A-396-17, 2019 FCA 151, 2019 CAF 151 – Webb J.A. (Gauthier J.A., Stratas J.A. concurring) – 19/05/16 -- Tax – Income tax – Tax avoidance – General anti-avoidance rule (GAAR) – Avoidance transaction -- Company V filed proposal in bankruptcy and ceased medical business, but had $16 million in business losses -- Taxpayer B was oil and gas company which negotiated amalgamation agreement with V -- Agreement between corporations involved issuance of Class B shares of V to shareholders, which were converted to shares of amalgamated company -- V claimed losses on 2006 return and Minister re-assessed and denied losses -- Taxpayer unsuccessfully appealed and even though transaction was not found to be sham, it was found that general anti-avoidance rule (GAAR) applied -- Ability of amalgamated corporation to use V's losses was tax benefit, as V wanted to monetize its tax attributes and B wanted to obtain those attributes -- Contrary to policy of s. 256(7) of Income Tax Act, to take account of Class B shares where existence of shares was ephemeral at time of amalgamation and where very existence of shares predicated on amalgamation occurring, and where, only on amalgamation, did Class B shareholders contribute to capital stock of corporation, constituted abuse of provision -- Taxpayer appealed – APPEAL DISMISSED -- Policy underlying s. 256(7)(iii)(B) of Income Tax Act would dictate that there was acquisition of control of V in this situation, therefore transactions were abuse of this provision -- As result, GAAR applied and restrictions in s. 111(5) of Act were applicable in determining what non-capital losses incurred by V, taxpayer was entitled to claim -- Since business that gave rise to non-capital losses incurred by V was not being carried on in 2005 or 2006, taxpayer was not entitled to claim these non-capital losses.

Birchcliff Energy Ltd. v. R.

BIRCHCLIFF ENERGY LTD. (Appellant) and HER MAJESTY THE QUEEN (Respondent)

Citation: 2019 CarswellNat 2047, 2019 FCA 151, 2019 D.T.C. 5072, [2020] 1 C.T.C. 1
Federal Court of Appeal
Johanne Gauthier, David Stratas, Wyman W. Webb JJ.A.
Heard: December 10, 2018
Judgment: May 16, 2019
Year: 2019
Docket: A-396-17

Proceedings: affirming *Birchcliff Energy Ltd. v. The Queen* (2017), 2017 CarswellNat 9711, 2017 CCI 234, [2018] 3 C.T.C. 2225, 2017 D.T.C. 1151, 2017 CarswellNat 6871, 2017 TCC 234 (T.C.C. [General Procedure])

Counsel: Patrick Lindsay, Colin Bartlett, for Appellant
Michael Taylor, Neva Beckie, for Respondent

Subject:
Corporate and Commercial; Income Tax (Federal)

Table of Authorities

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Generally — referred to

Can. *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.)
Generally — referred to
s. 44(1) — considered
s. 44(3) — considered
s. 87 — considered
s. 87(2)(a) — considered
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s. 256(7)(b) — considered
s. 256(7)(b)(iii) — considered
s. 256(7)(b)(iii)(A) — considered
s. 256(7)(b)(iii)(B) — considered
s. 256(7)(b)(iii)(C) — considered

APPEAL by taxpayer from judgment reported at *Birchcliff Energy Ltd. v. The Queen* (2017), 2017 TCC 234, 2017 CarswellNat 6871, 2017 D.T.C. 1151, [2018] 3 C.T.C. 2225, 2017 CCI 234, 2017 CarswellNat 9711 (T.C.C. [General Procedure]), denying taxpayer non-capital losses.

***Wyman W. Webb J.A.*:**

1 This is an appeal from the judgment of Justice Jorré of the Tax Court of Canada (2017 TCC 234 (T.C.C. [General Procedure])). The Tax Court dismissed the appeal of Birchcliff Energy Ltd. (Birchcliff) from the reassessment of its 2006 taxation year under the *Income Tax Act*, R.S.C. 1985 (5th Supp.), c. 1 (the Act). As a result of the reassessment, approximately $16 million in non-capital losses that had been incurred by Veracel Inc. (Veracel) and claimed by Birchcliff were denied. The reassessment was not originally based on an application of the general anti-avoidance rule (the GAAR) as set out in section 245 of the Act. However, by the time the matter was heard by the Tax Court this was one of the bases for the reassessment and it was the basis on which Birchcliff s appeal was dismissed. In this appeal, the only issue is the application of the GAAR to the transactions in question.

2 For the reasons that follow, I would dismiss this appeal.

I. Background

3 The parties had filed a “Partial Agreed Statement of Facts” in the appeal before the Tax Court that consisted of 96 paragraphs. This partial agreed statement of facts is set out in paragraph 39 of the reasons of the Tax Court Judge. It is not necessary to repeat all of the facts that are set out therein. However, for the purpose of this appeal certain facts should be noted.

4 There are two corporations (Veracel and Birchcliff Energy Ltd.) that amalgamated to form Birchcliff.

5 Veracel was incorporated in 1994 as Morphometric Technologies Inc. Its business was to develop, manufacture and market automated diagnostic instruments for medical applications. However, the business was not successful and on November 15, 2002 Veracel filed a proposal under the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3. It ceased to carry on its medical equipment business. As of the end of 2004, Veracel had the following tax attributes:

	Amount:
Non-capital Losses	$16,226,489
Scientific research and experimental development expenses	$15,558,003
Investment Tax Credits	$1,874,979

6 1116463 Alberta Ltd. was incorporated on July 6, 2004 and soon thereafter changed its name to Birchcliff Energy Ltd. On January 18, 2005, Birchcliff Energy Ltd. amalgamated with Scout Capital Corp. (a publicly listed company). The amalgamated company adopted the name Birchcliff Energy Ltd. Since this amalgamated corporation had the same name as the corporation later formed as a result of the amalgamation of this company with Veracel on May 31, 2005, this corporation, as it existed as a separate corporation prior to the amalgamation with Veracel, will be referred to herein as the Predecessor Birchcliff.

7 The Predecessor Birchcliff entered into two letter agreements (dated February 14, 2005 and March 9, 2005) to purchase properties in the Peace River Arch area of Alberta. The first agreement was to acquire properties for $2.75 million and this purchase closed on May 5, 2005. The second agreement was to purchase oil and natural gas properties for $255 million (the Devon Properties). The purchase agreement for the Devon Properties was executed on March 29, 2005 and provided that the purchase price was $243 million. For the purposes of this appeal, it is not relevant why the purchase price appears to have been reduced from $255 million to $243 million.

8 Veracel and the Predecessor Birchcliff entered into several agreements and completed various steps during March, April and May 2005 with the objective of using the non-capital losses and the other tax attributes of Veracel to reduce the taxes payable by Birchcliff under the Act that would otherwise be payable as a result of the income that would be generated from the oil and gas properties that would be acquired by the Predecessor Birchcliff.

9 In order to raise the money to acquire the Devon Properties, Veracel sold subscription receipts to public investors. The sale of the subscription receipts was completed on May 4, 2005 and the total amount raised was $136 million. Since Veracel is not the corporation that had the right to acquire the Devon Properties, there were certain conditions that were imposed to assure the investors that the money raised by selling the subscription receipts would be used to acquire the Devon Properties. The funds would only be released if Veracel amalgamated with the Predecessor Birchcliff to form Birchcliff. Furthermore, if Veracel did not amalgamate with the Predecessor Birchcliff, the holders of the subscription receipts would have been refunded their money.

10 The transactions were completed sequentially on May 31, 2005 and the key transactions were the following:

- The holders of the subscription receipts were issued Class B common shares of Veracel;
- Veracel and the Predecessor Birchcliff amalgamated;
- Birchcliff received a credit facility of up to $70 million; and

• Birchcliff purchased the Devon Properties for $243 million.

11 The shareholders of Veracel (who held their shares prior to the issuance of the subscription receipts) had the option of receiving either common shares of Birchcliff or nonvoting preferred shares of Birchcliff. The total amount that was allocated for these shareholders of Veracel was $1,500,000. The preferred shares were redeemed for cash shortly after the amalgamation. Those shareholders of Veracel who opted for the common shares of Birchcliff received approximately 117,000 common shares of Birchcliff.

12 The holders of the Class B common shares of Veracel (those who purchased the subscription receipts) received approximately 34 million common shares of Birchcliff on the amalgamation of Veracel and the Predecessor Birchcliff. The shareholders of the Predecessor Birchcliff received approximately 20 million common shares of Birchcliff.

II. Decision of the Tax Court

13 The Crown had raised a number of issues before the Tax Court including: whether the doctrine of sham would apply and the Class B common shares of Veracel could be ignored; whether the Class B shareholders had acquired control of Veracel immediately before the amalgamation; and whether the GAAR would apply to the transactions. The Tax Court Judge did not agree that the transactions were a sham or that the Class B shareholders had acquired control of Veracel immediately before the amalgamation.

14 With respect to the application of the GAAR, the Tax Court Judge found that there was a tax benefit and an avoidance transaction. In a brief analysis related to the question of whether the transactions were an abuse of the Act, the Tax Court Judge concluded that the issuance of the Class B shares of Veracel immediately before its amalgamation with the Predecessor Birchcliff was contrary to the object and spirit of the rules in subsection 256(7) of the Act and, therefore, it was abusive. He concluded that the appropriate result was to ignore the Class B shares that had been issued by Veracel before the amalgamation.

III. Issue and standard of review

15 The only issue raised in this appeal is whether the transactions that were completed resulted in an abuse of the provisions of the Act for the purposes of the GAAR. As noted by this Court in, *Canada v. Oxford Properties Group Inc.*, 2018 FCA 30 (F.C.A.) (*Oxford Properties Group Inc.*

> [39] The inquiry as to whether there has been an abuse gives rise to a question of mixed fact and law and is therefore subject to the standard of palpable and overriding error *([Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54, [2005] 2 S.C.R. 601*(Trustco)]* at para. 44; *Housen v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235 (S.C.C.) at para. 37 *[Housen])*. However, the abuse analysis proceeds in two stages. The first stage requires the determination of the object, spirit and purpose of the provisions giving rise to the tax benefit while the second turns on whether the provisions, so construed, were frustrated by the tax benefit achieved *(Trustco* at para. 44). The object, spirit and purpose of a provision is discerned by way of statutory interpretation *Copthorne Holdings Ltd. v. R.*, 2011 SCC 63, [2011] 3 S.C.R. 721 (S.C.C.)*(Copthorne)]* at para. 70). This gives rise to a question of law and is an extricable part of the analysis. It is therefore subject to the standard of correctness *(Trustco* at para. 44; *Housen* at paras. 8, 37).

16 In this appeal, Birchcliff is not challenging any of the factual findings made by the Tax Court Judge, other than the finding of mixed fact and law that there was an abuse of the provisions of the Act.

IV. Relevant statutory provisions

17 The key provisions of the Act that are relevant in determining whether there has been an abuse of the Act are subsections 111(5) and 256(7). These provisions, as they read during the taxation year in issue, are set out in the Annex attached to these reasons.

18 Subsection 111(5) of the Act provides a general restriction on carrying forward non-capital losses following an acquisition of control of a corporation by a person or group of persons. There is an exception to this general restriction if the business that gave rise to the non-capital losses is carried on by that corporation throughout the year in which the losses are being claimed. If that business is being carried on, there are further restrictions related to the amount of such losses that may be claimed. It seems clear that the business that gave rise to the losses was not being carried on during the taxation year in issue and, therefore, if there was acquisition of control of Veracel the non-capital losses incurred by Veracel would not be available to Birchcliff for its 2006 taxation year.

19 The restriction on the carry-forward of non-capital losses is triggered by an acquisition of control by a person or group of persons. Paragraph 256(7)(*b*) of the Act sets out certain rules for determining whether control of one or more of the predecessor corporations has been acquired when two or more corporations are amalgamated.

20 For the purpose of this appeal, the relevant rule is that found in subparagraph 256(7)(*b*)(iii) of the Act. The opening part of this subparagraph provides a general rule that when two or more corporations amalgamate, control of each predecessor corporation is deemed to have been acquired by a person or a group of persons immediately before the amalgamation. There are exceptions to this rule as set in clauses (A), (B) and (C).

21 The only clause that is relevant in this appeal is clause 256(7)(*b*)(iii)(B). This clause provides an exception to the general rule if the hypothetical shareholding test set out therein is satisfied. This test examines the shares issued to the shareholders of a predecessor corporation as a result of the amalgamation. If all of the shares of the amalgamated corporation that are issued on the amalgamation to the shareholders of a particular predecessor corporation are issued, instead, to one person and that one person would then control the amalgamated corporation, then control of that predecessor corporation is not deemed to have been acquired.

V. Analysis

22 Non-capital losses that have been incurred by a particular corporation that will not be able to use them will be attractive to another corporation that has profits. Such losses are not assets that can be sold or transferred directly from one corporation to another. Rather, corporations will want to use the provisions of sections 87 or 88 of the Act that allow such losses to flow through to an amalgamated corporation or to a parent corporation on a winding-up of the loss corporation to have the losses available to the amalgamated corporation or to the profitable corporation. If the profitable corporation were to acquire all of the shares of the loss corporation and then wind it up or amalgamate with it, there would be an acquisition of control of the loss corporation and the restrictions on using the non-capital losses as set out in paragraph 88(1.1)(e) (which mirrors subsection 111(5) of the Act) or subsection 111(5) of the Act would be applicable. If the loss corporation were to amalgamate with the profitable corporation without any acquisition of shares prior to the amalgamation, the rules as set out in paragraph 256(7)(*b*) of the Act would be applicable to determine whether control of the loss corporation has been acquired with the result that the restrictions on claiming the non-capital losses as set out in subsection 111(5) would be applicable.

23 In this case, Birchcliff submits that the exception as set in clause 256(7)(*b*)(iii)(B) of the Act applied and control of Veracel was not acquired by a person or group of persons. Given the large number of shares that were issued to the shareholders of Veracel on the amalgamation of Veracel and the Predecessor Birchcliff, if all of these shares would have been issued to one person, that person would control Birchcliff. As a result, it is the position of Birchcliff that control of Veracel had not been acquired by a person or group of persons and, therefore, the loss carry-forward restrictions in subsection 111(5) of the Act do not apply.

24 While Birchcliff has satisfied the wording of clause 256(7)(*b*)(iii)(B) of the Act, the issue in this case is whether the transactions are an abuse of the Act for the purposes of the GAAR. As noted by the Supreme Court of Canada in *Copthorne Holdings Ltd.* [2011 CarswellNat 5201 (S.C.C.)]:

> [66] The GAAR is a legal mechanism whereby Parliament has conferred on the court the unusual duty of going behind the words of the legislation to determine the object, spirit or purpose of the provision or provisions relied upon by the taxpayer. While the taxpayer's transactions will be in strict compliance with

> the text of the relevant provisions relied upon, they may not necessarily be in accord with their object, spirit or purpose. ...

25 The GAAR has imposed limitations on the tax planning arrangements of taxpayers. Even though a taxpayer's transactions comply with the wording of the particular provisions of the Act in issue, if the transactions are not in accord with their object, spirit or purpose, then the tax planning arrangement will not achieve the results that the taxpayer had anticipated.

26 The GAAR provisions are contained in section 245 of the Act. In order for the GAAR to apply there must be a tax benefit, an avoidance transaction, and an abuse of the provisions of the Act (*Copthorne Holdings Ltd.*, at para. 33; *Oxford Properties Group Inc.*, at para. 36). In this case, Birchcliff does not dispute that there was a tax benefit nor does it dispute that there was an avoidance transaction. The only issue in this appeal is whether there was an abuse of the provisions of the Act.

27 The first stage in the analysis of whether there has been an abuse of the provisions of the Act is to determine the object, spirit or purpose of the relevant provisions. The Supreme Court in *Copthorne Holdings Ltd.* made the following comments in relation to the determination of the object, spirit or purpose of a provision in relation to the GAAR:

> [70] The object, spirit or purpose can be identified by applying the same interpretive approach employed by this Court in all questions of statutory interpretation—a "unified textual, contextual and purposive approach" *(Trustco*, at para. 47; *Lipson v. Canada*, 2009 SCC 1, [2009] 1 S.C.R. 3, at para. 26). While the approach is the same as in all statutory interpretation, the analysis seeks to determine a different aspect of the statute than in other cases. In a traditional statutory interpretation approach the court applies the textual, contextual and purposive analysis to determine what the words of the statute mean. In a GAAR analysis the textual, contextual and purposive analysis is employed to determine the object, spirit or purpose of a provision. Here the meaning of the words of the statute may be clear enough. The search is for the rationale that underlies the words that may not be captured by the bare meaning of the words themselves. However, determining the rationale of the relevant provisions of the Act should not be conflated with a value judgment of what is right or wrong nor with theories about what tax law ought to be or ought to do.
>
> [71] Second, a court must consider whether the transaction falls within or frustrates the identified purpose *(Trustco*, at para. 44). As earlier stated, while an avoidance transaction may operate alone to produce a tax benefit, it may also operate as part of a series of transactions that results in the tax benefit. While the focus must be on the transaction, where it is part of a series, it must be viewed in the context of the series to enable the court to determine whether abusive tax avoidance has occurred. In such a case, whether a transaction is abusive will only become apparent when it is considered in the context of the series of which it is a part and the overall result that is achieved*(Lipson*, at para. 34, *per* LeBel J.).
>
> (emphasis added)

28 In this case, there was a series of transactions that were completed which resulted in the non-capital losses that had been incurred in the medical supply business that had been carried on by Veracel being used against the revenue from the oil and gas properties that were acquired by Birchcliff. Prior to the amalgamation, the Predecessor Birchcliff (and not Veracel) had the right to acquire these oil and gas properties under an agreement of purchase and sale. As part of the analysis, it will be necessary to determine whether the overall result that was achieved in this case is abusive.

29 As noted above in paragraph 17, there are two provisions that are relevant in this analysis. Subsection 111(5) of the Act is the provision that will directly impact the tax liability of a particular corporation. This provision will limit the ability of a corporation to carry forward non-capital losses if there has been an acquisition of control of that corporation. Subsection 256(7) sets out certain rules that will determine whether there has been an acquisition of control of one or more predecessor corporations when two or more corporations are amalgamated. In this case, the issue is whether there was an abuse of

subsection 256(7) that allowed Birchcliff to avoid the application of the loss carry-forward restrictions in subsection 111(5) of the Act.

30 Essentially, the argument of Birchcliff is that it complied with the provisions of the Act. In the first part of its memorandum addressing the text of section 111 of the Act, Birchcliff submits that this section allows a taxpayer to use non-capital losses incurred in a particular taxation year against income generated in a subsequent taxation year (subject to a limitation on the number of years that such losses can be carried forward). Birchcliff acknowledges that this right to carry forward non-capital losses is restricted if there has been an acquisition of control of the corporate taxpayer. As part of this analysis, Birchcliff sets out the history of the provisions of the Act that have permitted or restricted the carry forward of non-capital losses. The conclusion of Birchcliff, at paragraph 40 of its memorandum, is that "Parliament: (i) has consistently increased the scope of loss carryover and use; (ii) has confirmed that losses from one business can be used against income from any other business; and (iii) has restricted loss use for a taxpayer where control of such taxpayer has been acquired".

31 I agree with these general statements with respect to the use of losses as permitted under the Act by a particular taxpayer. However, the issue in this appeal is whether the provisions of subsection 256(7) of the Act have been abused and thereby the application of a deemed acquisition of control has been avoided. If the Predecessor Birchcliff would have acquired the shares of Veracel, there would have been an acquisition of control and the loss carry-forward restrictions found in subsection 111(5) of the Act would have been applied. By completing the transactions as they were done in this case, in the absence of an application of the GAAR, this result has been avoided.

32 Birchcliff mentioned the absence of a reference to the GAAR when it was first reassessed and also to a prior ruling that Veracel had obtained from the Canada Revenue Agency in relation to another proposed transaction (that was not completed). However, since the determination of the object, spirit or purpose of the relevant provisions is a question of law, references to a previous advance ruling and whatever inference could be drawn from the absence of a reference to the GAAR in the first reassessment, are of little assistance.

33 In relation to its submissions on the policy of section 111, Birchcliff submitted that any company that is insolvent will need to raise capital if it is to pursue a new business venture. Birchcliff also submitted, in paragraph 52 of its memorandum, that "[i]n 2005, the shareholders of Veracel quite reasonably understood that an insolvent business could get value for its losses if it was able to raise new capital, in the absence of an acquisition of control, and participate in a new business". However, after reviewing several of the relevant documents related to the issuance of the subscription receipts, the Tax Court Judge found that:

> [50] It is abundantly clear that anyone paying for a subscription receipt was seeking to acquire shares in the amalgamated company, a company that, as a result of the agreements entered into by predecessor Birchcliff, had already acquired some oil and gas properties and that would be on the verge of acquiring some much bigger oil and gas properties, the Devon Properties—an acquisition to be funded in large measure with the funds raised through the issuance of the Class B shares. They were in no way seeking to acquire an ownership interest in predecessor company B.

34 It would appear that the reference to "predecessor company B" should be a reference to Veracel.

35 Birchcliff has not challenged this finding of fact. Therefore, there is no basis for the statement by Birchcliff that Veracel, on its own, raised sufficient capital to allow it to participate in a new oil and gas business.

36 As another part of its argument in relation to the applicable policy for the use of non-capital losses incurred in one year against income generated in another year, Birchcliff relies on the comments of Chief Justice Rossiter in *594710 British Columbia Ltd. v. R.*, 2016 TCC 288 (T.C.C. [General Procedure]) related to whether section 111 was abused. In that case, certain transactions were undertaken which resulted in almost all of the profit of a partnership being allocated to a corporation that was not a member of the partnership until just before the year end of the partnership. That corporation had certain tax losses and deductions that it could use to reduce the taxes payable in relation to this income. The Chief Justice concluded

that the GAAR did not apply to the transactions in that case. However, on appeal to this Court (2018 FCA 166 (F.C.A.) - the decision of this Court will be referred to herein as *594 FCA*), it was determined that the GAAR did apply to the allocation of income to the new partner and to certain transactions completed by the previous corporate partners and their holding companies. This Court indicated, at paragraph 45 of its reasons, that it would not be expressing any views on whether the Tax Court committed any error as outlined in paragraphs 44 (1) and (3), "which deal with the policy in the Act concerning profit and loss trading".

37 In its memorandum, at paragraph 71, Birchcliff also acknowledges that "[t]here is a body of GAAR jurisprudence involving loss use and such jurisprudence has identified a policy against loss trading. The concept of prohibited loss trading is not codified; however, a review of the jurisprudence indicates that prohibited loss trading appears to involve three general circumstances, none of which are present in this case." The cases that are referenced are *Mathew v. R.*, 2005 SCC 55 (S.C.C.), *OSFC Holdings Ltd. v. R.*, 2001 FCA 260 (Fed. C.A.), *MacKay v. R.*, 2008 FCA 105 (F.C.A.), and *Global Equity Fund Ltd. v. R.*, 2012 FCA 272 (F.C.A.).

38 The first general circumstance that is identified by Birchcliff is when "tax attributes are transferred to another entity". Under the Act, the general rule (which is found in paragraph 87(2)(a) of the Act) is that the corporation that is formed as a result of an amalgamation of two or more corporations is deemed to be a new corporation. Subsection 87(2.1) of the Act, however, provides that for certain purposes, including the determination of the amalgamated corporation's non-capital losses and the extent to which subsection 111(5) of the Act will apply to restrict the ability of the amalgamated corporation to claim the non-capital losses incurred by a predecessor, the new corporation is deemed to be the same corporation and a continuation of each predecessor. This would mean that the non-capital losses incurred by a predecessor corporation will be the non-capital losses of the amalgamated corporation and if there has been an acquisition of control, the restrictions in subsection 111(5) of the Act are applied as if the predecessor and the amalgamated corporation are the same corporation. It does not, however, assist in determining whether there has been an acquisition of control.

39 None of the GAAR cases to which Birchcliff referred as the "body of GAAR jurisprudence involving loss use" arose in relation to whether a taxpayer had abused the Act by entering into transactions designed to avoid an acquisition of control. In this case, the question is whether there was an abuse of clause 256(7)(*b*)(iii)(B) of the Act.

40 In addressing clause 256(7)(*b*)(iii)(B) of the Act, Birchcliff focuses on the following comments of the Tax Court Judge in paragraph 137 of his reasons:

> ...it would be contrary to the policy of the provision to take account of the Class B shares where the existence of the shares is an ephemeral one at the time of the amalgamation...

41 Birchcliff submits that it was inappropriate to use the words ephemeral or artificial since the Tax Court Judge found that these Class B shares were issued. Birchcliff submits that there is no policy as found by the Tax Court Judge and that the clear and plain meaning of the text of this clause confirms that Birchcliff is entitled to claim the losses that it did.

42 Birchcliff also refers to the absence of the expression of a series of transactions in section 256 as support for its position that the timing provisions of this section are determinative. Since, on the amalgamation of Veracel and the Predecessor Birchcliff, the shareholders of Veracel were issued approximately 63% of the common shares of Birchcliff, it satisfied the provisions of clause 256(7)(*b*)(iii)(B) of the Act. Birchcliff also submitted that since clause 256(7)(*b*)(iii)(B) is a precise deeming rule, the only purpose should be the one identified by the text of the provision itself. Birchcliff referred to *Bioartificial Gel Technologies (Bagtech) Inc. (Syndic de) c. R.*, 2012 TCC 120 (T.C.C. [General Procedure]), aff'd 2013 FCA 164 (F.C.A.), as support for this proposition. However, that case did not involve the application of the GAAR and, therefore, it was not necessary to look behind the words to ascertain the object, spirit or purpose of the provision in issue.

43 The common thread running through these arguments is that since the Class B shares of Veracel were issued to the holders of the subscription receipts, there was no abuse of clause 256(7)(*b*)(iii)(B) as the transactions as completed satisfied the requirements of this clause.

44 In *594 FCA*, this Court held that the GAAR applied to certain transactions undertaken to avoid the application of section 160 of the Act. Section 160, in general, provides that a particular person will be jointly and severally liable for any amount payable under the Act by another person with whom the particular person is not dealing at arm's length if the other person has transferred property to the particular person. The amounts payable under the Act must for the taxation year in which the transfer of property occurred or a previous year. The liability of the transferee is the lesser of (a) the total of all such amounts payable by the transferor, and (b) the amount by which the fair market value of the property transferred exceeds any consideration given for such property.

45 In *594 FCA*, the corporate partners of a partnership were each owned by holding companies. Each corporate partner issued a stock dividend that was paid by issuing preferred shares. These preferred shares were then redeemed. The issue was whether section 160 would apply to the amount paid on the redemption of the preferred shares since these shares would have been surrendered by the holding companies when they were redeemed.

46 In addressing this issue, this Court, in *594 FCA*, made the following comments:

> [112] In my view, the Tax Court erred by failing to consider this combination. The stock dividends and the redemption together resulted in a transfer of cash "indirectly ... by any means whatever" from Partnerco to Holdco without consideration. It was an extricable error of law for the Court to fail to consider this language in this part of its analysis.
>
> [113] The two steps together resulted in the equivalent of a cash dividend. In *Algoa Trust v. Canada* (February 4, 1998, docket A-201-93, unreported), this Court upheld the decision of the Tax Court (*Algoa Trust v. Canada*, 93 D.T.C. 405, [1993] 1 C.T.C. 2294) which concluded that a cash dividend is a transfer of property without consideration for purposes of section 160.
>
> [115] Although the *Algoa Trust* decision deals with a cash dividend, the combination in this case of stock dividends followed by a redemption has the same effect and similarly results in a transfer of property without consideration.
>
> (emphasis added)

47 In section 160 the reference to "directly or indirectly" is in the opening part of subsection 160(1) and is relevant in determining whether there has been a transfer of property from one person to another person. Once it has been determined that there has been a transfer of property (directly or indirectly) then the rules as set out in paragraphs *(d)* and *(e)* apply. The reference to the consideration given by the transferee is in subparagraph (e)(i) and, therefore, is only relevant once it has been determined that a transfer of property has occurred. There is no reference to "directly or indirectly" in paragraph (e), which sets out the liability of the transferee. The issue in *594 FCA* in relation to the application of the GAAR to the transactions was whether the transactions could be viewed as a payment of a cash dividend without consideration rather than as a payment for a redemption of shares (in which case the shares that were redeemed would be surrendered in exchange for the payment). This Court concluded that the transactions that were completed had "the same effect and similarly results in a transfer of property without consideration" and therefore, there was a tax benefit.

48 In this case, the holders of the subscription receipts were either to receive shares of Birchcliff or their money back. The combination of the issuance of the Class B shares of Veracel to the holders of the subscription receipts followed immediately by the amalgamation of Veracel and the Predecessor Birchcliff, has the same effect and is equivalent to the holders of the subscription receipts only receiving shares of Birchcliff following the amalgamation of Veracel and the Predecessor Birchcliff. If the holders of the subscription receipts would only have received shares of Birchcliff, there would have been an acquisition of control of Veracel on the amalgamation of Veracel and the Predecessor Birchcliff.

49 As noted in paragraph 50 of his reasons, the Tax Court Judge found that "[i]t is abundantly clear that anyone paying for a subscription receipt was seeking to acquire shares in the amalgamated company...". The Tax Court Judge did not err in reaching this conclusion based on the evidence that was presented and in particular the agreements entered into with the purchasers of the subscription receipts which provided that those purchaser would either receive shares of Birchcliff (the amalgamated corporation) or their money back. Also, the Tax Court Judge's finding that the transactions should be viewed as if the Class B common shares of Veracel had not been issued is reinforced by the decision of this Court in *594 FCA* where it was held that the transactions, in that case, should be viewed, not as a stock dividend and a redemption of shares, but rather as a cash dividend for the purposes of determining whether the GAAR applies.

50 It is important to ascertain whether this result would be consistent with the rationale for subparagraph 256(7)(*b*)(iii) of the Act. As noted by the Supreme Court in *Copthorne Holdings Ltd.* at paragraph 70, "[t]he search is for the rationale that underlies the words that may not be captured by the bare meaning of the words themselves". As noted by Birchcliff, the text of clause 256(7)(*b*)(iii)(B) of the Act provides that control of a predecessor will not be deemed to be acquired if the shareholders of that corporation, in total, receive sufficient shares in the amalgamated corporation to allow a person (if that person acquired all of those shares) to control the amalgamated corporation.

51 In examining the context and purpose of this provision, it should be noted that control of a corporation is exercised through the ownership of shares *Duha Printers (Western) Ltd. v. R.*, [1998] 1 S.C.R. 795, 225 N.R. 241 (S.C.C.), at para. 36). Generally, shares in an amalgamated corporation will be issued to the shareholders of the predecessor corporations in proportion to the relative fair market value of the predecessor corporations. Therefore, the number of shares issued by the amalgamated corporation to the shareholders of each predecessor corporation will generally reflect the relative fair market value of each predecessor corporation.

52 The logical rationale of the exception in clause 256(7)(*b*)(iii)(B) is that it would apply to exclude the larger corporation from the deemed acquisition of control rule in the opening part of subparagraph 256(7)(*b*)(iii), if two corporations amalgamate. This would mean that control of the smaller corporation will, however, be deemed to be acquired. If both corporations are of equal size (and therefore, the shareholders of each predecessor corporation receive collectively the same number and class of shares of the amalgamated company), the exception in clause 256(7)(*b*)(iii)(C) will be applicable and there would not be a deemed acquisition of control of either predecessor corporation.

53 The Tax Court Judge found, in paragraph 57 of his reasons, that "[u]nder the arrangement agreement, Veracel represented and warranted that at the time of the amalgamation it would have no assets and no employees". While the subscription receipts had been arranged through Veracel, the holders of the subscription receipts were either to receive shares of Birchcliff or their money back. There was no scenario under which Veracel would have been allowed to retain the money that had been raised by selling the subscription receipts.

54 In my view, the transactions completed in this case were contrary to the object and spirit of clause 256(7)(*b*)(iii)(B) of the Act. The result of the general rule, as stated in subparagraph 256(7)(*b*)(iii) of the Act, and the exceptions in clauses (B) and (C), is that there will either be (a) an acquisition of control of Veracel or the Predecessor Birchcliff or (b) neither. Veracel had no assets and no employees. The persons who had purchased the subscription receipts were either to receive shares of Birchcliff or their money back. The Predecessor Birchcliff had acquired some oil and gas properties prior to the amalgamation (reasons of the Tax Court Judge at para. 66) and had the right to purchase the Devon Properties. In my view, the policy underlying clause 256(7)(*b*)(iii)(B) of the Act would dictate that there was an acquisition of control of Veracel in this situation. Therefore, the transactions were an abuse of this provision.

55 As a result, I agree with the Tax Court Judge that the GAAR applies. When the GAAR applies, subsection 245(2) of the Act provides that the tax consequences are to be determined as is reasonable to deny the tax benefit. The tax benefit in this case is the unrestricted right of Birchcliff to claim the non-capital losses incurred by Veracel in determining the taxable income of Birchcliff under section 111. The application of the GAAR in this case will mean that for the purposes of subsection 111(5) of the Act, control of Veracel would be deemed to have been acquired immediately before the

amalgamation of Veracel and the Predecessor Birchcliff. Therefore, the restrictions in subsection 111(5) of the Act will be applicable in determining what non-capital losses incurred by Veracel, if any, Birchcliff may be entitled to claim. Since the business that gave rise to the non-capital losses incurred by Veracel was not being carried on in 2005 or 2006, Birchcliff is not entitled to claim these non-capital losses.

56 I would dismiss this appeal. Based upon the agreement reached by the parties in relation to costs, I would award the respondent a lump sum cost award of $40,000, inclusive of disbursements, on account of costs in both the Tax Court and this Court.

***Johanne Gauthier J.A.*:**

I agree

***David Stratas J.A.*:**

I agree

Appeal dismissed.

Annex

Relevant Provisions of the Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.) as they read during the Taxation Year in Issue

Beginning part of subsection 111(5):

111(5) Where, at any time, control of a corporation has been acquired by a person or group of persons, no amount in respect of its non-capital loss or farm loss for a taxation year ending before that time is deductible by the corporation for a taxation year ending after that time and no amount in respect of its non-capital loss or farm loss for a taxation year ending after that time is deductible by the corporation for a taxation year ending before that time...

Subsections 245(1), (2) and (5):

245(1) 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;

245(2) 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.

(5) Without restricting the generality of subsection (2), and notwithstanding any other enactment,

> (a) any deduction, exemption or exclusion in computing income, taxable income, taxable income earned in Canada or tax payable or any part thereof may be allowed or disallowed in whole or in part,
>
> (b) any such deduction, exemption or exclusion, any income, loss or other amount or part thereof may be allocated to any person,
>
> (c) the nature of any payment or other amount may be recharacterized, and
>
> (d) the tax effects that would otherwise result from the application of other provisions of this Act may be ignored,

in determining the tax consequences to a person as is reasonable in the circumstances in order to deny a tax benefit that would, but for this section, result, directly or indirectly, from an avoidance transaction.

Subsection 256(7):

256(7) For the purposes of subsections 10(10), 13(21.2) and (24), 14(12) and 18(15), sections 18.1 and 37, subsection 40(3.4), the definition superficial loss in section 54, section 55, subsections 66(11), (11.4) and (11.5), 66.5(3) and 66.7(10)

and (11), section 80, paragraph 80.04(4)(h), subsections 85(1.2), 88(1.1) and (1.2) and 110.1(1.2), sections 111 and 127, subsection 249(4) and this subsection,

(b) where at any time 2 or more corporations (each of which is referred to in this paragraph as a "predecessor corporation") have amalgamated to form one corporate entity (in this paragraph referred to as the "new corporation"),

(i) control of a corporation is deemed not to have been acquired by any person or group of persons solely because of the amalgamation unless it is deemed by subparagraph 256(7)(b)(ii) or 256(7)(b)(iii) to have been so acquired,

(ii) a person or group of persons that controls the new corporation immediately after the amalgamation and did not control a predecessor corporation immediately before the amalgamation is deemed to have acquired immediately before the amalgamation control of the predecessor corporation and of each corporation it controlled immediately before the amalgamation (unless the person or group of persons would not have acquired control of the predecessor corporation if the person or group of persons had acquired all the shares of the predecessor corporation immediately before the amalgamation), and

(iii) control of a predecessor corporation and of each corporation it controlled immediately before the amalgamation is deemed to have been acquired immediately before the amalgamation by a person or group of persons

(A) unless the predecessor corporation was related (otherwise than because of a right referred to in paragraph 251(5)(b)) immediately before the amalgamation to each other predecessor corporation,

(B) unless, if one person had immediately after the amalgamation acquired all the shares of the new corporation's capital stock that the shareholders of the predecessor corporation, or of another predecessor corporation that controlled the predecessor corporation, acquired on the amalgamation in consideration for their shares of the predecessor corporation or of the other predecessor corporation, as the case may be, the person would have acquired control of the new corporation as a result of the acquisition of those shares, or

(C) unless this subparagraph would, but for this clause, deem control of each predecessor corporation to have been acquired on the amalgamation where the amalgamation is an amalgamation of

(I) two corporations, or

(II) two corporations (in this subclause referred to as the "parents") and one or more other corporations (each of which is in this subclause referred to as a "subsidiary") that would, if all the shares of each subsidiary's capital stock that were held immediately before the amalgamation by the parents had been held by one person, have been controlled by that person;

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