, given that the estimated tax benefit to the SRMP partners far exceeds the estimated business earnings, it is open for the Court to find that Transactions 5 and 6 were avoidance transactions. Based on the fact that business returns expected by the Appellants in the present appeals were considerably less than those expected by OSFC and that the Federal Court of Appeal found that Transaction 4 was an avoidance transaction, it follows that Transactions 5 and 6 were a fortiori avoidance transactions.

226 Counsel for the Respondent also submitted that the documentary and other objective evidence in the present appeals was essentially the same as that in OSFC (FCA), supra, and that the only additional evidence here concerned the subjective intention of the Appellants. According to counsel, this subjective evidence is not relevant and he referred the Court to the reasons of the majority of the Federal Court of Appeal in OSFC (FCA), where Rothstein J.A. stated at paragraph 46:

> The words "may reasonably be considered to have been undertaken or arranged" in subsection 245(3) indicate that the primary purpose test is an objective one. Therefore the focus will be on the relevant facts and circumstances and not on statements of intention. It is also apparent that the primary purpose is to be determined at the time the transactions in question were undertaken. It is not a hindsight assessment, taking into account facts and circumstances that took place after the transactions were undertaken.

227 Counsel for the Respondent also noted that the majority of the Federal Court of Appeal found that simply making the tax aspect contingent would not result in a finding that the primary purpose was a business purpose, because such an approach would always deprive a transaction of its avoidance character and thus nullify the purpose of the general anti-avoidance provision. Accordingly, he submitted that this Court was bound to reject the Appellants' identical argument in the present appeal.

228 Counsel for the Respondent also referred to Létourneau J.A.'s reasons for judgment in which was expressed the opinion that the transactions constituted a misuse of subsection 18(13) of that Act. Having cited Judge Bowie's conclusion on that matter, Létourneau J.A. said at paragraph 134:

> I agree. Subsection 18(13) was not intended to be used by a corporation to increase the adjusted cost base of a related corporation or partnership for the purpose of selling its losses to an arm['s] length corporation.

229 Létourneau J.A. also agreed with Judge Bowie that the transactions were an abuse of the Act as a whole when he said at paragraph 135:

> ... STC's losses were made a marketable commodity and transferred from one corporation to another corporation through the artifice of a partnership (the STIL II partnership) which had never incurred the losses and acted as a conduit.

230 Counsel for the Respondent thus submitted that the minority of the Federal Court of Appeal found a policy against loss trading underlying both subsection 18(13) and the Act read as a whole.

231 Counsel for the Respondent stressed that the findings of the minority are to be preferred to those of the majority. However, as they are findings of law rather than of fact and as the findings of the majority are binding on this Court, counsel stated that, for the purposes of the present appeals, the Respondent was adopting and relying on the findings of the majority.

(D) ANALYSIS

232 I will state at the outset that I agree with the Respondent that section 245 of the Act is applicable in the present case. It is applicable basically for the reasons advanced in the Respondent's initial as well as supplementary submissions.

233 In determining whether section 245 of the Act is applicable, I have the benefit of the recent decision of the Federal Court of Appeal in OSFC (FCA), supra. That decision, dealing with basically the same transactions as those that are the subject of the present appeals, is also the first by the Federal Court of Appeal on the GAAR. It is trite to say that I am bound by the findings of the majority of that Court regarding the interpretation of section 245 and other sections of the Act.

234 According to the majority of the Federal Court of Appeal, the first task is to determine whether there is a tax benefit. Next, it is necessary to consider whether the benefit results from a transaction that is an avoidance transaction or from a series of transactions that includes an avoidance transaction.

(a) Tax benefit

235 A "tax benefit" is defined in subsection 245(1) to include inter alia, a reduction, avoidance or deferral of tax payable under the Act. Ultimately, whether there has been a "tax benefit" or not is a

question of fact.

236 On October 1, 1993, SRMP allocated its 1993 year-end losses of over $52 million to its partners. Each of the individual Appellants in this appeal deducted his share of these allocated losses against his other income for the year. The corporate Appellants did likewise in their 1994 taxation year. Because of insufficient income, some Appellants computed non-capital losses that were carried back to prior years or forward to future years. This obvious tax benefit flows from Transaction 6. The Appellants have not denied that the deduction of these losses is a tax benefit. However, they assert that the benefit is limited in scope and that it is primarily merely a tax deferral. The Appellants assert that the loss allocations reduced the adjusted cost base of each partnership interest. As a result, on the dissolution of the partnership, on the sale of an interest in the partnership or on the death of an individual partner, there would be a deemed disposition of their partnership interest and a resulting capital gain and thus a recapture of 75% of the tax benefit in that form.

237 Regardless of whether the losses claimed result in only a deferral of 75% of the amount claimed, given the broad definition of tax benefit in subsection 245(1) there can be no doubt that the losses claimed result in a tax benefit. It should be noted that 25% of the losses claimed would produce a tax saving, not a mere deferral. Further, the present value of a deferral is dependent on the length of the deferral and the applicable interest rates.

238 However, three key pieces of evidence point to the fact that the tax benefit contemplated from the outset was more than just a deferral of tax. In my opinion, a permanent tax saving was contemplated. First, the SRMP Partnership Agreement (Exhibit 35, vol. 3), provides in article 10.01 that the SRMP partnership would only be dissolved at the earliest of the following:

> (a) 180 days following the bankruptcy of OSFC, unless OSFC is replaced within such 180 day period; or
> (b) the passage of a Partners' Special Resolution approving the dissolution and winding-up of the Partnership, provided that no such Partners' Special Resolution may be voted on or passed prior to December 31, 2100.

239 Article 10.02 of the same document then lists all the events that would not terminate or dissolve the partnership and states the intent that it should not be dissolved except as provided for in article 10.01. Moreover, in his testimony, Mr. Cook admitted that the term was indefinite and that there was no sunset date.

240 Second, a memorandum from Mr. Robertson to Mr. Gregory dated April 9, 1996 (Exhibit 57, vol. IV), states that pursuant to the original plan to continue the business of the SRMP Partnership, a property acquisition should occur prior to the sale of the last property in the Portfolio.

241 Third, in another memorandum from Mr. Robertson to Mr. Gregory dated December 17, 1997 (Exhibit 208), there is a statement at page 4 that "the final consideration is the partnership can never be wound up, or the tax consequences to the partners would be unacceptable."

242 This evidence certainly does not demonstrate that a mere tax deferral was contemplated. I will address the question of the value of the tax benefit later when discussing the primary purpose of the SRMP transactions. The death of any individual partners was definitely not something that was foreseen at the time. Moreover, there is no evidence as to the exact tax consequences following a partner's death nor, more particularly, as to whether or not there might have been a rollover of their partnership interest.

(b) Tax benefit as a result of an avoidance transaction or series of transactions that includes an avoidance transaction

243 Transaction is defined in subsection 245(1) as including an arrangement or event.

244 According to the majority of the Federal Court of Appeal in OSFC (FCA), supra, a transaction is part of a "series" under subsection 245(2) if:

1. a series of transactions within the common law meaning of the term exists;
2. the particular transaction is "related" to the common law series; and
3. the related transaction is completed in contemplation of the series.

(i) Common Law Series

245 The majority of the Federal Court of Appeal concluded that in enacting subsection 245(3) Parliament intended to adopt the common law definition of a "series of transactions" developed by the House of Lords in Furniss v. Dawson, [1984] A.C. 474 (H.L.). Rothstein, J.A. summarized that definition in paragraph 24 as follows:

> ... for there to be a series of transactions, each transaction in the series must be pre-ordained to produce a final result. Pre-ordination means that when the first transaction of the series is implemented, all essential features of the subsequent transaction or transactions are determined by persons who have the firm intention and ability to implement them. That is, there must be no practical likelihood that the subsequent transaction or transactions will not take place.

(ii) Related Transaction

246 The majority of the Federal Court of Appeal determined that this common law definition was broadened by subsection 248(10), which provides that for the purposes of the Act, where there is a reference to a series of transactions or events, the series shall be deemed to include any related transactions or events completed in contemplation of the series.

247 Rothstein J.A. described the effect of the broadened definition on the application of section 245 as follows in paragraph 36:

> ... Subsection 248(10) does not require that the related transaction be pre-ordained. Nor does it say when the related transaction must be completed. As long as the transaction has some connection with the common law series, it will, if it was completed in contemplation of the common law series, be included in the series by reason of the deeming effect of subsection 248(10).

(iii) Completed in Contemplation

248 Rothstein J.A. described the assessment of whether a related transaction is completed in contemplation of a common law series, again in paragraph 36, as follows:

> ... Whether the related transaction is completed in contemplation of the common law series requires an assessment of whether the parties to the transaction knew of the common law series, such that it could be said that they took it into account when deciding to complete the transaction. If so, the transaction can be said to be completed in contemplation of the common law series.

249 Accordingly, where the parties knew of the common law series and took that series into account when completing the related transaction that transaction will be considered part of the series.

250 The majority of the Federal Court of Appeal found that the first three transactions were "pre-ordained" and thus constituted a common law series. It was further concluded that Transaction 4, namely OSFC's acquisition of its STIL II partnership interest was related to the first three transactions and was completed in contemplation of that series. Therefore, the majority concluded at paragraph 39 that, based on the deeming effect of subsection 248(10), the first four transactions constituted a series of transactions.

251 The task in the present appeal is to determine whether the Appellants knew of the first four transactions and took that series into account when they completed Transactions 5 and 6.

252 Strangely enough, although the tax benefit to OSFC would have ultimately resulted from Transaction 6, neither Judge Bowie in OSFC (TCC), supra, nor the Federal Court of Appeal in OSFC (FCA), supra, made a definite finding as to whether Transactions 5 and 6 were also part of the series. The situation is the same in the present appeals, as all the Appellants would in the end have enjoyed the tax benefit resulting from Transaction 6.

253 However, Transactions 5 and 6 were commented on by the majority of the Federal Court of Appeal in the following terms at paragraph 11:

> The Appellant did not intend to retain its ninety-nine percent interest in the STIL II Partnership. In transactions that were pre-arranged before the closing of its

purchase of the STIL II Partnership interest, the appellant disposed of seventy-six percent of its STIL II Partnership interest. The transactions were as follows:

1. July 5, 1993 - Formation of SRMP Realty and Mortgage Partnership;
2. September 22, 1993 - Closing of sale of appellant's ninety-nine percent interest in STIL II Partnership to SRMP, with the appellant obtaining a twenty-four percent interest in SRMP.

254 From this description it probably can be inferred that the majority of the Federal Court of Appeal found that Transactions 5 and 6 had been arranged with full knowledge of the earlier transactions and that the existence of those earlier transactions was taken into account in completing Transactions 5 and 6.

255 In the present appeals, counsel for the Respondent submitted that the Appellants were aware of the earlier transactions and had taken them into account when entering into Transactions 5 and 6. On this point the Respondent referred to the SRMP Partnership Agreement dated July 5, 1993 (Exhibit 35, vol. 3) and to the Agreement of Purchase and Sale of the STIL II interest between OSFC and SRMP dated July 7, 1993 (Exhibit 40, vol. 3), as evidence of the Appellants' knowledge.

256 In addition, counsel for the Respondent submitted that there is clear evidence that the Appellants had been made aware of and become interested in participating in OSFC's acquisition of the 99% interest in the STIL II partnership. According to counsel, the SRMP partners from Thorsteinssons were involved in the syndication of OSFC's partnership interest in STIL II from at least the time of the letter of intent dated March 5, 1993. As evidence of this, he referred to the testimony of Mr. Bradeen before Judge Bowie in which Mr. Bradeen acknowledged that OSFC intended from the outset to syndicate its partnership interest in STIL II to, among others, a number of lawyers from Thorsteinssons. Counsel for the Respondent also referred to the testimony given in these proceedings by Mr. Kaulius, who acknowledged that OSFC intended to syndicate its partnership interest from the very beginning. I agree.

257 Thus, I find that Transactions 5 and 6 were completed in contemplation of Transactions 1 through 4, as the Appellants knew of the earlier series and took it into account when deciding to complete Transactions 5 and 6. By virtue of the deeming effect of subsection 248(10) of the Act, Transactions 1 through 6 therefore form a series of transactions for the purposes of section 245.

258 Another precondition to the application of the GAAR is that there must be an "avoidance transaction" as defined in subsection 245(3) of the Act.

259 In OSFC (FCA), supra, Rothstein J.A. summarized the assessment under section 245(3) as follows at paragraph 17:

Under subsection 245(3), to find that a transaction is an avoidance transaction,

> two tests must be satisfied. The first is a results test. The results test requires a determination of whether a transaction or series of transactions would, but for the GAAR, result in a tax benefit. The second is a purpose test. Here, the focus is on the primary purpose of the transaction, or the individual transactions that form the series, as the case may be. Only if a transaction or series of transactions would result in a tax benefit is it necessary to consider the primary purpose of the transaction or transactions.

260 Under the results test it must be determined that a tax benefit resulted from the transaction or series of transactions. Rothstein J.A. noted that, with regard to the determination of whether a transaction or series of transactions results in a tax benefit, it is not necessary that the person who obtained the tax benefit be the person who arranged the transactions. He wrote at paragraph 41:

> ... I see no words in subsection 245(3) that express or imply that the person who obtains the tax benefit must necessarily have been the person that undertook or arranged the transaction in question. I think this interpretation is consistent with the scheme of section 245 which does not, in any of its subsections, link the obtaining of a tax benefit to the person or persons undertaking or arranging the transactions. In particular, subsection 245(2) speaks of the tax consequences to a person without identifying who the person is, other than that the tax benefit to that person would have resulted, directly or indirectly, from an avoidance transaction or from a series of transactions that includes the avoidance transaction. Simply put, subsection 245(3) does not say that the person who undertakes or arranges the transaction must be the one who obtains the tax benefit.

261 Rothstein J.A. then discussed the second - primary purpose - test, noting that it is an objective test that is to be applied with respect to the time at which the transactions in question were undertaken, the focus being on the facts and circumstances of each case and not on statements of intention. He stated at paragraphs 46, 48 and 58:

> The words "may reasonably be considered to have been undertaken or arranged" in subsection 245(3) indicate that the primary purpose test is an objective one. Therefore the focus will be on the relevant facts and circumstances and not on statements of intention. It is also apparent that the primary purpose is to be determined at the time the transactions in question were undertaken. It is not a hindsight assessment, taking into account facts and circumstances that took place after the transactions were undertaken.
>
> ...

> ... it is normally necessary to analyse the primary purpose of all the relevant transactions. The reason is that the analysis under subsection 245(4) involves assessing whether an avoidance transaction would result in a misuse or an abuse of provisions of the Act. It may be that some avoidance transactions in a series would not result in a misuse or abuse. Therefore, it is necessary to review all the relevant transactions to determine which ones are avoidance transactions, in order for the analysis under subsection 245(4) to be complete....
>
> ...
>
> ... I would stress that the primary purpose of a transaction will be determined on the facts of each case. In particular, a comparison of the amount of the estimated tax benefit to the estimated business earnings may not be determinative, especially where the estimates of each are close. Further, the nature of the business aspect of the transaction must be carefully considered. The business purpose being primary cannot be ruled out simply because the tax benefit is significant.

262 In OSFC (FCA), supra, the majority of the Federal Court of Appeal determined that Transactions 1 to 4 were avoidance transactions. Three questions thus arise here. First, does this Court have to determine again whether Transactions 1 to 4 are avoidance transactions? Second, is it sufficient to determine that Transactions 5 and 6 are part of the series of transactions that included either "an avoidance transaction" or "avoidance transactions"? Third, is it necessary to determine as well whether Transactions 5 and 6 are also both avoidance transactions?

263 The majority of the Federal Court of Appeal found it necessary to determine whether or not Transaction 4 was also an avoidance transaction, stating at paragraph 48:

> In view of this conclusion respecting the Standard transactions, it appears the Tax Court Judge did not consider it necessary to determine whether the appellant's acquisition of its STIL II Partnership interest was also an avoidance transaction. However, in my respectful opinion, it is normally necessary to analyse the primary purpose of all the relevant transactions. The reason is that the analysis under subsection 245(4) involves assessing whether an avoidance transaction would result in a misuse or an abuse of provisions of the Act. It may be that some avoidance transactions in a series would not result in a misuse or abuse. Therefore, it is necessary to review all the relevant transactions to determine which ones are avoidance transactions, in order for the analysis under subsection 245(4) to be complete. Accordingly, an assessment of whether the appellant's acquisition of its STIL II Partnership interest was an avoidance transaction must

be undertaken.

264 After applying the two-part test the majority determined that Transaction 4 was an avoidance transaction. However, Létourneau J.A., speaking for himself, agreed with Judge Bowie of this Court that, as Transaction 4 was part of a series of transactions, it was not necessary to determine whether or not it too was an avoidance transaction.

265 In my view, it would be nonsensical and contrary to the wording of subsection 245(2) and paragraph 245(3)(b) of the Act to interpret the majority's statement as imposing a requirement that each of the transactions be an avoidance transaction. The use of the word "series" would have no meaning if such an interpretation were adopted. I would tend to agree with counsel for the Respondent that the majority engaged in an analysis of whether Transaction 4 was an avoidance transaction probably for the sake of convenience so that it could express an opinion as to whether any of the transactions in the series resulted in a misuse or an abuse of the Act and not because that analysis was necessary under subsection 245(3).

266 There is obviously more than one way to analyse transactions that are part of a series. For example, the six transactions in issue could be grouped in twos. Transactions 1 and 2 could be viewed as preparatory in nature. Transactions 3 and 4 would be considered the core transactions in the sense that they are the very transactions that effected the transfer of the tax losses from STC to an arm's length party. From this perspective, it is Transactions 3 and 4 that would be the focus of the misuse and abuse analysis under subsection 245(4) of the Act. They would in fact be considered the main avoidance transactions. Transactions 5 and 6 would be viewed as permitting the end result, that is, the sharing among all the SRMP partners, including OSFC and all the Appellants in the present case of the tax benefit already secured by OSFC.

267 It is interesting to note that more recently, in Her Majesty The Queen v. Canadian Pacific Limited (hereinafter Canadian Pacific (FCA)), 2001 FCA 398, a unanimous Federal Court of Appeal was of the view that section 245(3) only requires that one of the transactions in the series be found to be an avoidance transaction. Sexton J.A. stated at paragraph 17:

> If a transaction or series of transactions creates a tax benefit and the primary purpose of any one of those transactions is to obtain a tax benefit, then there was an avoidance transaction. Once it has been established that an avoidance transaction occurred, subsection 245(4) must be considered.

268 It has been the Appellants' contention from the beginning that each transaction in the series must be found to be an avoidance transaction. Further, the Appellants contend that the Federal Court of Appeal did not have before it the extensive evidence of the substantial commercial nature of the core transactions and the Appellants' participation in those transactions. In view of the fact that lengthy submissions were made by each party on the issue of whether Transactions 5 and 6 were avoidance transactions, I will conduct an analysis based on the evidence before this Court. However, having found that Transactions 5 and 6 constitute part of the series, I would again note

that such analysis is not necessary in order for section 245 to apply. In my opinion, the inquiry into the Appellants' primary purpose will probably prove later to have been unnecessary.

269 Judge Bowie concluded in OSFC (TCC), supra, that the first three transactions were avoidance transactions. He explained his determination as follows at paragraph 40:

> ... This requires that I examine the subjective evidence of Mr. Bradeen against the more objective backdrop of the documents from the liquidator's files, and common sense.

270 The Federal Court of Appeal accepted Judge Bowie's finding that the first three transactions were avoidance transactions. The majority of the Federal Court of Appeal went on to determine that Transaction 4 was also an avoidance transaction. In so determining, the majority appears to have relied on the evidence of Mr. Bradeen and the documents admitted into evidence during the trial in OSFC (TCC), supra.

271 During the course of the proceedings herein the transcripts of Mr. Bradeen's testimony in OSFC (TCC), were filed by consent of the parties and constituted his evidence for the purpose of the present appeals. As well, many of the documents that were filed in OSFC (TCC), were also filed as evidence in the present proceedings. Moreover, two binders containing the documentary evidence referred to during Mr. Bradeen's testimony in OSFC (TCC) were tendered separately. Having reviewed this evidence and quite apart from the decisions of Judge Bowie in OSFC (TCC), and of the majority as well as the minority of the Federal Court of Appeal in OSFC (FCA), supra, I simply cannot reach a different conclusion in the present appeals. I do not find that any of the evidence submitted by the Appellants in the case at bar would justify any other conclusion. The peculiar and unusual manner in which E & Y proceeded in packaging the mortgages comprised in the Portfolio and in which it effected the transfer from STC to STIL II by entering into the first three transactions leaves no doubt about its purpose. It would be vain to attempt to find in the evidence presented any serious indication of a primary business purpose to those transactions. It was never demonstrated how the commercial objectives would be better achieved through that scheme. Moreover, it is difficult to accept that a partnership would prove to be a superior vehicle for carrying on the real estate business for STC when 99 % of the interest it acquired in that partnership was meant from the outset to be disposed of to an arm's length party as soon as possible after the period of 30 days prescribed in subsection 18(13) of the Act. The 1% interest retained by 1004568 can only be considered to have been marginal from STC's standpoint. In my opinion, the primary purpose was, to use the expression employed by both Judge Bowie in OSFC (TCC), supra, and by Létourneau J.A. in OSFC (FCA), supra, to make STC's tax losses, which would have been useless otherwise, "a marketable commodity" for which it could obtain some additional money. To get $5 million for more than $52 million in losses that would otherwise be worthless was the objective pursued from the outset. Although Mr. Bradeen said otherwise, there is ample evidence that the deal was presented by E & Y as an indivisible package comprising the Portfolio and the tax attributes. It is clear that E & Y had proceeded differently in seven distinct transactions out of nine involving

over 4000 mortgages. Why was STIL II, and for that matter STIL I, created, if not primarily for the purpose of selling the tax losses? There is little doubt that all the commercial objectives could have been attained by other means. Now, whether or not Houlden J. was made fully aware of the tax implications of the first three transactions and the subsequent sale of STC's partnership interest in STIL II to OSFC makes no difference. After all, they were perfectly legal and enforceable transactions. However, one will notice in examining in sequence Draft 3 of the Real Estate Portfolio Transaction Term Sheet dated July 24, 1992 (Exhibit 77, vol. 11), which was never given to Houlden J., Liquidator's Report No. 13 (Exhibit 1, vol. I) and finally Liquidator's Report No. 22 (Exhibit 9, vol. 1), which were given to Houlden J., that the tax aspect of the transactions is rendered less and less evident.

272 On examination, OSFC's transaction (Transaction 4) does not warrant a different conclusion as to its primary purpose. When comparisons are made, things should be stated as they really are. A dollar is a dollar and 52 million dollars in losses offset 52 million dollars in profits. One would thus have to look at the potential return on a dollar invested in the Portfolio versus a dollar invested in purchasing someone else's losses. The return would vary depending on the structure of the investment, the percentage of borrowed money used to make the investment, the interest rate and the leverage effect. Next, additional tax considerations - such as the applicable tax rates, interest deductibility and whether or not the tax savings are permanent or represent merely a deferral, and if so, for how many years - would come into play. Estimates of expected returns from the real estate portfolio could vary widely depending on the different cash flow and proceeds hypotheses used, whereas the tax losses were a fixed amount of more than $52 million and would not vary. At the end of the day, one thing remains clear: the basic, hard numbers. If, as most of the evidence reveals, the total net potential realizable value of the Portfolio was $37.8 million and the guaranteed purchase price was $17.5 million, the potential profit from the proceeds was $20.3 million. The proceeds-sharing structure would allow less than $3.4 million to go to OSFC and its future partners in SRMP as profit, as the rest would go to STC and 1004568. It is true that most of the net operating income from the properties comprised in the Portfolio would go to OSFC as payment of its substantial fees for managing the properties. This could represent an additional amount of something in the order of between $1 and $2 million for OSFC, plus the $850,000 obtained on syndication. But, as the evidence shows, the $37.8 million in proceeds was uncertain and speculative even if that target was thought to be attainable through the expenditure of a lot of time and energy on managing the properties and, as was said, on sprucing them up. However, the "purchase price" for the $52-odd million of losses was a mere $5 million, or less than 10[cents] for each dollar of potentially usable tax losses. The payment of that $5 million to STC was moreover contingent on the availability of the losses for tax purposes. And no time or energy was involved; all that was required was that it be accepted by the tax authorities. Otherwise, the "purchase price" for the tax losses would simply be nil. To put it bluntly, the tax losses were ten times the maximum profit expected from the real estate. I simply do not believe that an investor would not have figured what the real numbers were on each side of the equation. To be sure, the real estate deal had to make sense and the risk had to be minimized, as Mr. Kaulius said. The sheer magnitude of the tax reward and its cost compared with the potential profit from the real estate would have made it

attractive to anyone who specialized in the field and who was knowledgeable, skilled and willing to take the risks. However, those risks could best be minimized by sharing them with others. On that aspect, there is clear evidence from both Mr. Kaulius and Mr. Robertson that OSFC could not have utilized the $52 million in losses and that the decision to syndicate its interest in STIL II was made at the very outset.

273 With regard to Transactions 5 and 6, as stated above, their effect was to spread the STC losses to arm's length parties. According to the majority of the Federal Court of Appeal in OSFC (FCA), supra, the first step in determining whether a transaction or series of transactions constitutes an avoidance transaction is the results test requiring the court to determine whether the transactions or series of transactions would result in a tax benefit but for the application of the GAAR. Here the formation of the SRMP Partnership and the purchase of 76% of OSFC's 99% interest in STIL II effected the delivery of what would have have been a tax benefit to the Appellants but for the application of the GAAR. Transactions 5 and 6 would accordingly result in a tax benefit but for the application of section 245 of the Act.

274 It is worth noting that according to the Federal Court of Appeal in OSFC (FCA), supra, it is not necessary that the person who obtained the benefit be the person who arranged the transactions. So, regardless of who arranged and participated in any of the six transactions, the Appellants' deduction of the allocated losses may still be denied under the GAAR.

275 The remaining question with regard to establishing whether Transactions 5 and 6 were avoidance transactions is what the primary purpose of those transactions was.

276 I would remark at the outset that it is somewhat difficult to understand why British Columbia real estate developers on the one hand and a group of lawyers, a few with experience in real estate and all residing in British Columbia, on the other would be interested in investing in third-rate properties that were all located in unfamiliar real estate markets in Ontario, Manitoba and Saskatchewan. This might appear even more surprising at a time when the real estate market was depressed and no one could predict with any accuracy when it would recover. Although developers like Mr. Verlaan and Mr. De Cotiis might have been interested in some specific properties, globally the properties underlying the Portfolio were, according to the descriptions provided by Mr. Robertson and Mr. Kaulius, far from impressive. Here again, in my opinion, the answer lies in the numbers, which speak for themselves.

277 In the supplementary submissions by counsel for the Respondent, it was emphasized that the existence of a significant disparity between the tax benefit and the commercial benefit suggests that the primary purpose was to obtain a tax benefit. Reference was made to the Federal Court of Appeal's decision in OSFC (FCA), supra, in which Rothstein J.A., for the majority, stated at paragraph 51:

> he significant disparity between the potential tax benefit to the appellant of about $52 million and expected returns from the operation and disposition of the STIL

> II portfolio strongly suggests that the appellant's acquisition of Standard's 99% interest in the STIL II Partnership was not undertaken primarily for bona fide purposes other than to obtain the tax benefit.

278 Further, counsel for the Respondent rejected the Appellants' contention that the Federal Court of Appeal did not have before it sufficient evidence regarding the commercial aspect of the transactions. Counsel for the Respondent noted that the documentary evidence before the Federal Court of Appeal in OSFC (FCA), supra, was essentially the same as that now before this Court and that the only additional evidence concerned the Appellants' subjective intention, which is not relevant in determining the primary purpose under subsection 245(3).

279 It is worth noting that the majority of the Federal Court of Appeal also commented on the primary purpose of Transactions 5 and 6. Rothstein J.A. stated at paragraphs 53 and 54:

> ... There is no indication the SRMP partners were involved in, or knowledgeable about, the rehabilitation and disposition of distressed mortgages. On the other hand, they would receive 76% of the tax benefit accruing to SRMP. I think it is a fair inference that the SRMP partners, other than the appellant, did not invest in SRMP to participate in the rehabilitation and sale of distressed mortgage properties. Rather, I think it is apparent from the documentation that their interest was to obtain their share of the tax benefit, that is, some $40 million in potential deductions.
>
> The appellant made no secret of the close relationship between its acquisition of the STIL II Partnership interest and the SRMP transaction. Without the availability of the tax benefit to the SRMP partners, the SRMP transaction would not have occurred. I think therefore, notwithstanding its business purpose in acquiring the Standard STIL II Partnership interest, that was not the primary purpose for which the transaction was undertaken. Its primary purpose was to obtain a tax benefit for itself and to assign to its SRMP partners that portion of the tax benefit it did not require for its own purposes, in consideration for a substantial cash payment and other consideration from those partners.

280 Clearly, in the estimation of the majority of the Federal Court of Appeal the primary purpose of Transactions 5 and 6 was to obtain a tax benefit.

281 From my perspective, the evidence presented by the Appellants in these proceedings, particularly the lengthy description of each property in the Portfolio and the evidence regarding the difficult negotiations with E & Y, the extensive due diligence work done by OSFC and the management of the properties, conveys a first impression that the commercial aspect of the transactions was considerably more important, in both absolute and relative terms, than it was in reality.

282 While the payment for the losses was contingent, the fact remains that the tax benefit sought would not be obtained independently of the commercial component of the transaction. Indeed, substantial amounts had to be paid for the Portfolio and the underlying assets, which were far from first-rate properties. The risks involved were significant and they had a price. All of which is to say that the Appellants have certainly succeeded in demonstrating that their primary concern was the real estate aspect of the transactions. It is true that, because of the risks involved, considerable time and effort had to be spent on minimizing those risks during the negotiation process with E & Y and thereafter. There is more than ample evidence in this respect. In my view, all this was done because, at the end of the day, if the tax losses were not accepted by the authorities, the Appellants would be left only with the real estate, on which they did not want to lose anything. However, primary concern does not equate with primary purpose.

283 Moreover, the concern over the commercial aspect of the deal during the negotiation process between STC and OSFC might also have been due to a concern about the possible denial of the tax benefit through the invocation of the GAAR. I would simply note here that, although it was put forward as a last-minute negotiation tactic, this point is emphasized by the letter from Peter Thomas to Mr. Drake of E & Y dated May 31, 1993 (Exhibit 98, vol. VII), which proposed an amended sharing formula for the proceeds so as to increase OSFC's share of profits from the mortgages in order to satisfy the GAAR and meet the expectation of profits.

284 As stated by the majority of the Federal Court of Appeal, the assessment of the primary purpose of a transaction must be made with reference to the facts and circumstances and not to statements of intention. As said before, the evidence indicates that the target realization value of $37.8 million was uncertain and speculative. Given the prevailing real estate market and the quality of the properties it would have required time and considerable effort to attain that goal. Further, given the Appellants' pressing need to eliminate the $14.5 million promissory note, it is clear that the decision to sell some of the properties could not have waited for the real estate market to make a recovery.

285 Regardless, even if one merely weighs the risk inherent in the investment against the target realization, it is more than doubtful from a commercial perspective that the investment in the real estate Portfolio would have been made in the absence of immediate access to the substantial losses of STC.

286 In my opinion, the investment in the real estate Portfolio was secondary to obtaining of the tax benefit. In fact, the returns that the Appellants could reasonably expect to receive were far less than those anticipated by OSFC. Only when the Portfolio had yielded between $26.7 million and $32.1 million would the Appellants begin to earn any profit from the sale of the Portfolio.

287 It is not disputed that tax losses in the amount of $1,047,690 were allocated to each Class A unit. Assuming a tax rate of 45%, this would have provided $471,460 in tax savings. If one were to subtract the additional payment of $125,700 from the losses, the net immediate tax savings per

Class A unit would have amounted to $345,760.

288 At $32.1 million in proceeds from the Portfolio, each Class A unit would receive less than $10,000 in profit. At that level the tax savings would be more than 34 times the before-tax business profit from the disposition of the Portfolio.

289 As a rough approximation, the after-tax business profit would be $5,500 using the same 45% tax rate. At that point, the tax savings would be more than 62 times the after-tax business profit. It is not until the proceeds exceed the $32.1 million mark that any real profits accrue to the Class A unitholders.

290 Even if one accepts Mr. Gregory's calculation of a pre-tax return of $67,572 - which includes the net cash flow and net proceeds from the Portfolio on a realization value of $37.8 million - per Class A unit (Exhibit A-18), the potential tax benefit would still have been more than 5 times the before-tax business profit. Using the same tax rate of 45%, the approximate after-tax business profit would be less than $38,000 and the tax savings would still be more than 9 times the after-tax business profit.

291 With respect to the Class B unitholders, the tax benefit is even greater. Although, Mr. Kaulius said that the Class B unitholders did not have to pay for the tax losses, their eventual aggregate contribution to the additional payment was fixed at only $600,500, being the difference between the aggregate contribution of $4,399,500 from the Class A unitholders ($125,700 per unit) and the total additional payment of $5,000,000. The Class B unitholders had no obligation to present a $60,000 letter of credit and to provide $125,700 as security as the Class A unitholders had to do (Exhibit 35, vol. III, article 3.02, and Diagram 5: Capitalization of SRMP, July 9, 1993). Thus, each of the 15 Class B units would eventually contribute approximately $40,033 and receive tax losses of $1,047,690 if those losses were in the end available. Assuming a tax rate of 45% and subtracting the $40,033 contribution to the additional payment, the net immediate tax savings per Class B unit would be over $431,000.

292 As with the Class A unitholders, at $32.1 million in proceeds from the Portfolio, each Class B unit would receive less than $10,000 in profit. Assuming a tax rate of 45%, the after-tax business profit from the Portfolio would be less than $5,500. At this level the tax savings would be more than 78 times the after-tax business profit from the disposition of the Portfolio. If one assumes proceeds of $37.8 million, the total profit per Class B unit would be $67,572, the same as for each Class A unit, as per Mr. Gregory's calculations (Exhibit A-18). Using the same 45% tax rate, the after-tax return would again be less than $38,000 and the tax benefit would be more than 11 times higher.

293 Mr. Robertson's 1998 calculation of an annual cash-on-cash return of 32.82% on the Class A unitholders' initial cash investment of $3,850,000 ($110,000 per Class A unit) is nothing more than hindsight and is not to be taken as evidence of the Appellants' real expectations in 1993. Moreover, the calculation is partly based on an estimate of the value of the remaining properties and not just on actual proceeds received. The same holds true for the statement that by the year 2000 $30 million

worth of properties had been sold and that the value of the remaining properties was $8 million. For one thing, hindsight calculations are not evidence of the real expectations the Appellants had back in 1993. However, they might serve as a further indication that the short-term target realization dates shown in Exhibit A-16 were not meant to be strictly adhered to - at least for some properties - in order that the business of the partnership might be perpetuated. That this was the intention is demonstrated by ample documentary evidence referred to earlier.

294 As I have already said, I do not accept the Appellants' assertion that the potential tax benefit was merely a deferral. Hence, I do not accept Mr. Cook's calculation, on that basis, of a tax benefit of only $126,396 in Exhibit A-21. There is more than sufficient documentary evidence referred to in paragraphs 118 through 121 of these Reasons to indicate that the intent was definitely not to cease to operate the partnership in the near future.

295 It seems obvious from the above calculations that the primary purpose of Transactions 5 and 6 was to obtain the tax benefit. However, there is another point that warrants comment. There is evidence that most of the Appellants did not bother to calculate or pay any attention to expected rates of return from the Portfolio. This can be interpreted as a further indication that the primary purpose was to obtain the tax benefit. In conclusion, I find that Transactions 5 and 6 were avoidance transactions.

296 One final point also deserves comment. The Appellants submitted during these proceedings that where the tax aspect of a transaction is contingent, the tax benefit cannot not be the primary purpose. As stated by the majority of the Federal Court of Appeal in OSFC (FCA), supra, simply making the tax aspect contingent will not result in a characterization of the primary purpose of the transaction as being other than to obtain a tax benefit.

(c) Avoidance transaction which results in a misuse of the provisions of the Act or an abuse of the provisions of the Act read as a whole (subsection 245(4))

297 Where it is determined that there is a tax benefit resulting from an avoidance transaction or a series of transactions that include an avoidance transaction, section 245 will apply, unless the avoidance transaction does not result in a misuse of a specific provision of the Act or an abuse of the Act read as a whole. Subsection 245(4) of the Act is a relieving provision that will prevent the application of section 245 of the Act where it can be shown that the impugned transaction is not a misuse of a particular provision of the Act or an abuse of the Act read as a whole.

298 In OSFC (FCA), supra, Rothstein J.A. outlined the application of subsection 245(4) as follows in paragraph 59:

> I turn to subsection 245(4). The first question is whether it may reasonably be considered that any of the avoidance transactions would result in a misuse of a specific provision or provisions of the Income Tax Act. If so, the tax benefit

> resulting from the series will be denied. If not, it is then necessary to determine whether it may reasonably be considered that any of the avoidance transactions would result in an abuse, having regard to the provisions of the Act, other than section 245, read as a whole. Upon a finding of abuse, the tax benefit resulting from the series will be denied.

299 According to Rothstein J.A., determining whether or not a transaction results in a misuse or an abuse is a two-step process. At paragraph 67, he stated:

> Determining whether there has been misuse or abuse is a two-stage analytical process. The first stage involves identifying the relevant policy of the provisions or the Act as a whole. The second is the assessment of the facts to determine whether the avoidance transaction constituted a misuse or abuse having regard to the identified policy.

300 The first step involves an assessment of the policy of the specific provisions and of the Act as a whole. Rothstein J.A. described the assessment of the relevant policy as follows in paragraphs 68 to 70:

> Ascertaining the relevant policy is a question of interpretation. As such it is ultimately the duty of the Court to make this determination. There is no onus to be satisfied by either party at this stage of the analysis. However, from a practical perspective, the Minister should do more than simply recite the words of subsection 245(4), and allege that there has been misuse or abuse. The Minister should set out the policy with reference to the provisions of the Act or extrinsic aids upon which he relies. Otherwise he places the taxpayer and the Court in the difficult position of trying to guess the relevant policy at issue. Trying to ascertain the policy of a specific provision or of an Act as a whole, in the case of an Act as complex as the Income Tax Act, is a difficult exercise, particularly when the transaction in question conforms to the letter of the Act. Therefore, the Court requires the assistance of the parties to enable it to reach a correct conclusion. Nonetheless, with or without that assistance, the Court must attempt to determine the relevant policy....
>
> It is also necessary to bear in mind the context in which the misuse and abuse analysis is conducted. The avoidance transaction has complied with the letter of the applicable provisions of the Act. Nonetheless, the tax benefit will be denied if there has been a misuse or abuse. This is not an exercise of trying to divine Parliament's intention by using a purposive analysis where the words used in a statute are ambiguous. Rather, it is an invoking of a policy to override the words Parliament has used. I think, therefore, that to deny a tax benefit where there has

> been strict compliance with the Act, on the grounds that the avoidance transaction constitutes a misuse or abuse, requires that the relevant policy be clear and unambiguous. The Court will proceed cautiously in carrying out the unusual duty imposed upon it under subsection 245(4). The Court must be confident that although the words used by Parliament allow the avoidance transaction, the policy of relevant provisions or the Act as a whole is sufficiently clear that the Court may safely conclude that the use made of the provision or provisions by the taxpayer constituted a misuse or abuse.
>
> In answer to the argument that such an approach will make the GAAR difficult to apply, I would say that where the policy is clear, it will not be difficult to apply. Where the policy is ambiguous, it should be difficult to apply. This is because subsection 245(4) cannot be viewed as an abdication by Parliament of its role as lawmaker in favour of the subjective judgment of the Court or particular judges. In enacting subsection 245(4), Parliament has placed the duty on the Court to ascertain Parliament's policy, as the basis for denying a tax benefit from a transaction that otherwise would meet the requirements of the statute. Where Parliament has not been clear and unambiguous as to its intended policy, the Court cannot make a finding of misuse or abuse, and compliance with the statute must govern.

301 Once a policy has been identified the second step requires an assessment of the facts to determine whether the avoidance transaction constituted a misuse of specific provisions or an abuse of the Act as a whole having regard to the identified policy. Rothstein J.A. noted that in carrying out the second step of the subsection 245(4) analysis the onus is on the taxpayer to prove that the avoidance transaction was not a misuse of a specific provision or an abuse of the Act as a whole. In this regard Rothstein J.A. stated at paragraph 68:

> Of course, at the next stage, once the policy is determined, the onus remains on the taxpayer to prove the necessary facts to refute the Minister's assumptions of fact that the avoidance transaction in question results in a misuse or an abuse.

302 In OSFC (TCC), supra, Judge Bowie stated the policy of subsection 18(13) of the Act in the following terms at paragraph 54:

> ... Subsection 18(13) was enacted as a stop-loss provision, the object of which is to prevent taxpayers who are in the money-lending business from artificially realizing losses on assets which have declined in market value by transferring them to a person with whom they do not deal at arm's length, while maintaining control of the assets through the non-arm's length nature of their relationship with the transferee. The use of that provision to effect the transfer of unrealized losses

> from a taxpayer who has no income against which to offset those losses to a taxpayer which does have such income is clearly a misuse.

303 In OSFC (FCA), supra, Létourneau J.A., speaking for himself, agreed, stating at paragraph 134:

> ... Subsection 18(13) was not intended to be used by a corporation to increase the adjusted cost base of a related corporation or partnership for the purpose of selling its losses to an arm['s] length corporation.

304 Based on the above-stated policy, my assessment would also have been that subsection 18(13) of the Act has been misused. I certainly do not agree with the assertion by counsel for the Appellants that subsection 18(13) has been used in exactly the way intended by Parliament or that it is an enabling or permissive provision that can be used to arrive at the result sought here, for that would mean that Parliament was expressly permitting the transfer of losses between arm's length taxpayers. Subsection 18(13) was used to effect the transfer of STC's losses to arm's length parties that had nothing to do with STC's money-lending business. Further, in my view, that is a misuse of the mechanics of the provision - which was enacted to delay the recognition of a superficial loss - because the effect of the six transactions is to transfer assets to an arm's length party at the transferor's cost when that provision was actually intended to cover the transfer of assets to non-arm's-length parties at the transferor's cost.

305 However, in OSFC (FCA), supra, the majority of the Federal Court of Appeal concluded at paragraph 81 that "none of the avoidance transactions resulted, directly or indirectly, in a misuse of subsection 18(13)."

306 Counsel for the Respondent stated that, although the findings of Létourneau J.A - who was in the minority - in OSFC (FCA) with regard to the policy of subsection 18(13) were to be preferred, the findings of the majority in that case were binding on this Court, and that, for the purposes of the present appeals, the Respondent was adopting and relying on the findings of the majority. Accordingly, I do not think it would serve any useful purpose to go into detail on this question.

307 However, it is worth noting that counsel for the Appellants submitted that this Court is not bound by the findings of the Federal Court of Appeal with regard to assessing whether the transactions constituted a misuse of subsection 18(13) or an abuse of the Act as a whole. Counsel contended that the findings of the Federal Court of Appeal cannot logically co-exist with subsequent decisions of the Supreme Court of Canada in Ludco, supra, and Singleton, supra. Consequently, I would be permitted to fully examine the issue at first instance. However, I take counsel's submission on this point to mean that this Court should reject both the Federal Court of Appeal's finding in OSFC (FCA), supra, with regard to the policy of the Act as a whole and the unanimous conclusion that there was an abuse of that policy.

308 I do not agree that the Supreme Court of Canada's recent jurisprudence displaces the findings

of the majority of the Federal Court of Appeal in OSFC (FCA) or relieves this Court from adopting the stated policy of the majority of the Federal Court of Appeal. The Supreme Court of Canada did not consider the application of the GAAR in either Ludco or Singleton. There is no doubt that the Supreme Court of Canada will have the opportunity in the future to provide guidance on the interpretation of section 245. However, until that time, this Court should resist the Appellants' enticement to attempt to speak for the Supreme Court of Canada on issues that have yet to be presented to that Court. Whether or how its decisions in Ludco and Singleton will influence that Court's interpretation of this very distinct and exceptional statutory rule is not for me to prophesize.

309 Both the majority and the minority decisions of the Federal Court of Appeal in OSFC (FCA), supra, held that OSFC's acquisition of STC's losses through the acquisition of the latter corporation's interest in STIL II constituted an abuse of the Act as a whole. After an extensive review of how losses are treated under the Act, Rothstein J.A., speaking for the majority, concluded at paragraph 98:

> I have no difficulty concluding that the general policy of the Income Tax Act is against the trading of non-capital losses by corporations, subject to specific limited circumstances.

310 On the issue of whether the transactions constituted an abuse of the relevant policy with respect to partnerships, the majority of the Federal Court of Appeal concluded that at the relevant time there was no policy in the Act against the transfer of losses between partners. Therefore, the transfer of the losses from the partnership to the partners did not constitute an abuse of the Act as a whole. However, Rothstein J.A. felt that the avoidance transactions had to be viewed in a wider context. At paragraph 105, he states:

> However, to view the avoidance transactions here without taking account of the wider context would be to ignore relevant facts and in particular, the result of the series of transactions. What the avoidance transactions accomplished was the transfer of the loss from one corporation to another through the mechanism of subsection 18(13) and the Partnership Rules. Having regard to the GAAR, these transactions violated the general policy of the Act against the transfer of losses from one corporation to another.

311 He further stated at paragraphs 111 to 114:

> It is true, as the Tax Court Judge pointed out, that Standard's business included dealing with its mortgages and in cases of default, dealing with the mortgaged properties as well. However, the loss which was acquired by the appellant from Standard did not arise from Standard's dealing with distressed properties. It arose from the lending of money on properties whose value fell dramatically in the real estate downturn of the late 1980s and early 1990s.

> The appellant did not acquire its STIL II Partnership interest to rehabilitate an unprofitable mortgage-lending business. Standard was in liquidation. The appellant's sole business purpose (besides the tax benefit purpose) was to acquire its STIL II Partnership interest on terms which would enable it to profit from the management and disposition of distressed properties.
>
> The business of lending money on the security of mortgages may occasionally include disposing of distressed properties. But the business of disposing of distressed properties does not include the business of lending money on mortgages. In these circumstances, I do not think the policy of the Act is such as to allow losses incurred in the business of lending money on mortgages to be used to offset profits in the business of rehabilitating distressed real properties.
>
> Therefore, I am not satisfied that this exception to the general rule against the transfer of losses from one corporation to another would be applicable on policy grounds in this case.

312 Counsel for the Appellants submitted both at trial and in the Appellants' supplementary submissions that there is no general scheme in the Act prohibiting the transfer of losses; rather there is a series of specific restrictions which apply only in specific circumstances. Further, counsel argued that the conclusion that there is an abuse of the Act's corporate loss scheme, and yet no misuse of subsection 18(13), which forms a part of the corporate loss regime, and no abuse of the Act's partnership scheme constitute contradictory findings that cannot co-exist.

313 Counsel for the Respondent noted that the policy against loss trading between corporations that the majority of the Federal Court of Appeal found in the Act is a general policy that overrides specific provisions of the Act or the policy behind them, which would otherwise be applicable in a non-tax-avoidance context. Therefore, in his opinion, the submission of the Appellants with regard to an inconsistency in the findings of the majority of the Federal Court of Appeal has no merit. Further, in counsel's view, the alternative wording of subsection 245(4), where immunity from the application of the GAAR is only available if the transaction does not fall within either the misuse or the abuse tests, provides for instances where a transaction is not a misuse of a specific provision's policy yet is still an abuse of the underlying policy of the Act as a whole.

314 Firstly, as I have already indicated, my own view would be that there has been a misuse of subsection 18(13) of the Act. However, while I have some difficulty in accepting the Federal Court of Appeal's conclusion in the present case, I must concede that there is no inconsistency in finding that there is no misuse of the policy of a specific provision and in finding at the same time that there is an abuse of the Act read as a whole. The policy behind a specific provision, especially a very detailed or technical provision that may involve an arithmetic formula, might not be as clear as the

general policy that may be seen when one looks at the legislation from a global perspective. It is also true that the assessment of each is a separate issue, a fact that is supported by the alternative wording of subsection 245(4). Although the policy underlying a specific provision may be instructive for the purpose of determining the general policy of the Act as a whole on a given subject matter, it is not necessarily determinative.

315 Secondly, I find myself in agreement with the general policy articulated by the majority of the Federal Court of Appeal. The Act indeed contains a general policy against trading in non-capital losses by corporations, which policy is subject to some specific exceptions. The analysis by the Federal Court of Appeal need not be repeated here.

316 In the current appeals, I must assess whether the ultimate allocation of STC's losses to the SRMP partners constituted an abuse of the Act's policy against the trading of non-capital losses by corporations and, in a more general way, by any taxpayers. Obviously, if the losses originated in the SRMP Partnership or the STIL II Partnership then the Appellants' access to the losses through the purchasing of a partnership interest would not be an abuse of the policy against the trading of non-capital losses. However, in the present appeals, as in OSFC (TCC), supra, and OSFC (FCA), supra, the losses stem from STC, not the partnerships. What Transactions 1 through 6 accomplish is the transfer of one corporation's losses to other corporations and individuals. This is an abuse of the above-stated policy. The transfer of losses by one taxpayer to another is definitely not permitted under the Act except in the case of corporations, in very limited circumstances, pursuant to subsection 111(5). This was stated by Rothstein, J.A. at paragraph 87 in OSFC (FCA), supra, "[g]enerally, there is no provision for the sale of a loss to an arm's length purchaser as if it were inventory of the business", and by Létourneau J.A. at paragraph 135, as if it were a "marketable commodity" referring to what Judge Bowie had said in OSFC (TCC), supra, at paragraph 58. As a matter of fact, the losses claimed had nothing to do with SRMP's business of managing, through OSFC, the underlying properties of the Portfolio in order to maximize the income and the eventual proceeds on disposition. They were from the outset and throughout STC's losses from its money-lending operations, incurred and crystallized before the Appellants even contemplated entering into their transactions.

317 Further, I would note that, for the purpose of these appeals, I accept the Respondent's submission that the majority's conclusion that there is a general policy against the trading of losses between corporations is in fact wider, and that, as a matter of the Act's general policy, losses cannot be transferred from one taxpayer to another. This general policy is evident from the structure of the Act.

318 In OSFC (FCA), supra, Rothstein J.A. stated the following at paragraph 85:

> I agree with the respondent that under the Income Tax Act, every person has an independent status and is liable for tax on that person's taxable income. It would also appear that, as a general policy, losses cannot be transferred from one

> taxpayer to another. (See, for example, Hogg, Magee and Cook, supra, at page 406.)

319 In paragraphs 86 to 97, Rothstein J.A. undertook a closer examination of the rationale of the policy and of the limited exception in the case of corporations. I agree with his conclusions.

320 One further issue raised in the supplementary submissions of the Appellants warrants discussion. The Appellants submitted that the implication of the Federal Court of Appeal's decision is that the GAAR can be used to prohibit a taxpayer from structuring a commercial transaction by choosing among co-existing schemes in the Act. In counsel's view, this implication and approach is inconsistent with the Supreme Court of Canada's most recently articulated policy in the Shell, supra, Ludco, supra, and Singleton, supra, decisions. In support of this argument, counsel for the Appellants referred the Court to excerpts from those recent Supreme Court of Canada cases.

321 Hence, in Shell, supra, at paragraph 46, the Supreme Court stated that "... in the absence of a specific statutory bar to the contrary, taxpayers are entitled to structure their affairs in a manner that reduces the tax payable ...."

322 In Singleton, supra, at paragraph 28, referring to the above statement, the Court added that "[t]he fact that the structures may be complex arrangements does not remove the right to do so."

323 In Ludco, supra, at paragraph 38, the Court said:

> Furthermore, when interpreting the Income Tax Act courts must be mindful of their role as distinct from that of Parliament. In the absence of clear statutory language, judicial innovation is undesirable: Royal Bank of Canada v. Sparrow Electric Corp., [1997] 1 S.C.R. 411, at para. 112. Rather, the promulgation of new rules of tax law must be left to Parliament: Canderel Ltd. v. Canada, [1998] 1 S.C.R. 147, at para. 41. As McLachlin J. (now C.J.) recently explained in Shell Canada Ltd. v. Canada, [1999] 3 S.C.R. 622 at para. 43 .....

The Court further stated at paragraph 39:

> In addition, given that the Income Tax Act has many specific anti-avoidance provisions and rules, it follows that courts should not be quick to embellish the provisions of the Act in response to concerns about tax avoidance when it is open to Parliament to be precise and specific with respect to any mischief to be prevented: Neuman v. M.N.R., [1998] 1 S.C.R. 770, at para. 63, per Iacobucci J ....

324 Here again, I find myself in agreement with the Respondent: the Federal Court of Appeal's decision does not say that the GAAR can be used to prohibit a taxpayer from structuring

commercial transactions by choosing among co-existing schemes in the Act. Rather, all the GAAR does is deny a tax benefit where it is determined that the transactions contravene a clear policy of a provision or a policy of the Act read as a whole. Again, the Ludco, supra, and Singleton, supra, cases did not involve the GAAR and thus neither can be said to enlighten this Court as to the relevant interpretation of the GAAR. Moreover, while, as the Supreme Court of Canada said, judicial innovation is undesirable in the absence of clear statutory language subsection 245(4) clearly mandates an inquiry as to Parliament's policy. As Rothstein J.A. stated in OSFC (FCA), supra, at paragraph 70 of his reasons, which I reproduce again:

> In answer to the argument that such an approach will make the GAAR difficult to apply, I would say that where the policy is clear, it will not be difficult to apply. Where the policy is ambiguous, it should be difficult to apply. This is because subsection 245(4) cannot be viewed as an abdication by Parliament of its role as lawmaker in favour of the subjective judgment of the Court or particular judges. In enacting subsection 245(4), Parliament has placed the duty on the Court to ascertain Parliament's policy, as the basis for denying a tax benefit from a transaction that otherwise would meet the requirements of the statute. Where Parliament has not been clear and unambiguous as to its intended policy, the Court cannot make a finding of misuse or abuse, and compliance with the statute must govern.

V
CONSTITUTIONAL ISSUE

325 While it may follow from the foregoing that subsection 245(4) is capable of interpretation and therefore not vague, the discretion this provision provides requires further analysis, since the issue has been raised by the Appellants. What must now be determined is whether the discretion conferred by subsection 245(4) is such that the provision does not give sufficient guidance to satisfy the applicable constitutional requirements of both section 7 of the Charter and the rule of law.

(A) CONSTITUTIONAL PROVISIONS

326 The relevant constitutional provisions are the preamble and sections 1, 7 and 26 of the Charter as well as subsection 52(1) of the Constitution Act, 1982.

327 The Charter provisions read as follows:

> Whereas Canada is founded upon principles that recognize the supremacy of God and the rule of law:
>
> 1. The Canadian Charter of Rights and Freedoms guarantees the rights and

freedoms set out in it subject only to such reasonable limits prescribed by law as can be demonstrably justified in a free and democratic society.

7. Everyone has the right to life, liberty and security of the person and the right not to be deprived thereof except in accordance with the principles of fundamental justice.

26. The guarantee in this Charter of certain rights and freedoms shall not be construed as denying the existence of any other rights or freedoms that exist in Canada.

328 Subsection 52(1) of the Constitution Act, 1982 reads as follows:

> 52.(1) The Constitution of Canada is the supreme law of Canada, and any law that is inconsistent with the provisions of the Constitution is, to the extent of the inconsistency, of no force or effect.

(B) ARGUMENTS

1. Submissions on the Constitutional Challenge

329 As will be seen, counsel for the parties approached the constitutional issue from very different angles and were not necessarily responding to one another on specific points; this accordingly leaves me with little choice in the presentation of their submissions, which I will set out consecutively before getting to the analysis.

(a) Appellants

330 The Appellants are challenging the constitutionality of section 245 of the Act on the basis that it is impermissibly vague and thus contrary to section 7 of the Charter and/or the substantive requirements of the rule of law.

331 The Appellants' constitutional challenge begins with the assertion that section 245 of the Act contains a fundamental defect in its application. Counsel for the Appellants presented this argument in the following terms:

> Expressed in narrative terms, the Appellant submits that ITA s. 245 necessarily requires the Court to conduct a two-step analysis in any fact situation to which ITA s. 245 is said to apply. The first step is to apply the sanctioned methods of statutory interpretation applicable to a taxation statute to determine if the Act, without s. 245, otherwise sanctions the tax result claimed by the taxpayer. ITA s. 245 only applies where the transaction at issue "works". Only if it is found that the transaction would "work" for tax purposes can the transaction be found to be

> an "avoidance transaction" as defined, thereby requiring the court to go to the second step of determining whether there has been a misuse or abuse based on the same rules that have otherwise sanctioned the tax result. It is the contradiction of the first step by the second that creates constitutionally intolerable uncertainty within ITA s. 245.

332 Counsel for the Appellants submitted that in the first step, applying the accepted methods of statutory interpretation, the courts are required to follow the Supreme Court of Canada's prescription that if the words of a provision are clear and unambiguous, those words must be applied. According to counsel, inherent in this principle is the concept that Parliament speaks through the words of the statute, and where those words are clear the statutory interpretation exercise is at an end.

333 Counsel submitted that an analysis of the Supreme Court of Canada's approach to statutory interpretation reveals that the proper method is found in E.A. Driedger, Construction of Statutes, 2d ed. (Toronto: Butterworths, 1983) (hereinafter Driedger 2d) at page 87:

> Today there is only one principle or approach, namely, the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament.

334 Counsel referred to the following cases in support of the contention that the Supreme Court of Canada has unreservedly embraced the above-cited Driedger 2d approach to statutory interpretation: Stubart, supra, Antosko, supra, Friesen, supra, Alberta (Treasury Branches) v. M.N.R., [1996] 1 S.C.R. 963, Duha Printers, supra, Neuman, supra, Shell, supra, and 65302 British Columbia Ltd. v. Canada, [1999] 3 S.C.R. 804.

335 The Appellants explicitly reject the applicability of the subsequent approach, found in R. Sullivan, ed., Driedger on the Construction of Statutes, 3d ed. (Toronto: Butterworths, 1994) (hereinafater Driedger 3d), which requires that all relevant and admissible indicators of legislative meaning be examined. Counsel submitted that the Driedger 3d approach is not in keeping with the law, as it destroys legal certainty by requiring a citizen to search through the legislative process to determine whether there is an unexpressed Parliamentary intention even where the words are clear and unambiguous.

336 Counsel submitted that if in the first step it is determined that the transaction works, that it complies with the Act, then according to the Driedger 2d approach the statutory interpretation exercise would be at an end. According to counsel, where Parliament's intent is expressed in clear and unambiguous words that permit a tax benefit because a transaction complies with the Act in the first step, it is illogical to then find in the second step, a misuse or abuse on the basis of a violation of the object and spirit of the provision. The misuse or abuse test in subsection 245(4) thus results in a "judicial smell test" which is contrary to section 7 of the Charter and the rule of law.

(i) Legislative History of Section 245 of the Act

337 Counsel for the Appellants contended that in determining whether a particular provision is constitutional or not it is appropriate to consider its legislative history. On this point, the argument advanced is that the legislative history reveals a fundamental inconsistency among the intent of the drafters of section 245, the rationale advanced by the defenders of the legislation, the statement of the government witnesses before the House of Commons committees and the words that were actually used in the final version of the provision.

338 The first draft of the GAAR was issued in Tax Reform 1987, Income Tax Reform by the Honourable Michael H. Wilson, Minister of Finance, on June 18, 1987. The draft legislation then read in part as follows, at pages 143 and 144:

> General Anti-Avoidance Provision
>
> "245.(1) Notwithstanding any other provision of this Act, where a transaction is an avoidance transaction, the income, taxable income, tax payable or other amount payable of or refundable to any person under this Act shall be determined as is reasonable in the circumstances ignoring the transaction.
> Avoidance transaction
>
> (2) An avoidance transaction includes:
>
> (a) any transaction that results in a significant reduction, avoidance, deferral or refund of tax or other amount payable under this Act, unless the transaction may reasonably be considered to have been carried out primarily for bona fide business purposes; or
> (b) any transaction that is part of a series of transactions or events, which series results in a significant reduction, avoidance, deferral or refund of tax or other amount payable under this Act, unless the transaction may reasonably be considered to have been carried out primarily for bona fide business purposes.
>
> Interpretation
>
> (3) For the purposes of this section,
>
> (a) "transaction" includes an arrangement, scheme, or event; and
> (b) for greater certainty, the reduction, avoidance, deferral or refund of tax or

other amount payable under this Act shall not be considered to be a bona fide business purpose.

Adjustments

(4) ....

Adjustments by the Minister or on request

(5) ....

Purpose

(6) The purpose of this section is to counter artificial tax avoidance."

339 Counsel for the Appellants contended that it was understood that this version of the provision would introduce a "bona fide business purpose" test similar to the one brought in by judicial doctrine in the United States. It was submitted that in focusing on a business purpose test in the first draft the government was maintaining a position consistent with that taken before the Supreme Court of Canada in Stubart, supra and further, that the government knew there existed in the United States a workable system based on that doctrine.

340 Following hearings in the House of Commons in the summer and fall of 1987, the Standing Committee on Finance and Economic Affairs issued its report, Tax Reform '87, which was tabled in the House of Commons on November 16, 1987 (hereinafter Standing Committee Report). Counsel for the Appellants referred to the Standing Committee Report as support for the contention that the new GAAR was controversial. Referring to pages 197 through 207, counsel observed that various representatives of the financial community were from the outset of the opinion that the proposed new GAAR was unnecessary, void for uncertainty, contrary to the rule of law or inconsistent with the Charter. Counsel further noted that critics argued that the uncertainty, administrative discretion and essential arbitrariness which the proposed provision implied would undermine both the economic development of the Canadian nation and the settled understanding that taxation law, uniquely and intrinsically, must possess a very high degree of certainty.

341 In its report, the Standing Committee on Finance and Economic Affairs stated that it was not in favour of the use of the business purpose test in the draft legislation presented by the government and that it was preferable to bolster the already existing artificiality rule in subsection 245(1) of the Act. In reply to the report, B.J. Arnold, a Department of Finance consultant, expressed his preference for the business purpose test in an article entitled "In Praise of the Business Purpose Test", Canadian Tax Foundation, Conference Report 1987, 10:1. In that article, Mr. Arnold argued that a business purpose test was superior to all other anti-avoidance approaches including the object

and spirit test.

342 On December 16, 1987, following the consultation process, the Honourable Michael H. Wilson tabled in the House of Commons a revised version of the GAAR draft legislation in the Supplementary Information Relating to Tax Reform Measures at page 146 ff. Included in the text of Bill C-139 was the new version of section 245 which would subsequently be proclaimed on September 13, 1988.

343 Counsel for the Appellants contended that the architecture of this second version of the GAAR, which had evolved from a "business purpose test" to a combined "bona fide purpose absent misuse and abuse test", aggravated rather than mitigated the controversy surrounding the provision. In support of this view, reference was made to P.W. Hogg, J.E. Magee and T. Cook, Principles of Canadian Income Tax Law, 3d ed., at page 36:

> The provision was introduced to catch avoidance behaviour that escaped the many specific anti-avoidance provisions of the Act. It was (and remains) controversial, because of the vagueness of its language.

There was a further reference to page 509 where it is stated that:

> The general anti-avoidance rule is a new development in Canada's income tax law, and the breadth and vagueness of the controlling concepts make its potential application somewhat unpredictable.

344 The Department of Finance issued explanations for the changes in the proposed GAAR in the Supplementary Information Relating to Tax Reform Measures, December 16, 1987. The government explained that the deletion of the words "notwithstanding any other provision of this Act" in the revised legislation was intended to make it clear that the new rule would not supplant the other provisions of the Act. Indeed, it is stated at page 101 that:

> The "notwithstanding" provision: ... The government proposes elimination of the "notwithstanding" provision in the revised text, to clarify that the new rule would not supplant other provisions of the Act but would apply together with these other provisions to require economic substance in addition to literal compliance with the words of the Act.

345 It was pointed out that the deleted subsection 245(6) of the first version was a statement of the general purpose of the provision. Accordingly, it was stressed that, to leave no doubt that the new rule was not intended to affect genuine transactions with economic substance that are consistent with the object and purpose of the Act, a specific provision was included in the revised version to exempt transactions that may reasonably be considered not to result in a misuse or abuse of the Act read as a whole. Hence, it is stated at page 102:

> General purpose provision: Subsection (6) of the original draft rule was a purpose provision of a general nature. To clarify and to emphasize that the new rule is not intended to affect genuine transactions with economic substance that are consistent with the object and purpose of the Act, a specific provision is made in the revised text with respect to transactions that may reasonably be considered not to result in a misuse or abuse of the Act read as a whole.

346 In January of 1988, D.A. Dodge defended the new formulation of section 245 in his article entitled "A New and More Coherent Approach to Tax Avoidance" (1988), 36 Canadian Tax Journal 1-22. However, counsel for the Appellants submitted that Mr. Dodge explicitly acknowledged in his article the impracticality of the concepts and language used when he stated at page 21:

> Admittedly, however, the true object and spirit of some provisions of the Act may sometimes appear difficult or even impossible to assess. This, in fact, is the reason why the reference to "a misuse or abuse of the Act" could not practically constitute the basis of the proposed rule and why proposed section 245 relies basically on the non-tax purpose test.

Counsel noted that despite the discussion of the revised section 245's inadequacies, Mr. Dodge proceeded to force the legislation through the House of Commons.

347 Counsel then drew the Court's attention to the testimony of government witnesses, referring in particular to the Minutes of Proceedings and Evidence of the Standing Committee on Finance and Economic Affairs, House of Commons, August 17, 1988, Issue No. 176, Chairman: Don Blenkarn. Counsel submitted that the parliamentarians were told by government officials that the new rule would only apply in a narrow set of circumstances where there was no business purpose. During the hearings, one of the government's witnesses, Mr. Jewett, stated (at page 176:19) that "the essential test is either business purpose or a non-tax purposes test. It only applies after it has been found that no business purpose exists ..." In response to an inquiry whether there was any jurisprudence on what a misuse or an abuse of a provision was and how those words would affect taxpayers' right to arrange their affairs so as to minimize tax, another government witness, Mr. Sasseville, responded at page 176:21 that "the concept of abuse ... has been associated with the concept of fraus legis, which is fraud to the law." Mr. McCrossan, a member of Parliament, then pressed the government witnesses, inquiring how the provision would be interpreted and noting that it seemed sweeping to him. Mr. Peters, another government witness, responded at page 176:22 that the test is only engaged after you have established "that the transaction was done for no bona fide reason other than to get a tax benefit", in which case you still have a defence "if [the taxpayer] can demonstrate that he was not abusing the Act".

348 Counsel for the Appellants also referred to B.J. Arnold and J.R. Wilson: "The General Anti-Avoidance Rule - Part 1" (1988), 36 Canadian Tax Journal, pages 829-887, "The General Anti-Avoidance Rule - Part 2" op. cit. pages 1123-1185 and "The General Anti-Avoidance Rule -

Part 3", op. cit. pages 1369-1410, as support for their underlying contention that there is a fundamental defect in section 245. In particular, counsel cited the authors' finding that subsection 245(4) is both opaque and devoid of any standards that could give the judiciary anything to grasp for the purposes of legal debate. It is stated at page 1164 that:

> The major difficulty with the exception in subsection 245(4) is that its meaning is opaque. What constitutes a misuse of the provisions of the Act, or an abuse having regard to the provisions of the Act read as a whole; and what is the difference, if any, between the two concepts? Also, what criteria are the tax authorities or the courts to apply in deciding whether a transaction results in a misuse or an abuse of the provisions of the Act? Section 245 provides no elaboration.

349 However, counsel for the Appellants rejected Mr. Arnold's and Mr. Wilson's recommendation with respect to how the judiciary ought to approach this defective provision, the authors having suggested at page 1408 that the judiciary would be required to adopt "a judicial 'smell' test, grounded perhaps in an economic substance or commercial reality test". Counsel contended that this is fundamentally contrary to the rule of law, and violates what he expressed as being "the Charter s. 7 guarantee against unduly vague laws". Counsel further submitted that this proposed approach is contrary to all of the recent taxation jurisprudence of the Supreme Court of Canada referred to above in paragraph 335 of these Reasons.

350 Finally, counsel for the Appellants argued that the certainty standard required by section 7 of the Charter should be higher with respect to the Act than the standard that has been applied in the Supreme Court of Canada's vagueness jurisprudence to date. A higher standard was proposed by counsel because the Act is of a fundamentally different character, notably because of its centrality to all economic activity and because it touches the lives of all Canadians. Counsel submitted that the common law and the requirements of the rule of law have always demanded that the certainty standard applicable to a taxation statute be set very high.

(ii) Section 7 of the Charter

351 With respect to section 7 of the Charter, counsel for the Appellants referred to R. v. Nova Scotia Pharmaceutical Society, [1992] 2 S.C.R. 606, the leading case dealing with the doctrine of vagueness. In particular, he relied on the two rationales identified as the theoretical foundations of the doctrine of vagueness, being fair notice to citizens and law enforcement discretion.

352 Citing the Supreme Court of Canada's decision in Ontario v. C. P., supra, counsel noted that fair notice was required to be viewed from the perspective of the average citizen. He stated that, where you create a general anti-avoidance rule on top of extraordinarily detailed provisions such as those contained in the Act, it is necessarily difficult to meet the requirement of providing fair notice.

353 With respect to the subject of the limitation of law enforcement discretion, counsel for the

Appellants submitted that vagueness leads to too much law enforcement discretion, which invites abuse. Citing J.C. Jeffries, "Legality, Vagueness, and the Construction of Penal Statutes" (1985), 71 Va. L. Rev. 189 at 215, he contended that an important first step in curtailing abuse is to invalidate indefinite laws.

354 With respect to the issue of restraining judicial discretion, counsel cited R. v. Morales, [1992] 3 S.C.R. 711, as authority for the proposition that the guarantee against unduly vague laws applied to restraining both the executive and the judiciary. He noted that even if individual judges are able to interpret section 245, that is not determinative of whether the provision is unduly vague. In Morales, supra, the Court considered a provision of the Criminal Code permitting an accused to be detained where a judge determined that it was in the "public interest". The Supreme Court of Canada canvassed the recent jurisprudence on the issue of vagueness and the cases that had purported to interpret the term "public interest" and concluded that there was no constant or settled meaning arising from the case law. The majority of the Supreme Court of Canada concluded that the term provided no guidance for legal debate and that in essence it permitted a "standardless sweep". Counsel noted that the Supreme Court in Morales, supra, relied heavily on its earlier decision in Nova Scotia Pharmaceutical, supra, where it was said that terms failing to give direction as to how to exercise broad discretion are unacceptable. Counsel for the Appellants contended that in tax matters especially, where there is no moral underpinning and where the Act is a mix of fiscal and economic policy, it is absolutely critical that the rules contain core standards that can be given meaning and applied consistently in a principled manner by the courts. He emphasized the importance of certainty in tax laws, referring the Court more particularly to the words of Adam Smith in The Wealth of Nations (1776), Book V, Chap. II, Part II (Methuen & Co., 1961 ed., vol. 2, at pages 350 and 351), which were adopted by Collier J. of the Federal Court - Trial Division in British Columbia Railway Co. v. The Queen, 79 D.T.C. 5020 at page 5025:

> II. The tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person. Where it is otherwise, every person subject to the tax is put more or less in the power of the tax-gatherer, who can either aggravate the tax upon any obnoxious contributor, or extort, by the terror of such aggravation, some present or perquisite to himself. The uncertainty of taxation encourages the insolence and favours the corruption of an order of men who are naturally unpopular, even where they are neither insolent nor corrupt. The certainty of what each individual ought to pay is, in taxation, a matter of so great importance, that a very considerable degree of inequality, it appears, I believe, from the experience of all nations, is not near so great an evil as a very small degree of uncertainty.

355 According to counsel, the Supreme Court of Canada reiterated this standard, albeit with understatement, in saying the following in Duha Printers (S.C.C.), supra, at paragraph 52:

> Moreover, as Wilson J. correctly observed in her dissent in Imperial General Properties, [1985] 2 S.C.R. 288, supra, taxpayers rely heavily on whatever certainty and predictability can be gleaned from the Income Tax Act....

356 Counsel for the Appellants contended that section 245, particularly the words "misuse" or "abuse" lack a core meaning that could provide fair notice to citizens and from which law enforcement authorities could derive the limits of their power. In support of the contention that a law must possess a core meaning, counsel directed the Court's attention to the words of Gonthier J. speaking for the Supreme Court of Canada in Nova Scotia Pharmaceutical, supra, at page 639:

> A vague provision does not provide an adequate basis for legal debate, that is for reaching a conclusion as to its meaning by reasoned analysis applying legal criteria. It does not sufficiently delineate any area of risk, and thus can provide neither fair notice to the citizen nor a limitation of enforcement discretion.

357 Counsel distinguished the present appeals from the cases in which the Supreme Court of Canada has examined vagueness on the basis that unlike the situation with respect to legislation in the areas of pollution, pornography or hate literature, there are no societal values underpinning tax laws that can provide citizens with guidance as to what is or is not permissible. In this sense, the enforcement of section 245 would, according to counsel, result in a "faux judgment", which occurs when a rule requires the exercise of judgment that for its validation refers to social standards that are insufficiently dense and textured to sustain the bona fide exercise of judgment.

358 Counsel for the Appellants submitted that the structural deficiencies in section 245, particularly the combination of subsections 245(3) and 245(4), render the judgment as to the presence of misuse or abuse either impossible or hopelessly subjective and any decision in that regard is necessarily "standardless" and uncontrolled. Counsel submitted that subsection 245(4) requires the discovery of another object and/or spirit of the provision at issue, an object and/or spirit which provides the basis for a finding of misuse or abuse and which must necessarily, in order for the second step to have any validity or meaning, be different than the object and/or spirit under which the transaction was said to work in the first step. He submitted that this search under section 245(4) for a previously unidentified, unexpressed, often highly "genericized" object and spirit, which will be revealed within a particular provision or combination of provisions long after the transactions have been effected, is constitutionally unacceptable and illogical. Counsel referred to Professor Krishna's discussion in The Fundamentals of Canadian Income Tax, 5th ed. (Scarborough: Carswell, 1995) at page 64, with respect to the presumption against the retrospective application of taxation laws. According to counsel, section 245 violates the presumption against the retrospective application of tax laws because it requires judicial discovery of an unexpressed object and spirit which is then applied retrospectively.

359 Counsel for the Appellants anticipated that the Respondent would assert that subjection of section 245 to Charter and rule of law principles would involve the importation of property rights

into section 7 and consequently hamper Parliament's ability to achieve valid social policy objectives via legislation, as was the case during the Lochner era in the United States. The Lochner era refers to a period of time in the late 18th and early 19th centuries when the United States Bill of Rights was used to strike down progressive social legislation. The Appellants' counsel submitted that neither of these anticipated arguments addresses what the Appellants are actually advocating, which is the principle of legality as it affects a law that is vague to the extent that it permits arbitrary law enforcement action and arbitrary judicial decisions.

360 Counsel for the Appellants referred to Nova Scotia Pharmaceutical, supra, citing first the following passage at page 642, where Gonthier J. speaking for the Court stated:

> [t]he standard I have outlined applies to all enactments, irrespective of whether they are civil, criminal, administrative or other. The citizen is entitled to have the State abide by constitutional standards of precision whenever it enacts legal dispositions.

Counsel then referred to an earlier passage at pages 634 and 635:

> ... Many enactments are relatively narrow in scope and echo little of society at large; this is the case with many regulatory enactments. The weakness or the absence of substantive notice before the enactment can be compensated by bringing to the attention of the public the actual terms of the law, so that substantive notice will be achieved. Merit point and driving license revocation schemes are prime examples of this; through publicity and advertisement these schemes have been "digested" by society.

Finally, the following, at page 641, was cited:

> One must move away from the non-interventionist attitude that surrounded the development of the doctrine of the rule of law to a more global conception of the State as an entity bound by and acting through law. The modern State intervenes in almost every field of human endeavour, and it plays a role that goes far beyond collecting taxes and policing.

361 Counsel for the Appellants submitted that in Nova Scotia Pharmaceutical, the Supreme Court gave unqualified recognition of a right of citizens "to have the State abide by constitutional standards of precision whenever it enacts legal dispositions" and linked this right with rule of law principles. According to counsel, the Supreme Court of Canada's statement that the standard applies to all enactments is an indication that the Court may go beyond the ordinary section 7 analysis and, in effect, the Supreme Court of Canada is stating that in some cases there is going to be content review. The position of the Appellants is that the right to be free from arbitrary laws or "to have the State abide by constitutional standards of precision" naturally resides in the section 7 liberty right.

362 Counsel for the Appellants submitted that to accept the Respondent's position that the Charter does not prohibit legislatures from enacting arbitrary laws and that there is no independent rule of law standard would result in the Act being immune from any constitutional scrutiny. He contended that section 26 of the Charter specifically provides that other rights may exist and submitted that it is not in keeping with the "fabric" of our Constitution that prior to the enactment of the Charter common law courts would hold legislation ineffective for uncertainty, but after its enactment the courts should be unable to do so.

363 Counsel for the Appellants canvassed section 7 Charter jurisprudence and noted that the once narrow interpretation of the liberty right in the criminal context has broadened. For example, in Godbout v. Longueuil (City), [1997] 3 S.C.R. 844, a case in which the Supreme Court of Canada considered whether a requirement that municipal employees live within the municipality was a Charter violation, La Forest J., speaking for part of the Court, stated at page 893 that the liberty right is about "basic choices going to the core of what it means to enjoy individual dignity and independence". Moreover in B. (R.) v. Children's Aid Society of Metropolitan Toronto, [1995] 1 S.C.R. 315, La Forest J. analysed the liberty right in the context of the broader values that underlie the Charter. La Forest J.'s statements were adopted in Blencoe, supra, where Bastarache J., for the majority, cited the following at paragraph 51:

> ... the autonomy protected by the s. 7 right to liberty encompasses only those matters that can properly be characterized as fundamentally or inherently personal such that, by their very nature, they implicate basic choices going to the core of what it means to enjoy individual dignity and independence ....

364 Counsel for the Appellants contended that if restrictions on one's place of residency can potentially offend section 7 then freedom from arbitrary laws would also be protected under section 7.

365 Counsel submitted that the content of section 7 will continue to be delineated in this and other cases. He stressed that personal autonomy would mean little if it did not encompass the right to organize ones affairs, whether personal or business, free from government interference that was wholly arbitrary in nature.

366 Counsel for the Appellants submitted that the right to be free from arbitrary and indeterminate taxation is a right that has been upheld since the Magna Carta and that to say that arbitrary taxation has nothing to do with liberty and the struggle of human civilization to advance itself is to ignore history.

(iii) Rule of Law

367 Counsel for the Appellants contended that the substantive rule of law standards are an independent basis for assessing the constitutionality of legislation. He referred to Nova Scotia Pharmaceutical, supra. In that decision the Supreme Court of Canada examined case law from the

European Court of Human Rights ("ECHR") and noted that the ECHR gave the "prescribed by law" standards in the European Convention for the Protection of Human Rights and Fundamental Freedoms, 213 U.N.T.S. 222 ("European Convention") substantive content which went beyond a mere inquiry as to whether a law existed or not. Referring as well to L.B. Tremblay, The Rule of Law, Justice, and Interpretation (Montreal: McGill-Queens University Press, 1997), counsel stated that a mere inquiry into whether or not a law exists is known as the "orthodox parliamentary supremacy theory". Counsel contended that this is the theory that the Respondent relies on. However, counsel for the Appellants directed the Court's attention to what was described as the seminal decision of the ECHR, namely the Sunday Times case judgment of 26 April 1979, Series A no. 30, in which that Court considered a freedom of expression challenge of the English contempt of court law. In that case, the ECHR found that there were two requirements flowing from the expression "prescribed by law", at paragraph 49:

> ... Firstly, the law must be adequately accessible: the citizen must be able to have an indication that is adequate in the circumstances of the legal rules applicable to a given case. Secondly, a norm cannot be regarded as a "law" unless it is formulated with sufficient precision to enable the citizen to regulate his conduct: he must be able - if need be with appropriate advice - to foresee, to a degree that is reasonable in the circumstances, the consequences which a given action may entail.

368 Counsel for the Appellants submitted that the second requirement embodies the principle of legality. Referring to a summary of the ECHR case law in G. Zellick, "The European Convention on Human Rights: Its Significance for Charter Litigation", in R.J. Sharpe, ed., Charter Litigation (Toronto: Butterworths, 1987), at page 103, counsel submitted that the terms "prescribed by law" or "in accordance with law" have a qualitative character that requires conformity with the rule of law mentioned in the preamble of the European Convention as well as in the preamble of the Charter. Counsel contended that this conformity with the rule of law is what was sanctioned in Nova Scotia Pharmaceutical, supra, and is what the Appellants rely on in the present appeals.

369 Counsel for the Appellant stated that the concerns surrounding an arbitrary law - namely that citizens will not know how to make their conduct conform with the law and that there will be inadequate limitation of enforcement discretion - are such that all laws are subject to a requirement of certainty and lack of arbitrariness, as the Supreme Court of Canada indicated in Nova Scotia Pharmaceutical, supra.

370 In his written submissions, counsel traced the origins of the doctrine of vagueness to the abhorrence of arbitrary laws as one of the features animating the historic struggle that led to the establishment of the rule of law as a central distinguishing feature of a democratic society. On this point, counsel referred particularly to A.V. Dicey's Introduction to the Study of the Law of the Constitution, 10th ed. (London: MacMillan & Co. Ltd., 1960), Chapter IV, at page 183 ff.

371 Counsel for the Appellants also referred to the Supreme Court of Canada's decision in Roncarelli v. Duplessis, [1959] S.C.R. 121, as well as to a more recent pronouncement in Reference re Secession of Quebec [1998] 2 S.C.R. 217, in both of which it is stated that the rule of law is "a fundamental postulate of our constitutional structure".

372 In anticipation of a submission by the Respondent that the case law in Canada does not support the rule of law operating as an independent basis for assessing the constitutionality of legislation, counsel for the Appellants reviewed the relevant jurisprudence and submitted that all of the cases were distinguishable. With respect to the decisions in Bacon v. Saskatchewan Crop Insurance Corp. (hereinafter Bacon(C.A.)), [1999] 11 W.W.R. 51, Johnson v. British Columbia (Securities Commission) (1999), 67 B.C.L.R. (3d) 145 (B.C.S.C.), Singh v. Canada (Attorney General), [2000] 3 F.C. 185 (F.C.A.), Babcock v. Canada (Attorney General) (1999), 176 D.L.R. (4th) 417 (B.C.S.C.) and JTI-Macdonald Corp. v. British Columbia (Attorney General) (2000), 184 D.L.R. (4th) 335 (B.C.S.C.), counsel for the Appellants submitted that these cases were distinguishable because they all involved challenges to the periphery of the substantive content of the rule of law. Thus, he submitted that the principle drawn from Bacon (C.A.), supra, which was followed in Babcock, supra, Singh, supra, and JTI-Macdonald, supra, that Parliamentary supremacy itself excludes the possibility that legislation is reviewable to determine compliance with substantive rule of law standards, has no validity in the context of arbitrary laws.

373 In Vanguard Coatings and Chemicals Ltd. v. The Queen, 88 D.T.C. 6374, the Federal Court of Appeal reversed a determination by the Federal Court - Trial Division that a provision of the Excise Tax Act authorizing the Minister to determine the fair price of goods for tax purposes was unconstitutional and contrary to the rule of law. Counsel for the Appellants distinguished the holding in Vanguard, supra, on the basis that a fair price for goods is ascertainable based on external indicators and that what the Federal Court of Appeal was actually saying was that the particular provision was clear. Counsel also noted that the submissions and analysis in Vanguard, supra, on the rule of law issue were not very thorough and had not had the benefit of the recent academic writing on the subject. It was also stressed that that decision preceded the Supreme Court of Canada's decision in Nova Scotia Pharmaceutical, supra. Counsel submitted that none of the previous jurisprudence in Canada addressed the situation where a provision lacks core standards and is thus wholly arbitrary, as contended in the present case with respect to section 245.

374 Finally, counsel for the Appellants submitted that at common law the courts have always had the power to review legislation for certainty and that it would be perverse if the power of judicial review for certainty was somehow vitiated by the enactment of the Charter. Counsel referred to the use of the doctrine of vagueness to strike down racially restrictive covenants in Noble v. Alley, [1951] S.C.R. 64. It was also noted that a vague law was struck down on the basis that it could not be assigned to either federal or provincial competency in Saumur v. City of Quebec, [1953] 2 S.C.R. 299. Further, counsel reminded the Court that the doctrine of vagueness was used to assess municipal bylaws for the requisite certainty in Re Hamilton Independent Variety & Confectionery Stores Inc. and City of Hamilton (1983), 143 D.L.R. (3d) 498 (Ont. C.A.). Finally, he also noted

that the doctrine of vagueness was present in the mostly unwritten constitution of the United Kingdom and was applied in a tax context in the case of Vestey v. Inland Revenue Commissioners, [1980] A.C. 1148 (H.L.).

(iv) Interpretative Principles and Judicial Interpretation of Section 245

375 Counsel for the Appellants contended that it is inappropriate to embrace unexpressed policy in interpreting legislation which is as complicated as the Act. Counsel referred to 65302 British Columbia Limited, supra, where the Supreme Court of Canada stated that the Act is a complex document and that the courts should be reluctant to embrace unexpressed notions of policy. In counsel's view, attempts by academic commentators to develop a framework within which section 245 could work have only resulted in rhetoric. According to him, what began as an exercise to restore the common law business purpose test through legislation following Stubart, supra, has resulted in a provision which either undershoots or overshoots the legislative purpose. If appropriate statutory interpretation is used to reach the conclusion that a transaction works, then attempting to find a misuse or abuse in the second step is meaningless. In that sense, the provision would undershoot the legislative intention. Counsel submitted that the technical notes to section 245 indicate that the provision was only intended to apply to transactions that have no business purpose or economic substance. However, accepting the broader interpretation advanced by the Respondent would result in the provision overshooting the legislative intention.

376 Counsel for the Appellants submitted that section 245 is simply an inadequate first draft and that the Court should not hesitate to strike it down. He referred to the Supreme Court of Canada's decision in R. v. Mills, [1999] 3 S.C.R. 668, where McLachlin J. (as she then was) and Iacobucci J., speaking for the majority, stated that the striking down of legislation is an important part of the dialogue between the legislature and the judiciary, a dialogue through which each of those branches is held accountable and which therefore enhances democracy.

377 Counsel for the Appellants conducted a review of the cases involving section 245 of the Act and the parallel provision in the Excise Tax Act. In McNichol v. The Queen, 97 D.T.C. 111 (T.C.C.), Judge Bonner stated at page 120 that the "telos of section 245 is the thwarting of abusive tax avoidance transactions." In RMM Canadian Enterprises Inc. et al. v. The Queen, 97 D.T.C. 302 (T.C.C.), Judge Bowman, as he then was, stated at page 312 that "[i]t is easier to recognize an abuse or a misuse than to formulate a definition that fits all circumstances" and, adding to what Judge Bonner had said in McNichol, supra, he stated at page 313 that "[a] form of transaction that is otherwise devoid of any commercial objective ... is an abuse of the Act as a whole."

378 Contending that the Tax Court has been unable to develop a definition that fits all circumstances, counsel submitted that it has instead adopted a qualified approach in an attempt to limit the provision's application. According to him this qualified approach is apparent in Jabs Construction, supra, a decision in which Judge Bowman, as he then was, concluded at paragraph 48

that section 245 was "an extreme sanction" that "should not be used routinely", in Canadian Pacific (TCC), supra, at paragraph 17, where Judge Bonner adopted Judge Bowman's view that it was an extreme sanction, in Rousseau-Houle, supra, at paragraph 50, and in Fredette, supra, at paragraph 76. In these latter two decisions Judge Archambault added a further qualification to the approach taken in Jabs Construction, supra, expressing the opinion that section 245 was intended to prevent flagrant abuses and may not be used by the Minister as a means to force taxpayers to structure their transactions in the way most favourable to the tax authorities.

379 Counsel for the Appellants also referred to the decision in Geransky, supra, where, they submitted, Associate Chief Judge Bowman summarizes the Appellants thesis in stating at paragraph 40 that "[w]hat is a misuse or an abuse is in some measure in the eye of the beholder", and at paragraph 42, that "using the specific provisions of the Income Tax Act in the course of a commercial transaction, and applying them in accordance with their terms is not a misuse or an abuse". Counsel also stated that the decision of Judge Bowie in Duncan, supra, is consistent with a developing theme that the complete absence of any business purpose results in a qualitatively different level of scrutiny from the Court.

(v) Remedies

380 Counsel for the Appellants submitted that a principled approach is essential in order for the courts to apply the provision consistently and that the jurisprudence to date shows that the Tax Court has been unable to develop such an approach and that the provision should be struck down for that reason.

381 Counsel for the Appellants referred to subsection 52(1) of the Constitution Act, 1982 and cited Hunter et al. v. Southam Inc., 84 D.T.C. 6467 (S.C.C.) and R. v. Seaboyer; R. v. Gayme, [1991] 2 S.C.R. 577, as confirmation that there is a fundamental obligation on a court to strike down legislation where it is found to be inconsistent with the Constitution of Canada. In light of this jurisprudence, counsel submitted that the most appropriate approach in the present appeals is to find section 245 unenforceable and to leave it to Parliament to redraft the provision in light of the factors that have evolved since its enactment. Those factors include Parliament's continued implementation of specific anti-avoidance rules, the fact that no principled approach has been developed in the Tax Court, the efficiency of particularized amendments and the government's ability in the information age to provide accelerated dissemination of information, as well as the development of more elaborate reporting requirements. Lastly, counsel submitted that section 245 is less consonant with business interests than the rules in other jurisdictions and that it is therefore in Canada's interest to re-evaluate the approach taken to curtail abusive tax avoidance. Counsel for the Appellants contended that all of the issues involved are complex and require the assistance of committees and the Department of Finance and are therefore quintessentially issues that should be resolved by Parliament.

382 Counsel also stated that the Respondent has failed to demonstrate a pressing and substantial

need that would support a provision as vague and indeterminate as section 245. Counsel submitted that, under the Charter jurisprudence, if there is a finding that there has been a violation of the Charter then the onus is on the government to call affirmative evidence to justify the saving of the legislation under section 1 of the Charter. Counsel reminded the Court that in RJR-MacDonald Inc. v. Canada (A.G.), [1995] 3 S.C.R. 199, the Supreme Court of Canada struck down legislation that imposed restrictions on tobacco advertising primarily because the government had failed to discharge its onus under section 1 of the Charter.

383 The next available remedy under subsection 52(1) of the Constitution Act, 1982, is the reading down of legislation.

384 Counsel for the Appellant referred to Schachter v. Canada, [1992] 2 S.C.R. 679, where the Supreme Court of Canada articulated the principles applicable to the read-in and read-down (severance) remedy. Lamer C.J. speaking for the majority stated at pages 717-719:

> ... Once s. 52 is engaged, three questions must be answered. First, what is the extent of the inconsistency? Second, can that inconsistency be dealt with alone, by way of severance or reading in, or are other parts of the legislation inextricably linked to it? Third, should the declaration of invalidity be temporarily suspended? The factors to be considered can be summarized as follows:
>
> (i) The Extent of the Inconsistency
>
> The extent of the inconsistency should be defined:
>
> A. broadly where the legislation in question fails the first branch of the Oakes test in that its purpose is held not to be sufficiently pressing or substantial to justify infringing a Charter right or, indeed, if the purpose is itself held to be unconstitutional - perhaps the legislation in its entirety;
> B. more narrowly where the purpose is held to be sufficiently pressing and substantial, but the legislation fails the first element of the proportionality branch of the Oakes test in that the means used to achieve that purpose are held not to be rationally connected to it - generally limited to the particular portion which fails the rational connection test; or,
> C. flexibly where the legislation fails the second or third element of the proportionality branch of the Oakes test.
>
> (ii) Severance/Reading In

Severance or reading in will be warranted only in the clearest of cases, that is, where each of the following criteria is met:

A. the legislative objective is obvious, or it is revealed through the evidence offered pursuant to the failed s. 1 argument, and severance or reading in would further that objective, or constitute a lesser interference with that objective than would striking down;
B. the choice of means used by the legislature to further that objective is not so unequivocal that severance/reading in would constitute an unacceptable intrusion into the legislative domain; and,
C. severance or reading in would not involve an intrusion into legislative budgetary decisions so substantial as to change the nature of the legislative scheme in question.

(iii) Temporarily Suspending the Declaration of Invalidity

Temporarily suspending the declaration of invalidity to give Parliament or the provincial legislature in question an opportunity to bring the impugned legislation or legislative provision into line with its constitutional obligations will be warranted even where striking down has been deemed the most appropriate option on the basis of one of the above criteria if:

A. striking down the legislation without enacting something in its place would pose a danger to the public;
B. striking down the legislation without enacting something in its place would threaten the rule of law; or,
C. the legislation was deemed unconstitutional because of underinclusiveness rather than overbreadth, and therefore striking down the legislation would result in the deprivation of benefits from deserving persons without thereby benefitting the individual whose rights have been violated.

385 It is to be noted that in Schachter, supra, the Supreme Court of Canada noted - and this was conceded - that section 32 of the Unemployment Insurance Act, 1971, S.C. 1970-71-72, c.48, was underinclusive in providing less parental leave to natural parents than to adoptive parents and as such violated section 15 of the Charter. However, the Court decided that there should not have been a reading in by the Federal Court - Trial Division but that the legislation should have been declared of no force and effect because to read in was a substantial intrusion into the legislative domain.

Although the Supreme Court would have struck down the impugned provision and would have suspended the declaration of invalidity to allow Parliament time to amend it, by the time the case was heard in the Supreme Court of Canada Parliament had already repealed and replaced that provision.

386 Counsel for the Appellants referred the Court to the more recent Supreme Court of Canada decision in R. v. Sharpe, [2001] 1 S.C.R. 45, where the majority held that it was appropriate to read exceptions into legislation in order to bring it into line with the Charter. Counsel referred the Court to the following statements of McLachlin C.J., speaking for the majority, at paragraph 114:

> ... The Court decides on the appropriate remedy on the basis of "twin guiding principles": respect for the role of Parliament, and respect for the purposes of the Charter.

McLachlin C.J. added at paragraph 124:

> The second prong of Schachter, supra, is directed to the possibility that reading in, though recognizing the objective of the legislation, may nonetheless undermine legislative intent by substituting one means of effecting that intent with another. As we noted in Vriend v. Alberta, [1998] 1 S.C.R. 493, the relevant question is "what the legislature would ... have done if it had known that its chosen measures would be found unconstitutional" (para. 167). If it is not clear that the legislature would have enacted the legislation without the problematic provisions or aspects, then reading in a term may not provide the appropriate remedy. This concern has more relevance where the legislature has made a "deliberate choice of means" by which to reach its objective. Even in such a case, however, "a deliberate choice of means will not act as a bar to reading in save for those circumstances in which the means chosen can be shown to be of such centrality to the aims of the legislature and so integral to the scheme of the legislation, that the legislature would not have enacted the statute without them": Vriend, supra, at para. 167.

387 Based on the above, counsel for the Appellants submitted that the question of whether or how to read down section 245 involves an examination of the legislative intent of the proposed interpretative frameworks, and ultimately and necessarily, a sensitive balancing of the respective roles of Parliament and the courts in light of constitutional values. According to counsel, in the present appeals that would involve assessing what the legislature would have done if it had realized the defect in the object and spirit test and instead stuck with a business purpose test. As counsel noted, this is problematic as one cannot just strike out subsection 245(4) since it was added after the scope of subsection 245(3) was broadened and there is a relationship between the two provisions.

388 The next question addressed by counsel for the Appellants was the application of the read-down principles to section 245 of the Act.

389 Counsel for the Appellants referred to the Explanatory Notes to Legislation Relating to Income Tax (Bill C-139), June 30, 1988, which, in his opinion, "suggested", at page 465, that "[s]ubsection 245(4) draws on the doctrine of 'abuse of rights' which applies in some jurisdictions to defeat schemes intended to abuse the tax legislation". Counsel also submitted that, even though this suggestion has been criticized by academics, the Respondent continues to advance the said doctrine as foundational as regards the proper approach to section 245. In support of this submission counsel referred to the Respondent's factum in OSFC (FCA). Counsel submitted that if the terms "misuse" and "abuse" are derived from the abuse of rights doctrine then such terms should be interpreted with reference to the actual content of the doctrine, not selected parts of it.

390 With respect to the abuse of rights doctrine, counsel referred to D.A. Ward, "Tax Avoidance: Judicial and Legislative Approaches in Other Jurisdictions," in Canadian Tax Foundation, Conference Report, 1987, 8:1-53, at page 8:3, where the abuse of rights doctrine is summarized as a concept which "imposes reasonable limitations on a person's liberty in order to prevent him from injuring or annoying others by exercising his rights in bad faith, out of spite, or in circumstances amounting to a gross mistake equivalent to bad faith". Ward went on to state that, "[i]n the tax area, the doctrine of abuse of rights applies where a taxpayer, who has a right to enter into a contract, incorporate a company, transfer property, or undertake any other legal transaction, abuses that right by exercising it solely for the purpose of avoiding and reducing taxes and without a bone fide business or commercial purpose to the transaction". According to counsel for the Appellants, Ward is of the opinion that in taxation cases American courts have adopted the civil law abuse of rights doctrine in the form of their business purpose test.

391 Counsel for the Appellants also referred to the only judgment of the Supreme Court of Canada discussing the abuse of rights doctrine, National Bank v. Houle, [1990] 3 S.C.R. 122, where Madam Justice L'Heureux-Dubé reviewed the history and theories that underlie the doctrine. Counsel pointed out that the acceptance of the doctrine by the Supreme Court of Canada as part of the civil law of Quebec in the narrow context of contractual obligations demonstrates the difficulty of applying that doctrine to tax law. Counsel then conducted a thorough review of the judgment and the three possible theories that might underlie the abuse of rights doctrine, namely the "individualist theory", the "social function theory" and the "reasonable exercise of rights theory". Counsel noted that the Court explicitly rejected the "social function theory" because it was essentially a smell test, subjective in nature and informed by a judge's personal view. Counsel contended that it is this smell test that the Respondent essentially wishes to rely on in attempting to import the abuse of rights doctrine into tax law. Counsel for the Appellants acknowledged that the Court rejected the "individualist theory" in National Bank, supra, because L'Heureux-Dubé J. found the theory too limited in a contracts context given that contractual rights are already subject to good faith. Ultimately, the Court accepted the "reasonable exercise of rights theory", under which an abuse of rights occurs when a right is not exercised in a reasonable manner or in a manner consistent with the conduct of a prudent and diligent individual. Counsel submitted that although this theory has application in a contracts context, it can have no application in a tax context because it does not fit comfortably with tax law where conceptions of abstract normalcy are exceptionally difficult. To

illustrate this point, counsel stated that, unlike in contract law, there are no normative standards in tax law. What a reasonable individual would do in the context of deciding whether he should incorporate a business or run it as a proprietorship, or whether he should buy shares or assets is a question that has no correct answer because there is no normatively correct amount of tax one should pay. Finally, counsel for the Appellants submitted that if the abuse of rights doctrine is to have any application in tax law, then its ambit would necessarily have to be restricted to the concepts of bad faith or the malicious exercise of rights embodied in the "individualist theory".

392 The Appellants' counsel also reviewed academic commentaries from European Union countries on the application of the abuse of rights doctrine to tax law and concluded that to the extent that the doctrine had been adopted in a tax context it had been limited to the narrowest "individualist theory", which required proof of bad faith utilization of provisions of law. Such proof, counsel pointed out, was frequently founded on a complete absence of business purpose. He submitted that if the abuse of rights doctrine were to be applied in interpreting subsection 245(4), then the existence of economic substance or a business purpose would be of relevance in assessing whether a transaction was exempt from the application of subsection 245(2).

393 Counsel for the Appellants then submitted that the legislative record is crystal clear in demonstrating that Parliament intended to legislate a business purpose doctrine and that this intent was deflected during the consultation and parliamentary committee hearings process so that the resulting provision overshoots the legislative purpose and is intrinsically vague. Given the clear legislative intent, counsel contended, it is open for the Court to read down the provision so as to exempt transactions endowed with economic substance or possessing a credible, significant business purpose. In counsel's view, to read the legislation down in this manner would be wholly consistent with the abuse of rights doctrine, the legislative intent, the global anti-avoidance jurisprudence that has been developed, the certainty standards required in tax law and the constitutional values. According to counsel, the reading down of the legislation in this manner would reconcile and harmonize all of the competing interests. If read down subsection 245(3) would continue to screen from subsection 245(2) transactions whose primary purpose is a business purpose or some other bona fide purpose. Subsection 245(4) would exempt transactions endowed with economic substance or possessing a significant and credible business purpose. Counsel for the Appellant submitted that transactions that conform to the detailed provisions of the Act, but are organized in a manner that minimizes rather than maximizes tax, ought not to be said to misuse or abuse the Act. Counsel for the Appellants submitted that reading down the provision in this manner will bring about the substitution of certainty, predictability and principle for arbitrariness and discretion, both administrative and judicial.

394 Counsel for the Appellants submitted that whether the Court decided to strike down or to read down section 245 the result would be the same and the present appeals would be allowed because either the provision would be of no force and effect or the transactions in issue would not come within the ambit of the read-down provision.

(b) Respondent

395 The Respondent's position was summarized in the following propositions:

a. Whether a law is unconstitutionally vague is only considered once a breach of a Charter right has been found. In the present case, it is unnecessary to determine whether subsection 245(4) is vague unless it is found that the Appellant's right to life, liberty or security of the person has been breached.
b. As this case is not in the criminal context, a breach, actual or imminent, of the right to life, liberty or security of the person cannot be presumed. As a result, evidence of the effects of subsection 245(4) are necessary.
c. If the question of whether subsection 245(4) is unconstitutionally vague must be considered, the Respondent submits it is obviously not vague as it has been applied in a completely consistent fashion by the courts on a dozen occasions.
d. The rule of law cannot be used as a basis for invalidating legislation.

(i) Charter Challenges Generally

396 Relying on MacKay v. Manitoba, [1989] 2 S.C.R. 357, at pages 361 and 362, counsel for the Respondent submitted that the Supreme Court of Canada has made it clear that it is not appropriate in most cases to consider constitutional issues in a factual vacuum. He contended that in the present appeals the Appellants have not claimed they suffered any ill effects from subsection 245(4), other than the fact that it denies the tax benefits flowing from tax-motivated transactions. In such a case, the Court should heed the Supreme Court of Canada's repeated warnings and not presume any other effects in the absence of any evidence of such effects. In this respect, reference was made to Manitoba (A.G.) v. Metropolitan Stores Ltd, [1987] 1 S.C.R. 110, at page 133, Danson v. Ontario (Attorney General), [1990] S.C.R. 1086, at page 1099, and John Carten Personal Law Corp. v. British Columbia (Attorney General) (1997), 153 D.L.R. (4th) 460 at page 468.

397 Counsel for the Respondent agreed with counsel for the Appellants that the seminal vagueness case in Canada is Nova Scotia Pharmaceutical, supra. Counsel submitted that, in that case, the Supreme Court of Canada concluded that in a section 7 context vagueness only arises as a principle of fundamental justice. Counsel also referred to the recent decision of the British Columbia Supreme Court in Murphy v. British Columbia (Superintendent of Motor Vehicles) (2001), 89 B.C.L.R. (3d) 81 (B.C.S.C.), where the Court considered the use of the vagueness doctrine to invalidate legislation and concluded that vagueness could only be used to invalidate legislation either based on the division of powers or under section 7 of the Charter if a breach of the right to life, liberty or security of the person could first be made out. Counsel then pointed out that the Appellants were not asserting that section 245 was not within the scope of federal powers, nor were they arguing that it was so vague that it could not be considered to be within the competency

of Parliament. Therefore, counsel for the Respondent concluded that the Appellants could use the doctrine of vagueness to challenge the constitutionality of the provision only under section 7 and only after they have established a violation of the right to life, liberty or security of the person.

398 Relying on the decision of the British Columbia Court of Appeal in Perry v. Vancouver (City) (1994), 88 B.C.L.R. (2d) 328, counsel for the Respondent stressed the difference between legislation and bylaws and submitted that cases where bylaws have been declared invalid on the basis of vagueness without a breach of a Charter right having been demonstrated are distinguishable from the current appeals because the nature of bylaws, which are delegated legislation, provides the basis for such invalidation. This is not applicable to legislation passed by Parliament. As well, cases where restricted covenants on title were found not to be applicable because of vagueness can in no way be equated with legislation.

(ii) Section 7 of the Charter

399 With respect to the scope of section 7 of the Charter, counsel for the Respondent referred the Court to the Supreme Court of Canada's decision in Reference re ss. 193 and 195.1(1)(c) of the Criminal Code (Man), [1990] 1 S.C.R. 1123, where Lamer J., as he then was, stated at page 1173:

> ... Therefore the restrictions on liberty and security of the person that s. 7 is concerned with are those that occur as a result of an individual's interaction with the justice system, and its administration.

400 Counsel acknowledged that section 7 was not confined to the realm of criminal law and that it had been found applicable to proceedings dealing with civil committal to a mental institution and to child protection proceedings. In this regard, counsel referred particularly to the decisions in Reference re Criminal Code (Man.), supra, New Brunswick (Minister of Health and Community Services) v. G. (J.), [1999] 3 S.C.R. 46, and Blencoe, supra. However, he submitted that subsection 245(4) does not directly engage the justice system and its administration, accordingly it is not of a subject matter that can be equated with civil committal to a mental institution or with child protection proceedings, and therefore does not engage section 7.

401 Counsel for the Respondent referred to three Supreme Court of Canada decisions, R. v. Beare, [1988] 2 S.C.R. 387, Pearlman v. Manitoba Law Society Judicial Committee, [1991] 2 S.C.R. 869 and R. v. Pontes, [1995] 3 S.C.R. 44, as confirming that the analysis under section 7 of the Charter involves two steps. To trigger section 7 there must first be a finding that there has been a deprivation of an individual's right to life, liberty and security of the person. Only if such deprivation is established is the second step triggered, that is, the determination whether the deprivation is contrary to the principles of fundamental justice. Counsel pointed out that in Pontes, supra, the Supreme Court of Canada found that a provision imposing absolute liability violated the principles of fundamental justice but held that it was nonetheless constitutionally valid because there was no breach or potential breach of the right to life, liberty and security of the person.

402 Counsel for the Respondent submitted that the Supreme Court of Canada determined the application of the doctrine of vagueness in constitutional adjudication in Nova Scotia Pharmaceutical, supra, where Gonthier J., speaking for the Court, stated at page 626:

> Vagueness can be raised under s. 7 of the Charter, since it is a principle of fundamental justice that laws may not be too vague. It can also be raised under s. 1 of the Charter in limine, on the basis that an enactment is so vague as not to satisfy the requirement that a limitation on Charter rights be "prescribed by law". Furthermore, vagueness is also relevant to the "minimal impairment" stage of the Oakes test (Morgentaler, [1988] 1 S.C.R. 30, Irwin Toy and the Prostitution Reference).

At page 632, Gonthier J. added:

> The "doctrine of vagueness", the content of which will be developed shortly, is a principle of fundamental justice under s. 7 and it is also part of s. 1 in limine ("prescribed by law").

403 Counsel submitted that the above statements confirm that the doctrine of vagueness is a principle of fundamental justice and not a free-standing right.

404 Counsel rejected the Appellants' contention that the following statement by Gonthier J., speaking for the Supreme Court in Nova Scotia Pharmaceutical, supra, at page 642, widened the scope of the application of the doctrine of vagueness, elevating it to a protected right:

> Finally, I also wish to point out that the standard I have outlined applies to all enactments, irrespective of whether they are civil, criminal, administrative or other. The citizen is entitled to have the State abide by constitutional standards of precision whenever it enacts legal dispositions....

Counsel noted that the above passage continued as follows at pages 642 and 643:

> ... In the criminal field, it may be thought that the terms of the legal debate should be outlined with special care by the State. In my opinion, however, once the minimal general standard has been met, any further arguments as to the precision of the enactments should be considered at the "minimal impairment" stage of s. 1 analysis.

405 Counsel contended that the entire passage is simply a confirmation that the same standard or same test for vagueness - i.e., whether there is "sufficient guidance for legal debate" - applies in all cases.

406 Thus, before it is even possible to address the issue of whether subsection 245(4) is so vague

as to be unconstitutional under section 7 of the Charter, it must first be established that the right to life, liberty and security of the person is involved. If it is not, then the inquiry is at an end. Counsel noted that in Ontario v. C. P., supra, at paragraph 78, the Supreme Court of Canada made it clear that "reasonable hypotheticals" have no place in a vagueness analysis under section 7 of the Charter.

407 According to counsel, unless a breach or a potential breach of any of the section 7 Charter rights is evident on the face of the impugned legislation, a proper factual foundation is required for the first step of a section 7 analysis. As counsel stated, the Court must first decide whether subsection 245(4) of the Act presents a "real or imminent" threat to any of the rights enumerated in section 7 of the Charter. After having made that determination - but only then - the Court can decide whether the breach is or is not reconcilable with the principles of fundamental justice. In this respect, counsel relied as well on Létourneau J.A.'s analysis in Gregory(FCA), supra, at paragraphs 6 to 12, where the proper approach is described.

408 Counsel also submitted that the two-step analysis had been used earlier by the Tax Court of Canada in Fleming et al. v. M.N.R., 86 D.T.C. 1628 and in Byrt v. M.N.R., 91 D.T.C. 923.

409 Counsel for the Respondent first analysed the content of the liberty right.

410 Counsel acknowledged that the right to liberty is not restricted to freedom from physical restraint and that the Supreme Court of Canada has found that liberty is engaged where state compulsions or prohibitions affect important and fundamental life choices; counsel referred in this regard to B. (R.) v. Children's Aid Society, supra. Referring also to the Supreme Court of Canada's decisions in Blencoe, supra, and Godbout, supra, counsel submitted that the liberty right only encompasses decisions of fundamental personal importance, such as choosing where to establish one's home or how to raise one's children, and that it is illogical to expand this right to cover all decisions, personal or business.

411 Counsel for the Respondent submitted that section 245 of the Act only affects economic rights and that purely economic interests are not protected by section 7 of the Charter. In this respect, reference was made to Whitbread v. Walley et al. (1988), 51 D.L.R. (4th) 509 (B.C.C.A.) and Weyer v. Canada (1988), 83 N.R. 272 (F.C.A.). In this latter case, the Federal Court of Appeal relied on the qualification regarding the rights protected by section 7 of the Charter expressed by the Federal Court - Trial Division in Smith, Kline & French Laboratories Limited et al. v. Attorney General of Canada (hereinafater Smith, Kline & French (FCTD)), [1986] 1 F.C. 274 at page 313, which qualification was accepted by the Federal Court of Appeal in Smith, Kline and French Laboratories Ltd. v. Canada (Attorney General) (hereinafter Smith, Kline and French (FCA)), [1987] 2 F.C. 359 at page 364. According to counsel, it has been generally accepted by the courts that property interests such as the right to contract or ownership of property were not protected by section 7 of the Charter. Counsel stated that although the liberty right was found to protect the ability to carry on one's chosen profession in the British Columbia Court of Appeal's decision in Wilson v. British Columbia (Medical Services Commission), (1988), 30 B.C.L.R. (2d) 1, that case

actually involved the protection of personal dignity, not an economic right.

412 Counsel for the Respondent's opinion is that, in the present case, there is simply no evidence that the economic effects of section 245, namely, the denial of tax losses, have any impact on the liberty interest protected by section 7 of the Charter.

413 Although counsel for the Appellants did not directly address the question of whether section 245 of the Act infringed on the right to security of the person by section 7, counsel for the Respondent nonetheless felt it necessary to analyse that issue.

414 Counsel for the Respondent submitted that there was no infringement of the right to security of the person. He stated that security of the person protected both physical and psychological integrity, but noted that in the present case there was no allegation of any effect on an individual's physical integrity. Further, the right to psychological integrity did not protect an individual from the ordinary stresses and anxieties that a person of reasonable sensibility would suffer as a result of government action, such as those that may result from the application of section 245. Citing the following passage from P.W. Hogg, Constitutional Law of Canada (loose-leaf ed.), vol. 2, at 44-12, adopted by Bastarache J., in Blencoe, supra, at paragraph 53, the Respondent submitted that security of the person has been interpreted by the Supreme Court of Canada to exclude economic security:

> It also requires ... that those terms [liberty and security of the person] be interpreted as excluding economic liberty and economic security; otherwise, property, having been shut out of the front door, would enter by the back.

415 Counsel for the Respondent rejected the Appellants' characterization of the right at issue as being the right of taxpayers not to be subject to arbitrary and indeterminate taxation. In counsel's view, the specific right at issue in the present appeals is simply the right to claim a loss, or the right to claim whatever tax benefits result from transactions that were motivated by tax considerations. In counsel's view, it would be difficult to argue that the Charter was meant to protect such rights.

416 Counsel for the Respondent submitted that the proper approach to a vagueness challenge involving a provision of the Act was that taken by Judge Kempo of this Court in Fleming, supra, where it was found that certainty of the law is not a constitutionally protected right and that it must first be established that some other constitutionally protected right is involved. Although, in that decision, the Court acknowledged that liberty and security of the person may have an economic component, it was concluded that the specific economic effect must be akin to what is covered by the known protections afforded by the phrase "life, liberty and security of the person". Counsel noted that in the present case section 245 has no chilling effect: it does not in fact prevent any commercial activity. It does not prevent the purchase of a partnership interest; it merely alters the tax consequences thereof and denies the losses that flow from such a purchase.

417 Counsel for the Respondent submitted that if certainty is a guaranteed right then retroactive tax legislation would be unconstitutional. Counsel stated this is clearly not the case, as it is trite law

that Parliament has the ability to change laws retroactively as long as it is done in clear language. Furthermore, he noted that the Appellants' premise that the right to liberty encompasses the right to organize one's affairs implies that tax laws should remain constant. Counsel submitted that there is no right to have tax laws remain constant, citing Gustavson Drilling (1964) Ltd. v. M.N.R., 75 D.T.C. 5451 (SCC), where Dickson J., speaking for the majority, stated at page 5456:

> ... No one has a vested right to continuance of the law as it stood in the past; in tax law it is imperative that legislation conform to changing social needs and governmental policy. A taxpayer may plan his financial affairs in reliance on the tax laws remaining the same; he takes the risk that the legislation may be changed.

418 Counsel for the Respondent presented a thorough analysis of the second step in a section 7 Charter analysis. In the present case, the inquiry is whether section 245 is so vague that it constitutes a breach of the principles of fundamental justice. However, counsel reiterated that before the Court could engage in such an analysis it would first need to find a breach of one of the three substantive rights protected by section 7 of the Charter.

419 Counsel for the Respondent, referring to Nova Scotia Pharmaceutical, supra, submitted that a law is unconstitutionally vague if it so lacks precision as not to give sufficient guidance for legal debate. Counsel noted that in Ontario v. C.P., supra, the Supreme Court of Canada stated that vagueness must not be assessed in abstracto, but instead must be assessed within the larger interpretive context developed through an analysis of considerations such as the purpose, subject matter and nature of the impugned provisions, societal values, related legislative provisions and prior judicial interpretation of the provisions in question. Further, in Ontario v. C.P., the Supreme Court of Canada confirmed that when assessing whether a law is void for vagueness under section 7 the court must first exhaust its interpretive role by attempting to apply the impugned legislation to the particular facts of the case.

420 Counsel for the Respondent submitted that the words "misuse" or "abuse", which the Appellants assert are too vague to provide sufficient guidance for legal debate, are in fact contained in a phrase that does provide guidance, and further, that the explanatory notes clarify that it is an object and spirit test that is to be applied. Counsel reviewed several cases in which this Court has applied subsection 245(4) using the object and spirit test, and he concluded that the interpretation of the provision has been consistent. On this point reference was made to the analysis in Michelin Tires (Canada) Ltd. v. Minister of National Revenue, 3 G.T.C. 4040 (C.I.T.T.) at page 4054, and in OSFC (TCC), supra, at paragraph 54. Further, counsel stated that the cases the Appellants referred to, in which the Court held differently with respect to the primary purpose of a transaction, did not establish that the provision had been inconsistently applied, but were simply the result of distinct factual situations.

421 Despite the Appellants' assertion that the academic community, and in particular Professor

Krishna, believed section 245 was vague, the Respondent noted that Krishna in fact had no difficulty interpreting subsection 245(4) in the same manner as this Court, and referred in this regard to Krishna's statements in The Fundamentals of Canadian Income Tax, supra, at pages 1394 and 1395. Counsel also referred to page 1400, where Professor Krishna stated:

> In this context, it is important to distinguish between the rule of statutory construction that requires an ambiguous provision to be interpreted according to its "object and spirit" (the purpose rule) and the application of subsection 245(4), which limits the scope of GAAR to avoidance transactions that do not offend the policy of the Act. The general rule of statutory construction is that clear and unequivocal words are to be given their ordinary, grammatical meaning in the context in which they appear. Thus, it is not necessary to determine the object and spirit of a clear and unequivocal statutory provision. The statute is read as it is written.
>
> Subsection 245(4), however, exempts an "avoidance transaction" from GAAR if it does not result in a misuse of the particular provision or an abuse of the Act read as a whole. Thus, compliance with the literal language of the Act, even where that language is clear and unequivocal, is not sufficient to immunize a transaction from GAAR ....

422 Referring to various other writings, counsel for the Respondent concluded that subsection 245(4) has been given a consistent interpretation, not only by the courts but by tax lawyers and the tax community at large.

423 Finally, the Respondent submitted that subsection 245(4) does not rely on judicial discretion in its application and thus does not fall within the ambit of the Supreme Court of Canada's holding in Morales, supra, where it was stated that a provision of a law must be capable of receiving a constant or settled meaning and not be left to judicial discretion for its interpretation.

424 Counsel rejected the Appellants' argument that there is a constitutionally intolerable uncertainty within section 245 because it requires the court to apply the sanctioned methods of statutory interpretation applicable to a taxation statute in order to determine whether the transaction at issue "works" and then requires that the court determine whether there has been a misuse or an abuse based on the same rules as those under which the tax result is otherwise sanctioned. Counsel submitted that the task before the court in the first step of the analysis under section 245 does not involve an assessment of the object and spirit of a particular provision; this is the distinct purpose of the second step of the analysis and is why the provision is not defective as asserted by the Appellants. Counsel referred to the decision of the Supreme Court of Canada in Antosko, supra, where Iacobucci J., speaking for the Court, stated at page 330:

> This transaction was obviously not a sham. The terms of the section were

> met in a manner that was not artificial. Where the words of the section are not ambiguous, it is not for this Court to find that the appellants should be disentitled to a deduction because they do not deserve a "windfall", as the respondent contends. In the absence of a situation of ambiguity, such that the Court must look to the results of a transaction to assist in ascertaining the intent of Parliament, a normative assessment of the consequences of the application of a given provision is within the ambit of the legislature, not the courts. Accordingly, I find that the transaction at issue comes within s. 20(14).

425 Counsel for the Respondent submitted that it is because the Supreme Court of Canada has refused, absent a specific provision mandating an object and spirit test, to apply an object and spirit analysis in interpreting tax legislation that subsection 245(4) specifically mandates such test. Further, counsel argued, it is within the power of Parliament to mandate an object and spirit test. Despite assertions that it might be difficult to ascertain the object and spirit of many provisions, as was noted by B.J. Arnold in his article "In Praise of the Business Purpose Test", Canadian Tax Foundation, Conference Report, 1987, page 10:1-34 at page 10:7, counsel for the Respondent referred, as an example, to the Supreme Court's decision in Shell, supra, at paragraph 57, where an object and spirit analysis is conducted with respect to subparagraph 20(1)(c)(i) of the Act. According to counsel, such an object and spirit analysis is mandated in all other fields of the law and it is surely not unconstitutional to legislatively mandate such an analysis.

426 Counsel for the Respondent reminded the Court that tax avoidance is a serious problem, referring in particular to the findings of the Report of the Royal Commission on Taxation (Ottawa: Queen's Printer, 1966), vol. 3, in which it was acknowledged that tax avoidance caused loss of revenue to government, fruitless expenditure of intellectual efforts on economically unproductive activities (i.e., tax avoidance), a sense of injustice and inequality on the part of those who do not benefit from tax avoidance, and the deterioration of tax morality, which results in tax evasion and an unfair shifting of the tax burden. Counsel noted that the problem had been increasing since 1966. He referred in this respect to various Department of Finance documents as well as House of Commons Debates.

427 As specific anti-avoidance rules were found to be ineffective and as the Supreme Court of Canada had refused to recognize a business purpose test in Canada, Parliament chose to legislate a general anti-avoidance provision in response to the increasing problem of tax avoidance.

428 Counsel for the Respondent reiterated the contention that vagueness only arises as an issue under section 7 of the Charter following a violation of the right to life, liberty and security of the person or in the context of a division of powers challenge where it is asserted that a provision is not within the competence of Parliament or the legislatures. He referred to the Federal Court of Appeal's decision in Luscher v. Dep. Minister, Revenue Canada, [1985] 1 F.C. 85 (F.C.A.), where it is stated, at page 93 that prior to the Charter the "courts had no mandate to refuse to apply a duly enacted statute simply on the grounds that it was vague or uncertain."

(iii) The Rule of Law

429 Counsel for the Respondent referred to the British Columbia Supreme Court's decision in JTI-Macdonald Corp., supra, at paragraph 150, where Holmes J. stated that, based on the decisions in Singh, supra, Bacon (C.A.), supra, and Babcock, supra, the rule of law was not of itself a basis for setting aside legislation as being unconstitutional. Counsel also noted that no provision has ever been struck down as being unconstitutionally vague in the absence of a Charter breach. Further, he said, the Supreme Court of Canada dismissed an application for leave to appeal in Bacon (C.A.), supra, a case in which the Saskatchewan Court of Appeal had determined that the rule of law was not a basis for setting aside otherwise validly enacted legislation. Counsel also noted that in Nova Scotia Pharmaceutical, supra, the Supreme Court of Canada had all of the information and arguments necessary to find that the rule of law could be a basis for striking down legislation and decided not to so find.

430 Counsel for the Respondents submitted that, even if the Court were to hold that the rule of law provided a basis for striking down legislation, the test for vagueness under the rule of law would be the same as under section 7 of the Charter. Thus, if section 245 were not found to be vague under section 7, it would not be vague under the rule of law. However, counsel conceded that if section 245 was found to infringe section 7 of the Charter, then it would not constitute a reasonable limit prescribed by law and demonstrably justified in a free and democratic society so as to be saved under section 1 of the Charter.

2. Submissions on the Standing of the Corporate Appellants

431 With respect to the four corporate Appellants, counsel for the Respondent sought to strike out portions of the pleadings concerning the constitutional issues pursuant to paragraph 58(1)(b) of the Tax Court of Canada Rules (General Procedure). As stated above, at the hearing counsel agreed to address this issue during final argument.

432 Counsel submitted that there is a general rule that corporations cannot challenge the validity of legislation under section 7 of the Charter. He nonetheless acknowledged that the Supreme Court of Canada provided an exception to the general prohibition against a corporation challenging the validity of legislation under the Charter in R. v. Big M Drug Mart Ltd., [1985] 1 S.C.R. 295. However, counsel noted that the exception only applied to penal proceedings. He referred to the Supreme Court of Canada's decision in Irwin Toy Ltd. v. Quebec (Attorney General), [1989] 1 S.C.R. 927, where the Big M Drug Mart exception was held not to apply because the case did not involve penal proceedings. Counsel noted that in Irwin, supra, the Supreme Court of Canada held that a corporation's economic rights have no protection under section 7 of the Charter. Counsel for the Respondent acknowledged that the Big M Drug Mart exception was expanded in Canadian Egg Marketing Agency v. Richardson, [1998] 3 S.C.R. 157, where the Supreme Court of Canada held that a corporation could attack legislation it considered unconstitutional when it was involuntarily brought before the courts pursuant to a regulatory regime. Counsel submitted that the expanded

exception in Canadian Egg Marketing Agency does not apply to the present appeals because the corporate Appellants have not been involuntarily brought before this Court.

433 Counsel for the Appellants made very brief submissions with respect to the ability of the corporate Appellants to invoke section 7 of the Charter. First, counsel submitted that if this Court were to find that section 245 should be struck down as violating the individual Appellants' section 7 Charter rights then it would follow that the corporate Appellants would benefit from that decision. In short, if the provision could not be applied against individuals it could not be applied against corporations. Second, counsel referred to section 52 of the Constitution Act, 1982, submitting that the basis of the authority to strike down legislation is the invalidity of the law and not the standing or attributes of the party challenging the law. Counsel argued that it is the nature of the law and not the status of the party challenging it that matters.

(C) ANALYSIS

1. The Constitutional Challenge

(i) Section 7 of the Charter

434 While counsel for the Appellants argued that section 7 of the Charter provides a guarantee against unduly vague laws, the Respondent submitted that there is no free-standing right pursuant to which laws may not be too vague, rather, the Supreme Court has chosen to define the statement that laws may not be too vague as a principle of fundamental justice.

435 With respect to the GAAR's purported infringement of the Charter because of vagueness, both the Appellant and the Respondent relied on Nova Scotia Pharmaceutical, supra, in which the Supreme Court of Canada extensively analysed the doctrine of vagueness. The issue in that case was whether paragraph 32(1)(c) of the Combines Investigation Act infringed section 7 of the Charter because of vagueness arising from the use of the word "unduly". It is helpful to reproduce at the outset the summary of the doctrine of vagueness provided by Gonthier J., speaking for the Court, at pages 626 and 627:

> The foregoing may be summarized by way of the following propositions:
>
> 1. Vagueness can be raised under s. 7 of the Charter, since it is a principle of fundamental justice that laws may not be too vague. It can also be raised under s. 1 of the Charter in limine, on the basis that an enactment is so vague as not to satisfy the requirement that a limitation on Charter rights be "prescribed by law". Furthermore, vagueness is also relevant to the "minimal impairment" stage of the Oakes test (Morgentaler, Irwin Toy and

the Prostitution Reference).

2. The "doctrine of vagueness" is founded on the rule of law, particularly on the principles of fair notice to citizens and limitation of enforcement discretion (Prostitution Reference and Committee for the Commonwealth of Canada, [1991] 1 S.C.R. 139).
3. Factors to be considered in determining whether a law is too vague include (a) the need for flexibility and the interpretative role of the courts, (b) the impossibility of achieving absolute certainty, a standard of intelligibility being more appropriate and (c) the possibility that many varying judicial interpretations of a given disposition may exist and perhaps coexist (Morgentaler, Irwin Toy, Prostitution Reference, Taylor and Osborne, [1991] 2 S.C.R. 69).
4. Vagueness, when raised under s. 7 or under s. 1 in limine, involves similar considerations (Prostitution Reference, Committee for the Commonwealth of Canada). On the other hand, vagueness as it relates to the "minimal impairment" branch of s. 1 merges with the related concept of overbreadth (Committee for the Commonwealth of Canada and Osborne).
5. The Court will be reluctant to find a disposition so vague as not to qualify as "law" under s. 1 in limine, and will rather consider the scope of the disposition under the "minimal impairment" test (Taylor and Osborne).

Gonthier J. then examined the doctrine of vagueness in Charter adjudication and concluded as follows, at page 632:

1. What is referred to as "overbreadth", whether it stems from the vagueness of a law or from another source, remains no more than an analytical tool to establish a violation of a Charter right. Overbreadth has no independent existence. References to a "doctrine of overbreadth" are superfluous.
2. The "doctrine of vagueness", the content of which will be developed shortly, is a principle of fundamental justice under s.7 and it is also part of s. 1 in limine ("prescribed by law").

436 The Respondent submitted that the analysis under section 7 of the Charter involves two steps, as is evident from the structure of the provision itself. To trigger the operation of section 7, there must first be a finding that there has been a deprivation of an individual's right to "life, liberty and security of the person", and secondly, that that deprivation is contrary to the principles of fundamental justice. If the threshold issue is decided in the negative, there is no need to examine the second issue, namely, whether the deprivation is contrary to the principles of fundamental justice.

437 Counsel for the Appellants contended that the acknowledgment in Nova Scotia Pharmaceutical, supra, of an unqualified right "to have the State abide by constitutional standards of precision whenever it enacts legal dispositions" and in stating that this right applies to "all

enactments," the Supreme Court of Canada was indicating that when assessing whether a law is unduly vague one may go beyond the ordinary section 7 analysis. In essence, the Appellants thesis is that the right to protection against vague or arbitrary laws is a free-standing right.

438 I accept the Respondent's submission that the analysis under section 7 is in fact a two-step process. This analytical approach has been approved by the Supreme Court of Canada and consistently applied by the courts, as is evidenced by the following brief review of section 7 Charter jurisprudence.

439 In Blencoe, supra, the Supreme Court of Canada recently reviewed the principles applicable in section 7 challenges. Bastarache J., speaking for the majority, stated at paragraph 46:

> ... Section 7 can extend beyond the sphere of criminal law, at least where there is "state action which directly engages the justice system and its administration" (G. (J.), at para. 66). If a case arises in the human rights context which, on its facts, meets the usual s. 7 threshold requirements, there is no specific bar against such a claim and s. 7 may be engaged. The question to be addressed, however, is not whether delays in human rights proceedings can engage s. 7 of the Charter but rather, whether the respondent's s. 7 rights were actually engaged by delays in the circumstances of this case....

At paragraph 47, he explained:

> Section 7 of the Charter provides that "[e]veryone has the right to life, liberty and security of the person and the right not to be deprived thereof except in accordance with the principles of fundamental justice." Thus, before it is even possible to address the issue of whether the respondent's s. 7 rights were infringed in a manner not in accordance with the principles of fundamental justice, one must first establish that the interest in respect of which the respondent asserted his claim falls within the ambit of s. 7. These two steps in the s. 7 analysis have been set out by La Forest J. in R. v. Beare, [1988] 2 S.C.R. 387, at p. 401, as follows:
>
> > To trigger its operation there must first be a finding that there has been a deprivation of the right to "life, liberty and security of the person" and, secondly, that the deprivation is contrary to the principles of fundamental justice.
>
> Thus, if no interest in the respondent's life, liberty or security of the person is implicated, the s. 7 analysis stops there....

[Emphasis added.]

440 It should be emphasized that this two-step analysis was confirmed as a requirement in deciding the very constitutional question at issue in the present appeals by Létourneau J.A. of the Federal Court of Appeal in Gregory (FCA), supra. Létourneau J.A., speaking for himself, but concurring with the majority in the result, stated at paragraph 9 of his reasons:

> It is trite law that a section 7 challenge proceeds in two steps. First, there has to be evidence that a citizen is deprived of his section 7 rights. Second, evidence has to be adduced that this was done in a manner that was not in accordance with the principles of fundamental justice: Blencoe, supra, R. v. Beare, [1988] 2 S.C.R. 387, at page 401.

441 It is also worth noting that a similar methodology was prescribed by Iacobucci J. in R. v. White, [1999] 2 S.C.R. 417, in stating for the majority, at paragraph 38:

> ... Where a court is called upon to determine whether s. 7 has been infringed, the analysis consists of three main stages, in accordance with the structure of the provision. The first question to be resolved is whether there exists a real or imminent deprivation of life, liberty, security of the person, or a combination of these interests. The second stage involves identifying and defining the relevant principle or principles of fundamental justice. Finally, it must be determined whether the deprivation has occurred in accordance with the relevant principle or principles: see R. v. S. (R.J.), [1995] 1 S.C.R. 451, at p. 479, per Iacobucci J. Where a deprivation of life, liberty, or security of the person has occurred or will imminently occur in a manner which does not accord with the principles of fundamental justice, a s. 7 infringement is made out.

442 Bastarache J. in Blencoe, supra, proposed a two-step analysis whereas Iacobucci J. proposed a three-stage one in White, supra. However, both cases are consistent since both analyses include the same considerations, the distinction being that in Blencoe, Bastarache J. merges into one single step the second and third stages proposed by Iacobucci J. in White.

443 The two-step analysis referred to in Blencoe is also consistent with the approach of Lamer C.J. (as he then was) in R. v. Swain, [1991] 1 S.C.R. 933, where he stated for the majority, at page 969:

> In order to invoke the protection of s. 7, an individual must establish an actual or potential deprivation of life, liberty or security of the person. Once a life, liberty, or security of the person interest is established, the question becomes whether the deprivation of liberty or security of the person is or is not in accordance with the principles of fundamental justice.

444 While vagueness was not raised as an issue in the above-cited cases, they set forth the general principles applicable to section 7 challenges, which are, in my opinion, applicable to section 7 challenges for vagueness as well. Pursuant to those principles, the infringement of a section 7 right is a prerequisite to a vagueness challenge under that section. This is further supported by the majority decision of the Supreme Court of Canada in Re B.C. Motor Vehicle Act, [1985] 2 S.C.R. 486, where Lamer J., as he then was, stated at page 501 that the principles of fundamental justice referred to in section 7 "are not a protected interest, but rather a qualifier of the right not to be deprived of life, liberty and security of the person." It follows that in order to invoke section 7 of the Charter, one must establish an infringement of the right to life or the right to liberty or the right to security of the person.

445 I further agree with the Respondent that unless a violation or a potential violation of one of the protected rights in section 7 is evident on the face of the impugned legislation, a proper factual foundation is required for the first step of the section 7 analysis. The Court should not, in the absence of evidence, presume any effect of subsection 245 that could have an impact on a constitutionally protected right. However, an actual infringement is not a requirement. In White, supra, it was stated that an actual infringement of the right to life, liberty and security of the person is not required, rather, the language used by the Supreme Court of Canada is that there must be a "real or imminent" deprivation of the right to life, liberty and security of the person. Thus, the issue in the present appeals is whether subsection 245 of the Act entails a "real or imminent" deprivation of any of the rights enumerated in section 7 of the Charter. Only after an affirmative answer to that question can it be decided whether such deprivation is or is not in accordance with the principles of fundamental justice.

446 Thus, the first issue to be determined is whether section 245 of the Act engages the Appellants' liberty interest. Counsel for the Appellants asserted that the right to be free from arbitrary laws resides naturally in the section 7 liberty right. In particular, it was argued that the right to personal autonomy would mean little if it did not encompass the right to organize one's affairs - whether personal or business - free from arbitrary governmental interference. Counsel for the Respondent argued that the liberty right only encompasses the right to make decisions of fundamental personal importance and is not wide enough in scope to protect purely economic rights.

447 It is appropriate to first discuss the scope and content of the liberty right and then to determine whether section 245 infringes that right.

448 The once narrow interpretation of the liberty right has in recent years been expanded. In Blencoe, supra, Bastarache J., speaking for the majority, stated the following, at paragraph 45:

> Although there have been some decisions of this Court which may have supported the position that s. 7 of the Charter is restricted to the sphere of criminal law, there is no longer any doubt that s. 7 of the Charter is not confined

to the penal context. This was most recently affirmed by this Court in New Brunswick (Minister of Health and Community Services) v. G. (J.), [1999] 3 S.C.R. 46, where Lamer C.J. stated that the protection of security of the person extends beyond the criminal law (at para. 58). He later added (at para. 65):

> ... s. 7 is not limited solely to purely criminal or penal matters. There are other ways in which the government, in the course of the administration of justice, can deprive a person of their s. 7 rights to liberty and security of the person, i.e., civil committal to a mental institution: see B. (R.), supra, at para. 22.

449 In Blencoe, Bastarache J. recognized that, outside the penal context, the section 7 right to liberty comprises the right to "personal autonomy" and the right to make decisions of "fundamental personal importance" and, further, that the liberty interest should be interpreted broadly and in accordance with the principles and values underlying the Charter as a whole. He stated at paragraph 49:

> The liberty interest protected by s. 7 of the Charter is no longer restricted to mere freedom from physical restraint. Members of this Court have found that "liberty" is engaged where state compulsions or prohibitions affect important and fundamental life choices. This applies for example where persons are compelled to appear at a particular time and place for fingerprinting (Beare, supra); to produce documents or testify (Thomson Newspapers Ltd. v. Canada (Director of Investigation and Research, Restrictive Trade Practices Commission), [1990] 1 S.C.R. 425); and not to loiter in particular areas (R. v. Heywood, [1994] 3 S.C.R. 761). In our free and democratic society, individuals are entitled to make decisions of fundamental importance free from state interference. In B. (R.) v. Children's Aid Society of Metropolitan Toronto, [1995] 1 S.C.R. 315, at para. 80, La Forest J., with whom L'Heureux-Dubé, Gonthier and McLachlin JJ. agreed, emphasized that the liberty interest protected by s. 7 must be interpreted broadly and in accordance with the principles and values underlying the Charter as a whole and that it protects an individual's personal autonomy:
>
> > ... liberty does not mean mere freedom from physical restraint. In a free and democratic society, the individual must be left room for personal autonomy to live his or her own life and to make decisions that are of fundamental personal importance.
> >
> > [Emphasis added.]

450 In Godbout, supra, a residence requirement enacted by the City of Longueuil for its employees was unanimously held by the Supreme Court of Canada to constitute a violation of section 5 of the Quebec Charter of Human Rights and Freedoms. Section 5 provides that "[e]very person has a right to respect for his private life." However, the majority of the Court refused to engage in an analysis as to whether the impugned provision infringed section 7 of the Charter. That issue was examined only by La Forest J., speaking for himself, L'Heureux-Dubé J. and McLachlin J. (as she then was). La Forest J. discussed the nature and extent of the liberty interest, stating at paragraph 66:

> ... the right to liberty enshrined in s. 7 of the Charter protects within its ambit the right to an irreducible sphere of personal autonomy wherein individuals may make inherently private choices free from state interference. I must emphasize here that, as the tenor of my comments in B. (R.) should indicate, I do not by any means regard this sphere of autonomy as being so wide as to encompass any and all decisions that individuals might make in conducting their affairs. Indeed, such a view would run contrary to the basic idea, expressed both at the outset of these reasons and in my reasons in B. (R.), that individuals cannot, in any organized society, be guaranteed an unbridled freedom to do whatever they please. Moreover, I do not even consider that the sphere of autonomy includes within its scope every matter that might, however vaguely, be described as "private". Rather, as I see it, the autonomy protected by the s. 7 right to liberty encompasses only those matters that can properly be characterized as fundamentally or inherently personal such that, by their very nature, they implicate basic choices going to the core of what it means to enjoy individual dignity and independence. As I have already explained, I took the view in B. (R.) that parental decisions respecting the medical care provided to their children fall within this narrow class of inherently personal matters. In my view, choosing where to establish one's home is, likewise, a quintessentially private decision going to the very heart of personal or individual autonomy.
>
> [Emphasis added.]

451 The question to be determined here is whether the liberty interest encompasses economic rights, particularly the right to rely on specific provisions of the Act in planning one's affairs. The Appellants noted that the Supreme Court of Canada recognized in Godbout, supra, that restrictions on one's place of residence can potentially offend section 7, as that section is construed to protect individual choice, dignity and independence. The Appellants submitted that freedom from arbitrary laws thus goes to the heart of the notion of "liberty", most recently described as involving "individual dignity and independence". Furthermore, according to the Appellants, the right to "personal autonomy" recognized as part of the section 7 liberty right in Blencoe, supra, would mean little if it did not encompass the right to organize one's affairs, whether personal or business, free

from "governmental interference that is wholly arbitrary in nature". In response, counsel for the Respondent argued that to accept the position put forward by the Appellants would amount to a widening of the application of the doctrine of vagueness so as to elevate it to a protected right. This elevation to the status of a free-standing right is not in keeping with the Supreme Court of Canada's holding in Nova Scotia Pharmaceutical, supra, that the doctrine of vagueness is a principle of fundamental justice.

452 In Reference re Criminal Code (Man.), supra, the Supreme Court of Canada considered whether section 7 of the Charter protected economic rights in the context of a prostitute's right to earn a living from a chosen profession. Lamer J. (as he then was) speaking for himself, but concurring with the majority in the result, reviewed the case law relating to economic liberty and concluded that section 7, like the rest of the Charter, with the possible exception of the mobility rights provisions, does not concern itself with economic rights. Lamer J. stated at page 1162:

> This case raises an important issue that has been recurring in our jurisprudence under the Charter. Simply stated, the issue centers on the scope of s.7 of the Charter, more specifically the guarantees of life, liberty and security of the person. The appellants argue that the impugned provisions infringe prostitutes' right to liberty in not allowing them to exercise their chosen profession, and their right to security of the person, in not permitting them to exercise their profession in order to provide the basic necessities of life....

453 At pages 1166 and 1167 he further stated:

> With this in mind I now propose to examine the Canadian jurisprudence in the area of "economic liberty" and s. 7 of the Charter.
>
> I begin by noting the words of the Chief Justice in R. v. Edwards Books and Art Ltd., [1986] 2 S.C.R. 713, at pp. 785-86:
>
> > In my opinion "liberty" in s. 7 of the Charter is not synonymous with unconstrained freedom.... Whatever the precise contours of "liberty" in s. 7, I cannot accept that it extends to an unconstrained right to transact business whenever one wishes. Much in the same vein other courts in this country have decided that "liberty" does not generally extend to commercial or economic interests. In R.V.P. Enterprises Ltd. v. British Columbia (Minister of Consumer & Corporate Affairs), [1988] 4 W.W.R. 726, for example, the B.C. Court of Appeal had to decide whether the right to continue to hold a liquor license was a constitutionally protected liberty interest. The court, Esson J.A. speaking for it, held that it was not at pp. 732-33:

> It is enough to say that the licence here in question is an entirely economic interest and, as such, not one to which s. 7 has any application.

> It should be noted that the court expressly stated that it was not deciding that s. 7 could not apply to any interest which has an economic, commercial or property component. Another case from British Columbia, Whitbread v. Walley (1988), 26 B.C.L.R. (2d) 203 (C.A.) also dealt generally with the question of economic interests and s. 7 of the Charter. At issue in that case were two sections of the Canada Shipping Act that limited the liability of owners and crew members of ships. McLachlin J.A. (as she then was), speaking for the court, held at p. 213 that "purely economic claims are not within the purview of s. 7 of the Charter", although she did add the caution that she was not asserting that s. 7 could never include an interest with an economic component.

> [Emphasis added.]

Lamer J. continued as follows at pages 1168 and 1169:

> The court, in a per curiam decision, held that "liberty" within the meaning of s. 7 is not confined to freedom from bodily restraint. It did go on to say the following about the scope of s. 7 (at p. 18):

> > It does not, however, extend to protect property or pure economic rights. It may embrace individual freedom of movement, including the right to choose one's occupation and where to pursue it, subject to the right of the state to impose, in accordance with the principles of fundamental justice, legitimate and reasonable restrictions on the activities of individuals.

> > [Emphasis added.]

He then concluded at pages 1170 and 1171:

> In short then I find myself in agreement with the following statement of McIntyre J. in the Reference Re Public Service Employee Relations Act (Alta.), [1987] 1 S.C.R. 313, supra, at p. 412:

> It is also to be observed that the Charter, with the possible exception of s. 6(2)(b) (right to earn a livelihood in any province) and s. 6(4), does not concern itself with economic rights.
>
> [Emphasis added.]

454 In Wilson v. B.C. (Medical Services Commission), supra, the British Columbia Court of Appeal endorsed a limited exception to the proposition that economic rights are not protected by the liberty interest in section 7 of the Charter. The exception applies where economic interests are so fused with non-economic liberties, such as the right to exercise one's chosen profession, that they are incidentally protected.

455 I accept the Respondent's submissions that this limited exception does not apply in the present appeals where there is no evidence that the economic effects of section 245 of the Act would amount to an actual or potential deprivation of any protected liberty interest.

456 It is worth noting that the principle that purely economic interests are not included within the scope of the rights protected under section 7 has been affirmed in numerous other cases. In Gerol v. The Attorney General of Canada, 85 D.T.C. 5561, Rosenberg J. of the Ontario High Court of Justice stated, at page 5563:

> ... The right to life, liberty and security of the person is the single inter-related right which guarantees the individual freedom from interference with the person. It is meant to provide protection from physical threats or punishment and from arrest and detention. Security of the person refers to physical and personal integrity of an individual.
>
> Even if the rights included certain economic freedoms, they do not include the right to unrestrained conduct in business affairs, nor complete economic freedom: The Queen v. Operation Dismantle Inc., et al (1983), 3 D.L.R. (4th) 193 at pp. 199, 200 and 217; Public Service Alliance of Canada v. The Queen in Right of Canada et al (1984), 11 D.L.R. (4th) 337 (F.C.T.D.) affirmed (1984) 11 D.L.R. (4th) 387; Singh et al v. Minister of Employment and Immigration (1985), 17 D.L.R. (4th) 422 at 458; R. v. Videoflicks (1984), 48 O.R. (2d) 395 (C.A.) at 433; Gersham Produce Co. Ltd. v. The Motor Transport Board (1985), 14 D.L.R. (4th) 722 (Man. Q.B.) at 730; Becker v. The Queen in Right of Alberta (1983), 7 C.R.R. 232 (Alta. Q.B.) at 237; P. Garant, in W. Tarnopolsky, G. Beaudoin, eds. The Canadian Charter of Rights and Freedoms, 1982, p. 263, 270.

[Emphasis added.]

457 A similar conclusion was reached by the Federal Court of Appeal in Smith, Kline & French (FCA), supra. In that case, at page 364, Hugessen J. confirmed Strayer J.'s (as he then was) analysis in Smith, Kline & French (FCTD), supra, with respect to the denial of the right to life, liberty and security of the person protected under section 7 of the Charter. It is worth quoting on this issue the following excerpt from Strayer J.'s reasons, at page 313:

> ... In my view the concepts of "life, liberty and security of the person" take on a colouration by association with each other and have to do with the bodily well-being of a natural person. As such as they are not apt to describe any rights of a corporation nor are they apt to describe purely economic interests of a natural person. I have not been referred to any authority which requires me to hold otherwise.

[Emphasis added.]

458 Furthermore, in Taylor v. The Queen, 95 D.T.C. 591, Judge Sobier of this Court stated, at page 598, that "[s]ection 7 affords no safeguard of economic rights".

459 This interpretation of section 7 of the Charter was recently reaffirmed in Olympia Interiors Ltd. v. R., [1999] 3 C.T.C. 305 (F.C.T.D.), where MacKay J. stated, at paragraph 88:

> The law also limits the interests protected under s. 7, which protects an individual's physical liberty rather than her or his economic liberty. In MacPhee v. Nova Scotia (Pulpwood Marketing Board), 88 N.S.R. (2d) 345, the Nova Scotia Court of Appeal held that s. 7 did not apply to economic or proprietary interests. In Reference re s. 94(2) of the Motor Vehicle Act (British Columbia), Lamer J. (as he then was) found that a law imposing merely a fine rather than imprisonment was not subject to s. 7 scrutiny because it does not deprive an offender of liberty.

[Footnotes omitted.]

460 In the present appeals, I have definitely not been convinced that section 245 infringes on the Appellants' liberty right. A restriction on a taxpayer's ability to rely on specific provisions or specific words of the Act in a manner not in accord with their object and spirit, or on the Act read as a whole, for the purpose of planning transactions in order to mitigate tax consequences cannot be characterized as infringing a fundamentally or inherently personal right analogous to the right to choose where one lives. I do not believe that the "economic rights" of which one may be deprived

as a result of the application of section 245 are within the same class of economic rights as the right to social security, food or shelter that may be protected by section 7 of the Charter. I certainly cannot see any way to characterize section 245 of the Act as affecting an individual's autonomy in such a fundamental and inherently personal way as to deprive him of the ability to make basic choices that go to the core of his dignity and independence.

461 Moreover, I agree with the Respondent that section 245 of the Act does not operate to prevent the Appellants from purchasing interests in a partnership or participating in a partnership; that provision merely denies the losses which flow from the partnership interests.

462 The challenge to section 245 of the Act on the basis that the right to liberty protected under section 7 of the Charter is engaged must therefore fail.

463 Counsel for the Appellants did not advance any argument that section 245 of the Act infringed the section 7 right to "security of the person." Counsel for the Respondent nonetheless felt it necessary to address this potential Charter breach by arguing that security of the person does not come into play in the present circumstances.

464 The right to security of the person protects an individual's physical and psychological integrity. The present case does not involve any threat to an individual's physical integrity. Thus the only issue is whether section 245 of the Act operates to violate an individual's psychological integrity. Bastarache J. in Blencoe, supra, discussed the content of the protection of an individual's psychological integrity, stating for the majority, at paragraph 57:

> Not all state interference with an individual's psychological integrity will engage s. 7. Where the psychological integrity of a person is at issue, security of the person is restricted to "serious state-imposed psychological stress" (Dickson C.J. in Morgentaler, supra, at p. 56). I think Lamer C.J. was correct in his assertion that Dickson C.J. was seeking to convey something qualitative about the type of state interference that would rise to the level of infringing s. 7 (G. (J.), at para. 59). The words "serious state-imposed psychological stress" delineate two requirements that must be met in order for security of the person to be triggered. First, the psychological harm must be state imposed, meaning that the harm must result from the actions of the state. Second, the psychological prejudice must be serious. Not all forms of psychological prejudice caused by government will lead to automatic s. 7 violations.

Bastarache J. went on to state at paragraphs 82 and 83:

> The quality of the injury must therefore be assessed. In my opinion, all of the cases which have come within the broad interpretation of "security of the person" outside of the penal context differ markedly from the interests that are at issue in this case. Violations of security of the person in this context include only serious

> psychological incursions resulting from state interference with an individual interest of fundamental importance.
>
> It is only in exceptional cases where the state interferes in profoundly intimate and personal choices of an individual that state-caused delay in human rights proceedings could trigger the s. 7 security of the person interest. While these fundamental personal choices would include the right to make decisions concerning one's body free from state interference or the prospect of losing guardianship of one's children, they would not easily include the type of stress, anxiety and stigma that result from administrative or civil proceedings.
>
> [Emphasis added.]

465 Clearly the protection of one's psychological integrity involves only the most serious psychological incursions, as was affirmed in New Brunswick (Minister of Health and Community Services) v. G. (J.), supra. In that case, the Supreme Court of Canada held that the right to security of the person does not protect the individual from the ordinary stresses and anxieties that a person of reasonable sensibility would suffer as a result of government action. Lamer C.J., speaking for the majority of the Court, stated at paragraph 59:

> Delineating the boundaries protecting the individual's psychological integrity from state interference is an inexact science. Dickson C.J. in Morgentaler, supra, at p. 56, suggested that security of the person would be restricted through "serious state-imposed psychological stress" (emphasis added.). Dickson C.J. was trying to convey something qualitative about the type of state interference that would rise to the level of an infringement of this right. It is clear that the right to security of the person does not protect the individual from the ordinary stresses and anxieties that a person of reasonable sensibility would suffer as a result of government action. If the right were interpreted with such broad sweep, countless government initiatives could be challenged on the ground that they infringe the right to security of the person, massively expanding the scope of judicial review, and, in the process, trivializing what it means for a right to be constitutionally protected.
>
> [Emphasis added.]

466 One further point deserves comment. Unlike the Fifth Amendment and the Fourteenth Amendment (section 1) to the United States Constitution, section 7 of the Charter does not offer specific protection for property rights. Strayer J. (as he then was) in Smith, Kline & French (FCTD) stated at page 315:

> ... Further, it is well known that an amendment specifically to include "property" in the protection of section 7 was withdrawn during the consideration of the Charter by the Joint Parliamentary Committee on the Constitution. This indicates that at least in its origins section 7 was not understood to provide protection for property.

467 The Supreme Court of Canada considered the effect of the omission of the word "property" from section 7 of the Charter in Irwin Toy, supra. Dickson C.J., Lamer J. (as he then was) and Wilson J. who comprised the majority, stated at pages 1003 and 1004:

> What is immediately striking about this section is the inclusion of "security of the person" as opposed to "property". This stands in contrast to the classic liberal formulation, adopted, for example, in the Fifth and Fourteenth Amendments in the American Bill of Rights, which provide that no person shall be deprived "of life, liberty or property, without due process of law". The intentional exclusion of property from s. 7, and the substitution therefor of "security of the person" has, in our estimation, a dual effect. First, it leads to a general inference that economic rights as generally encompassed by the term "property" are not within the perimeters of the s. 7 guarantee. This is not to declare, however, that no right with an economic component can fall within "security of the person". Lower courts have found that the rubric of "economic rights" embraces a broad spectrum of interests, ranging from such rights, included in various international covenants, as rights to social security, equal pay for equal work, adequate food, clothing and shelter, to traditional property - contract rights. To exclude all of these at this early moment in the history of Charter interpretation seems to us to be precipitous. We do not, at this moment, choose to pronounce upon whether those economic rights fundamental to human life or survival are to be treated as though they are of the same ilk as corporate-commercial economic rights. In so stating, we find the second effect of the inclusion of "security of the person" to be that a corporation's economic rights find no constitutional protection in that section.

468 In Blencoe, supra, Bastarache J., speaking for the majority, cited at paragraph 53 the following passage from Hogg, Constitutional Law of Canada, vol. 2, loose-leaf ed., p. 44-12.1, with respect to the deliberate omission of the word "property" from section 7 of the Charter:

> It also requires ... that those terms [liberty and security of the person] be interpreted as excluding economic liberty and economic security; otherwise, property, having been shut out of the front door, would enter by the back.

469 From the foregoing, it seems clear that the protection of the right to liberty and to security of the person by section 7 of the Charter does not extend to economic rights that can properly be

described as strictly "corporate-commercial economic rights" such as the ones at stake in the present appeals.

(ii) Rule of Law

470 The Appellants argued that the substantive rule of law standards are an independent basis for assessing the constitutionality of legislation. The Respondent submitted that there is ample jurisprudence to support the proposition that, in the absence of a Charter breach, the courts cannot, or at least will not, make a finding that a statute is invalid as being void for vagueness.

471 I once again find myself in agreement with the Respondent and accept the submission that the rule of law is not an independent basis for striking down otherwise validly enacted legislation. This position is supported by the case law, as well as by the principles of constitutionalism and the rule of law and their interaction in the Canadian legal system.

472 As I understand it, the judiciary may only strike down a law that is inconsistent with the Constitution. The authority to strike down legislation is enshrined in subsection 52(1) of the Constitution Act, 1982, which reads:

> Primacy of Constitution of Canada
>
> 52.(1) The Constitution of Canada is the supreme law of Canada, and any law that is inconsistent with the provisions of the Constitution is, to the extent of the inconsistency, of no force or effect.

473 The principle of the rule of law in Canada is to be found in the preamble to the Charter, which reads as follows:

> Whereas Canada is founded upon principles that recognize the supremacy of God and the rule of law ....

474 Section 1 of the Charter requires that limitations on rights and freedoms be "prescribed by law", which is analogous to being "in compliance with the rule of law". Vagueness can be raised under section 1 of the Charter in limine on the basis that an enactment is so vague as not to satisfy the requirement that a limitation on Charter rights be "prescribed by law".

475 In Re Manitoba Language Rights, [1985] 1 S.C.R. 721, a unanimous Supreme Court of Canada described the rule of law as follows at pages 750-751:

> The constitutional status of the rule of law is beyond question. The preamble to the Constitution Act, 1982 states:

> Whereas Canada is founded upon principles that recognize the supremacy of God and the rule of law.
>
> (Emphasis added.)
>
> This is explicit recognition that "the rule of law [is] a fundamental postulate of our constitutional structure" (per Rand J., Roncarelli v. Duplessis, [1959] S.C.R. 121, at p. 142). The rule of law has always been understood as the very basis of the English Constitution characterising the political institutions of England from the time of the Norman Conquest (A.V. Dicey, The Law of the Constitution (10th ed. 1959), at p. 183). It becomes a postulate of our own Constitutional order by way of the preamble to the Constitution Act, 1982, and its implicit inclusion in the preamble to the Constitution Act, 1867 by virtue of the words "with a Constitution similar in principle to that of the United Kingdom".
>
> Additional to the inclusion of the rule of law in the preambles of the Constitution Acts of 1867 and 1982, the principle is clearly implicit in the very nature of a Constitution. The Constitution, as the Supreme Law, must be understood as a purposive ordering of social relations providing a basis upon which an actual order of positive laws can be brought into existence. The founders of this nation must have intended, as one of the basic principles of nation building, that Canada be a society of legal order and normative structure: one governed by rule of law. While this is not set out in a specific provision, the principle of the rule of law is clearly a principle of our Constitution.

476 Counsel for the Appellants' submitted that although the Supreme Court of Canada in Nova Scotia Pharmaceutical, supra, described the substantive rule of law principles as being specifically and integrally related to section 7 of the Charter, the Court also examined at pages 636 and 637 and at pages 641 and 642 ECHR case law, particularly as regards the relationship between vagueness and the rule of law in that case law. The Court noted that the ECHR gave the "prescribed by law" standards of the European Convention substantive content that went beyond a mere inquiry into whether a law existed or not.

477 Counsel for the Appellants noted the following commentary with respect to the ECHR case law in Zellick, supra, at p. 103:

> The court has also had occasion to focus on the words "prescribed by law" (found in both the Convention and in section 1) and precision, accessibility and clarity have been held to be necessary attributes in addition to the formal, positivist character of law. Common law is, however, included. In particular, a law which

> confers a discretion must indicate the scope of that discretion, but the actual detail need not be embodied in the authorising legislation itself. The expression "prescribed by" or "in accordance with" law thus has a qualitative character, too, requiring conformity to the rule of law, mentioned in the preamble to the Convention as in the preamble to the Charter. [Footnotes omitted.]

478 Counsel for the Appellants referred the Court to the following part of Gonthier J.'s vagueness analysis in Nova Scotia Pharmaceutical, supra, where, speaking for the Supreme Court, he referred at page 637 to ECHR case law:

> The ECHR developed its conception of "prescribed by law" in the course of two famous cases, the Sunday Times case, judgment of 26 April 1979, Series A No. 30, and the Malone case, judgment of 2 August 1984, Series A No. 82. In the former, the ECHR drew attention to the two aspects of fair notice, namely formal notice ("accessibility") and substantive notice ("foreseeability"). It wrote at p. 31:
>
> > In the Court's opinion, the following are two of the requirements that flow from the expression "prescribed by law". Firstly, the law must be adequately accessible: the citizen must be able to have an indication that is adequate in the circumstances of the legal rules applicable to a given case. Secondly, a norm cannot be regarded as a "law" unless it is formulated with sufficient precision to enable the citizen to regulate his conduct: he must be able - if need be with appropriate advice - to foresee, to a degree that is reasonable in the circumstances, the consequences which a given action may entail. Those consequences need not be foreseeable with absolute certainty: experience shows this to be unattainable. Again, whilst certainty is highly desirable, it may bring in its train excessive rigidity and the law must be able to keep pace with changing circumstances. Accordingly, many laws are inevitably couched in terms which, to a greater or lesser extent, are vague and whose interpretation and application are questions of practice.

479 I would note that even in the Sunday Times case, supra, the ECHR first found a violation of a right protected by the European Convention before it undertook the analysis of whether the interference with the right was "prescribed by law". In the Sunday Times case, the ECHR was interpreting Article 10 of the European Convention, which reads as follows:

> Article 10
>
> (1) Everyone has the right to freedom of expression. This right shall include freedom to hold opinions and to receive and impart information and ideas without interference by public authority and regardless of frontiers. This Article shall not

prevent States from requiring the licensing of broadcasting, television or cinema enterprises.

(2) The exercise of these freedoms, since it carries with it duties and responsibilities, may be subject to such formalities, conditions, restrictions or penalties as are prescribed by law and are necessary in a democratic society, in the interests of national security, territorial integrity or public safety, for the prevention of disorder or crime, for the protection of health or morals, for the protection of the reputation or rights of others, for preventing the disclosure of information received in confidence, or for maintaining the authority and impartiality of the judiciary.

[Emphasis added.]

480 The ECHR first found that there had been an interference with the right to freedom of expression and then proceeded to determine whether that interference was "prescribed by law", stating at paragraph 45:

> It is clear that there was an "interference by public authority" in the exercise of the applicants' freedom of expression which is guaranteed by paragraph I of Article 10. Such an interference entails a "violation" of Article 10 if it does not fall within one of the exceptions provided for in paragraph 2 (Handyside judgment of 7 December 1976, Series A no. 24, p. 21, [s] 43). The Court therefore has to examine in turn whether the interference in the present case was "prescribed by law", whether it had an aim or aims that is or are legitimate under article 10 [s] 2 and whether it was "necessary in a democratic society" for the aforesaid aim or aims.

[Emphasis added.]

481 As a result, it is my opinion that the ECHR's statements with respect to the expression "prescribed by law" should be construed as referring to the principles of fundamental justice and therefore should be viewed as similar to the second step of the analysis under section 7 of the Charter rather than as support for the rule of law as an independent basis for assessing the constitutionality of legislation.

482 Although the rule of law was the basis for restricting arbitrary and unlawful actions by public officials in Roncarelli, supra, there have been no cases where the doctrine was successfully extended to strike down legislation. In Bacon v. Saskatchewan Crop Insurance Corp. (hereinafter Bacon (Q.B.)), [1997] 9 W.W.R. 258, Laing J. acknowledged that the rule of law had never been employed to strike down legislation, stating at paragraph 102:

> ... the principle of the Rule of Law by itself, has not been utilized to date to strike down legislation that otherwise falls within the constitutional powers of the provinces.

483 However, he did go on to say that the rule of law could be used as a basis for striking down legislation and proceeded to assess whether the legislation in question was arbitrary. He was of the view that the prohibition against arbitrary action by government as a component of the rule of law was not restricted to the executive or administrative branches of government but also applied to the legislative branch. In Bacon (Q.B.), Laing J. held that the legislation was in fact not arbitrary. On appeal, a unanimous Saskatchewan Court of Appeal in Bacon (C.A.), supra, upheld Laing J.'s decision but rejected his analysis and affirmed that the rule of law was not a basis for striking down legislation. Wakeling J.A. speaking for the Court stated at paragraph 30:

> The protection we treasure as a democratic country with the rule of law as 'a fundamental postulate' of our constitution is twofold. Protection is provided by our courts against arbitrary and unlawful actions by officials while protection against arbitrary legislation is provided by the democratic process of calling our legislators into regular periods of accountability through the ballot box. This concept of the rule of law is not in any way restricted by the Supreme Court's statement that nobody including governments is beyond the law. That statement is a reference to the law as it exists from time to time and does not create a restriction on Parliament's right to make laws, but is only a recognition that when they are made they are then applicable to all, including governments.

484 It should be noted that the application for leave to appeal to the Supreme Court of Canada from the decision in Bacon (C.A.) was dismissed in June of 2000.

485 In Singh v. Canada (Attorney General), [1999] 4 F.C. 583, McKeown, J. of the Federal Court - Trial Division considered whether sections of the Canada Evidence Act, R.S.C., 1985, c. C-5, that permitted ex parte objections to the disclosure of information relating to national security were unconstitutional on the basis of the unwritten fundamental principles of the Constitution, including the rule of law. He held that unwritten constitutional norms were not a sufficient basis for striking down otherwise properly enacted laws. The use of unwritten constitutional norms was limited to filling gaps in the express terms of a constitutional text, or to their employment as interpretative tools where a section of the Charter is not clear.

486 After reviewing the Supreme Court of Canada's decision in Reference re Secession of Quebec, supra, McKeown J. stated at paragraph 39:

> The Supreme Court of Canada has concluded that unwritten constitutional norms may be used to fill a gap in the express terms of the constitutional text or used as interpretative tools where a section of the Constitution is not clear. However, as noted by La Forest J., dissenting in Provincial Court Judges Reference, the

> principles of judicial review do not enable a court to strike down legislation in the absence of an express provision of the Constitution which is contravened by the legislation in question.

487 McKeown J. went to conclude at paragraph 66:

> The rule of law cannot strike down legislation, as evidenced from the foregoing. Parliament is free to review the Crown's rights and privileges from time to time. However, it is Parliament and not the courts that must undertake this exercise.

488 It should be noted that the Federal Court of Appeal dismissed an appeal in the Singh case in January of 2000 and that an application for leave to appeal to the Supreme Court of Canada was dismissed, [2000] S.C.C.A. 92, in August of 2000.

489 In Johnson v. B.C. (Securities Commission), supra (varied on other grounds, 2001 BCCA 597), Allan J. of the British Columbia Supreme Court considered a challenge to provisions of the Securities Act, R.S.B.C. 1996, c. 418, which permitted the imposition of sanctions "in the public interest". The challenge was based on the provisions being unconstitutionally vague, the petitioners having alleged that those provisions offended against the rule of law and section 7 of the Charter. Allan J. first summarized the basis upon which a law may be held to be invalid, stating at paragraph 20:

> An enactment may be challenged for vagueness in one of two ways:
>
> (1) As being contrary to the division of powers: every law must be competent to either the legislative authority of the provinces or Parliament. An enactment that is excessively broad or vague is incompetent to both levels of government: P. Hogg, Constitutional Law of Canada, 3rd ed. (Supp.) (Toronto: Carswell, 1992) at p. 15-42.
> (2) As being contrary to the Charter: In Canada v. Pharmaceutical Society (Nova Scotia), [1992] 2 S.C.R. 606 (S.C.C.) at p. 626, Mr. Justice Gonthier, for the Court, stated that vagueness can arise in three ways:
>
> (a) Under s. 7, it is a principle of fundamental justice that laws may not be too vague;
> (b) Under s. 1 in limine: an enactment must be certain enough to satisfy the requirement that the limitation be "prescribed by law"; and
> (c) Under s.1: as part of the minimal impairment portion of the R.v. Oakes [[1986] 1 S.C.R. 103 (S.C.C.)] test.

490 On the issue of whether the rule of law was an independent basis for attacking the validity of

legislation, Allan J. stated at paragraphs 24 through 26:

> The petitioners submit that a statutory provision may be declared vague pursuant to s. 52 of the Constitution Act which provides that any law inconsistent with the provisions of the Constitution is of no force or effect. They say ss. 161 and 162 contravene the rule of law which is enshrined in the preamble to the Charter: "Whereas Canada is founded upon principles that recognize the supremacy of God and the rule of law ... Mr. Shapray submits that the preamble enshrines the supremacy of the rule of law as a keystone of the Canadian Constitution. He seeks to elevate the "superordinate status" of the "rule of law" to a justiciable principle which can be used to strike down a vague statutory provision regardless of whether that provision offends a specific Charter right or the division of powers between the federal government and the provincial legislatures.
>
> I disagree with that submission. The preamble to a statute reveals legislative purpose and may assist in the interpretation of the statute's provisions. The principles enshrined in the preamble - the supremacy of God and the rule of law - inform the interpretation of the substantive sections of the Charter. They are not discrete justiciable principles intended by the drafters to be "rights" which, if breached, will permit a challenge to legislation. There is no authority for the proposition that a Charter challenge will lie in the absence of a contravention of a substantive right.
>
> The rule of law has a broad underlying application and may be invoked to guarantee a positive system of laws. Thus, in Reference re Language Rights under s. 23 of Manitoba Act, 1870 & s. 133 of Constitution Act, 1867, [1985] 1 S.C.R. 721 (S.C.C.), the Court reiterated that the rule of law is "a fundamental postulate of our constitutional structure" and invoked that principle to temporarily continue the effect of unconstitutional laws so as to avoid a legal vacuum.
>
> [Emphasis added.]

491 From the foregoing case law, it can be concluded that the rule of law is not an independent basis for striking down legislation. The rule of law may be used to fill in gaps in the express terms of constitutional texts or as an interpretative tool. However, it would seem that it is only where a law is inconsistent with substantive rights guaranteed by the Charter or is incapable of being assigned to the legislative authority of either the provinces or Parliament that the judiciary has the authority to strike down or read down legislation pursuant to subsection 52(1) of the Constitution

Act, 1982.

2. The Standing of the Corporate Appellants

492 The Supreme Court of Canada has on numerous occasions addressed the issue of whether or not a corporation has standing to challenge the constitutionality of a law under the Charter.

493 In Big M Drug Mart, supra, Dickson C.J., speaking for the majority, stated at pages 313 and 314:

> Any accused, whether corporate or individual, may defend a criminal charge by arguing that the law under which the charge is brought is constitutionally invalid.

494 In Irwin Toy, supra, the Supreme Court of Canada held in relation to section 7 of the Charter that a corporation was incapable of possessing a right to "life, liberty or security of the person" because these are inherently human rights. Dickson C.J., Lamer J. (as he then was), and Wilson J., comprising the majority, stated at page 1004:

> ... read as a whole, it appears to us that this section was intended to confer protection on a singularly human level. A plain, common sense reading of the phrase "Everyone has the right to life, liberty and security of the person" serves to underline the human element involved; only human beings can enjoy these rights. "Everyone" then, must be read in light of the rest of the section and defined to exclude corporations and other artificial entities incapable of enjoying life, liberty or security of the person, and include only human beings. In this regard, the case of Big M Drug Mart, supra, is of no application.

495 There are no penal proceedings in the case at bar, so the principle articulated in Big M Drug Mart, supra, is not involved.

496 In Dywidag Systems v. Zutphen Brothers Construction, [1990] 1 S.C.R. 705, the Supreme Court of Canada clarified the distinction between the holdings in Big M Drug Mart, supra, and Irwin Toy, supra. Cory J., speaking for the Court, explained that only where it is defending against a criminal charge will a corporation be permitted to invoke section 7 of the Charter. Cory J. stated at page 709:

> There can now be no doubt that a corporation cannot avail itself of the protection offered by s. 7 of the Charter. In Irwin Toy Ltd. v. Quebec (Attorney General), [1989] 1 S.C.R. 927, the majority of this Court held that a corporation cannot be deprived of life, liberty and security of the person and cannot therefore avail itself of the protection offered by s. 7 of the Charter....

> It is true that there is an exception to this general principle that was established in R. v. Big M Drug Mart, supra, where it was held that "[a]ny accused, whether corporate or individual, may defend a criminal charge by arguing that the law under which the charge is brought is constitutionally invalid" (pp. 313-14). Here no penal proceedings are pending and the exception is obviously not applicable.

497 In R. v. Wholesale Travel Group Inc., [1991] 3 S.C.R. 154, the majority of the Supreme Court made it clear that a corporation can defend against a criminal charge on the basis that if the law were applied to an individual it would be a violation of that individual's right to "life, liberty or security of the person" and that the corporation could therefore benefit from a finding by the Court that the law was unconstitutional as violating section 7 of the Charter. The Court also referred to the above-cited passage from Dywidag Systems, supra, and to the fact that criminal charges laid against a corporation provide an exception to the general principle that a corporation cannot avail itself of the protection offered by section 7 of the Charter.

498 A corporation's ability to invoke the Charter was expanded in Canadian Egg Marketing Agency, supra. There, Iacobucci J. and Bastarache J., speaking for the majority, concluded that, in a situation where a corporation is a defendant in civil proceedings instituted by the state or an organ of the state pursuant to a regulatory scheme, the corporation may invoke the Charter. Iacobucci and Bastarache JJ. stated at paragraph 34:

> ... this case has provided this Court with an opportunity to revisit the rules governing the granting of standing to a corporation under the so-called Big M Drug Mart exception. Prior to this decision, the respondents could not obtain standing to invoke the Charter using the exception created by this Court in R. v. Big M Drug Mart Ltd., [1985] 1 S.C.R. 295, because they were not facing penal proceedings. In our opinion, it is now time to expand the exception to allow corporations to invoke the Charter when they are defendants in civil proceedings instigated by the state or a state organ pursuant to a regulatory scheme.
>
> [Emphasis added.]

Iacobucci and Bastarache JJ. further stated at paragraph 46:

> Although the respondents were not prosecuted under the scheme, it was nevertheless the federal egg marketing scheme which provided the basis for CEMA's civil claim. Were it not for this scheme, there would have been no harm to CEMA. Indeed, there would be no CEMA. A defendant in a civil proceeding brought pursuant to legislation is normally entitled to challenge the constitutionality of the legislation authorizing the proceeding. But it is argued that because the respondents were corporations and the proceedings against them were civil, they were barred from challenging the provisions of the scheme. In

> our opinion, ensuring the constitutionality of legislation under which the state initiates coercive proceedings is far more important to the rule of law and to the integrity of the justice system than whether the proceedings in question are penal or civil.
>
> [Emphasis added.]

499 In Canadian Egg Marketing Agency, the constitutional challenge was based on the assertion that the federal egg marketing scheme, which provided the basis for the civil action, violated the freedom of association rights guaranteed in paragraph 2(d), and the mobility rights protected by section 6 of the Charter. There are no subsequent cases that have applied the expanded Big M exception from the Canadian Egg Marketing Agency case so as to grant a corporation standing to challenge the constitutionality of legislation on the basis of section 7 of the Charter. However, the above-cited passages appear to apply to all Charter challenges where the party seeking standing does not benefit from the rights guaranteed by the Charter, as is the case in the present appeals with respect to the four corporate appellants.

500 Thus, the issue would be whether the present case is analogous to a civil suit by an arm of the state. The Respondent submitted that the expanded exception in Canadian Egg Marketing Agency, supra, does not apply in the present appeal because the Appellants have not been involuntarily brought before this Court. Due to the structure of the proceedings under the Act, in an appeal of an assessment or a reassessment the taxpayer is the party who initiates the court proceedings. However, it is arguable that this is simply a procedural nuance and that the Minister's role in attempting to uphold an assessment in the courts is analogous to a civil suit by an arm of the state. Unless the taxpayer wants to comply with the assessment, which is otherwise deemed valid and binding by virtue of subsection 152(8) of the Act, there is no choice but to appeal the matter to the Tax Court of Canada for a determination, at which point the civil proceedings between the taxpayer and the State commence.

501 In the present case, the appeals of the four corporate Appellants were heard on common evidence with the appeals of the other 14 Appellants[3], who are individuals. Further, as I have found that section 245 of the Act is not unconstitutional as being in violation of section 7 of the Charter or otherwise, the issue of whether the corporate Appellants can raise section 7 of the Charter or the rule of law has become moot at this stage of the proceedings. As a definite finding on that issue is not necessary in view of my other conclusions concerning the constitutional challenge, I will simply refrain from addressing the question here and leave it to be decided in another case when the circumstances are more appropriate.

VI

FINAL COMMENTS

502 There is no need to review decisions of this Court on the GAAR that involved completely different factual contexts and other provisions of the Act. However, there is one point I wish to address briefly. Counsel for the Appellants argued that it is evident from the jurisprudence that the Tax Court of Canada has adopted a qualified approach in applying section 245 of the Act and thus has failed to develop a principled approach. In support of this contention counsel cited Judge Bowman's conclusion in Jabs Construction, supra, and Judge Bonner's conclusion in Canadian Pacific (TCC), supra, that section 245 is an extreme sanction. Counsel also cited Judge Archambault's statement in Rousseau-Houle, supra, that section 245 of the Act is only intended to prevent flagrant abuses. In my opinion, this so-called qualified approach is precisely what is prescribed by the wording of the provision. Subsection 245(4) of the Act is a relieving provision that sets out an exception to the application of the anti-avoidance rule. In essence, subsection 245(4) provides that subsection 245(2) will not apply to transactions that are otherwise in accordance with the object and spirit of the provisions of the Act. The relieving nature of subsection 245(4) dictates that there be a qualified approach to the application of the GAAR.

503 In the case of a statute as complex as the Act, which is also replete with tax incentive provisions, it seems evident that a qualifier had to be added in order to exempt certain transactions that could not reasonably be considered to have been undertaken or arranged primarily for bona fide purposes other than to obtain a tax benefit. That is to say that the Courts, or for that matter the tax authorities, should not be prompt to find a misuse or an abuse but should reach a conclusion that such has occurred only where a clear object and spirit in respect of a provision or scheme of the Act has first been identified. Otherwise, section 245 should not be applied. To me, such an approach is not at odds with the statement that section 245 is an "extreme sanction" or that it should be used only to prevent "flagrant abuses". In my opinion, the facts of the present appeals have proved to entail such an abuse.

VII CONCLUSIONS

504 But for the application of section 245 of the Act each of the Appellants would have obtained a tax benefit from a series of six transactions, none of which was undertaken or arranged primarily for a bona fide purpose other than to obtain the tax benefit. Having regard to the provisions of the Act read as a whole, the six transactions resulted in an abuse with respect to the general scheme in the Act against the transfer of losses between taxpayers.

505 Section 245 of the Act does not present a "real or imminent" threat to the section 7 Charter rights to life, liberty and security of the person and cannot therefore be declared of no force and effect under subsection 52(1) of the Constitution Act, 1982.

506 The rule of law is not a basis for invalidating legislation under subsection 52(1) of the Constitution Act, 1982.

507 In view of the foregoing, the appeals are dismissed with costs to the Respondent. However, the fees with respect to the preparation and the conduct of the hearing are limited to those that

would be applicable to one appeal only.

* * * * *

Order

Released: May 15, 2002

Whereas the appeal of Warren J.A. Mitchell, Docket number 1999-476(IT)G, was withdrawn with consent of the Respondent on October 17, 2001.

The Reasons for Judgment rendered on May 3, 2002 are corrected to remove the name of Warren J.A. Mitchell and the Docket number 1999-476(IT)G, from the style of cause.

The Reasons for Judgment are corrected to include a footnote to paragraphs 1 and 501. Footnote 1 to paragraph 66 of the Reasons for Judgment is renumbered 2. Pages 1, 36, 181 and page 1 following page 183 are substituted thereof.

cp/d/qlspg/qlrcr/qlscl

1 One individual Appellant withdrew his appeal after hearing but before judgment was rendered.

2 This last allocation is not mentioned in paragraph 32 of the Statement of Admitted Facts but was referred to in the Appellants' Written Argument and reviewed by the Appellants' counsel in oral submissions.

3 One individual Appellant withdrew his appeal after hearing but before judgment was rendered.