PARTNERSHIP BUMP FLATTENED BY GAAR

Canada v. Oxford Properties Group Inc.
2018 FCA 30

KEYWORDS: SERIES OF TRANSACTIONS ■ ROLLOVERS ■ BUMP ■ SALE ■ TAX AVOIDANCE ■ GENERAL ANTI-AVOIDANCE RULE

Introduction

In *Canada v. Oxford Properties Group Inc.*,[19] the minister of national revenue was largely successful before the Federal Court of Appeal in reversing a decision of the Tax Court of Canada[20] that had vacated an assessment issued by the minister assessing Oxford Properties Group Inc. ("Oxford") for tax, on the basis that the general

18 *Gervais*, supra note 1, at paragraph 44, note 93.

19 2018 FCA 30.

20 2016 TCC 204.

anti-avoidance rule (GAAR) in section 245 of the Income Tax Act applied to a series of transactions undertaken by Oxford and its affiliates.

It was acknowledged by the parties that the series of transactions that gave rise to the assessment, including two rollovers under subsection 97(2), a bump under paragraphs 88(1)(c) and (d), a bump under subsection 98(3), and a sale to a tax-exempt entity, did not engage the elevated inclusion rate under paragraph 100(1)(b). The minister had assessed on the basis that the series of transactions constituted an avoidance transaction that abused the specified provisions, such that GAAR applied. Accordingly, Noël CJ's decision on behalf of the Court of Appeal focused on a determination of the object, spirit, and purpose of the various provisions.

Notwithstanding the minister's success, the Court of Appeal found the minister's methodology for reassessing the taxpayer to have been overly mechanical and not in accordance with the object, spirit, and purpose of the relevant provisions of the Act; therefore, the court instructed the minister to reduce the assessed amounts accordingly.

Facts

No witnesses were called at the Tax Court of Canada hearing. Instead, the parties filed a detailed statement of agreed facts, which was reproduced in appendix A to the Tax Court judgment. Certain selected facts are summarized below.

A publicly traded predecessor to Oxford ("Old Oxford") was a real estate investment, development, and property management firm that directly or indirectly held a global portfolio of real property, including the following properties situated in Canada: the Atria Complex, the Richmond Adelaide Centre ("RAC") and a 50 percent beneficial interest in the Calgary Eaton Centre ("CEC") (collectively, "the real estate properties"). Old Oxford and its affiliates, as applicable, had a relatively low adjusted cost base (ACB) and undepreciated capital cost (UCC) in each of the real estate properties, though the real estate properties had a relatively high fair market value (FMV) relative to their ACB and UCC.

In 2001, BPC Properties Inc. ("BPC") made a takeover proposal to acquire all of the issued and outstanding common shares of Old Oxford that were not already owned by the Ontario Municipal Employees Retirement System (OMERS). OMERS is a "registered pension plan" for the purposes of the Act and consequently exempt from tax levied under part I of the Act. At the time of the takeover proposal, OMERS purportedly owned shares of BPC representing the "vast majority"[21] of the FMV of the issued and outstanding shares of BPC.

Old Oxford and BPC entered into an agreement ("the support agreement") pursuant to which Old Oxford agreed to undertake a pre-closing reorganization of its business at BPC's request, provided that the request was reasonable and BPC reimbursed Old Oxford for the costs of the reorganization.

21 Ibid., appendix A, at paragraph 5.

At BPC's request pursuant to the support agreement, Old Oxford caused two limited partnerships to be created, OPGI Office Limited Partnership and MRC Office Limited Partnership (collectively, "the first-tier partnerships"). The limited partner of OPGI Office Limited Partnership was an entity that was formed on the amalgamation of Old Oxford and certain other affiliates, referred to in the decision as "OPGI Amalco." The limited partner of MRC Office Limited Partnership was Oxford MRC Inc., an affiliate of Old Oxford.

BPC also requested, pursuant to the support agreement, that

1. OPGI Amalco transfer its beneficial interest in certain real properties, including RAC and CEC, to OPGI Office Limited Partnership in exchange for the assumption of debt and an additional limited partnership interest in OPGI Office Limited Partnership; and
2. Oxford MRC Inc. transfer its beneficial interest in certain real properties, including the Atria Complex, to MRC Office Limited Partnership in exchange for the assumption of debt and an additional limited partnership interest in MRC Office Limited Partnership.

In each case, an election was made under subsection 97(2) to transfer the applicable real estate properties at their ACB and UCC. Accordingly, the limited partners of the first-tier partnerships had a relatively low ACB in their respective partnership interests (so-called low outside basis) and the first-tier partnerships had a relatively low ACB and UCC in their respective real estate properties (so-called low inside basis).

Approximately seven months after BPC's October 2001 acquisition of control of OPGI Amalco and its affiliates, OPGI Amalco, Oxford MRC Inc., and certain other affiliates amalgamated to form a new entity ("the target"). As a consequence of the amalgamation, the target became the sole limited partner of the first-tier partnerships. Thereafter, the target undertook a vertical amalgamation with its sole shareholder to form Oxford. Designations were filed in respect of the vertical amalgamation pursuant to paragraph 88(1)(d) to increase (bump) the ACB of the non-depreciable capital properties formerly held by the target, including the target's limited partnership interests in the first-tier partnerships.[22] As a consequence of the bump, Oxford had a relatively high ACB in its limited partnership interests in the first-tier partnerships (so-called high outside basis), while the first-tier partnerships continued to have a relatively low ACB and UCC (low inside basis) in the real estate properties.

Oxford subsequently caused three new limited partnerships to be formed: Atria Limited Partnership, RAC Limited Partnership, and Calgary Eaton Centre Limited Partnership (collectively, "the second-tier partnerships"). In February 2004, the first-tier partnerships transferred the real estate properties to the second-tier

22 As discussed in greater detail below, the bump occurred before the introduction of the statutory amendments (as defined below), including the introduction of subparagraph 88(1)(d)(ii.1).

partnerships on a tax-deferred rollover basis pursuant to subsection 97(2), with the elected amount equalling the first-tier partnerships' ACB and UCC in each of the respective real estate properties, as follows:

1. OPGI Office Limited Partnership transferred certain real properties to Calgary Eaton Centre Limited Partnership, including CEC, in exchange for the assumption of debt and an additional limited partnership interest in Calgary Eaton Centre Limited Partnership, with OPGI Office Limited Partnership being the sole limited partner of Calgary Eaton Centre Limited Partnership.
2. OPGI Office Limited Partnership transferred RAC to RAC Limited Partnership in exchange for the assumption of debt and an additional limited partnership interest in RAC Limited Partnership, with OPGI Office Limited Partnership being the sole limited partner of RAC Limited Partnership.
3. MRC Office Limited Partnership transferred certain real properties to Atria Limited Partnership, including the Atria Complex, in exchange for the assumption of debt and an additional limited partnership interest in Atria Limited Partnership, with MRC Office Limited Partnership being the sole limited partner of Atria Limited Partnership.

Accordingly, the limited partners of the second-tier partnerships had a relatively low ACB in their respective partnership interests (low outside basis) and the second-tier partnerships had a relatively low ACB and UCC in their respective real estate properties (low inside basis).

In August 2004, the first-tier partnerships were dissolved with each of their respective partners receiving proportionate undivided interests in the assets of the respective partnerships, including their limited partnership interests in the second-tier partnerships, and liabilities of the first-tier partnerships. An election was made by the partners of each of the first-tier partnerships to have subsection 98(3) apply, such that the ACB of the first-tier partnerships' non-depreciable capital property, including their respective limited partnership interests in the second-tier partnerships, was increased ("the second bump"). Accordingly, following the second bump, Oxford had a high ACB in its limited partnership interest in each of the second-tier partnerships, but the second-tier partnerships continued to have a low ACB and UCC in their respective real estate properties.

During its 2006 taxation year, Oxford sold its limited partnership interest in each of the second-tier partnerships to a purchaser that was exempt from tax under part I of the Act. As a consequence of the two bumps, little or no taxable capital gain was realized on the sale of such partnership interests. (In the case of the sale of RAC Limited Partnership, a capital loss was realized but was suspended since the purchaser of the limited partnership interest was an affiliate of OMERS.) Since no material capital gain was realized on the disposition of such partnership interests, subsection 100(1) was not materially engaged to include the non-taxable portion of a capital gain in income.

Procedural History

The Assessment

The minister reassessed the above series of transactions on the basis that the series constituted an abuse of provisions of the Act, such that GAAR applied to deny the bump. As reassessed pursuant to subsection 100(1), Oxford's disposition of the limited partnership interests in the second-tier partnerships gave rise to a taxable gain of $148,187,562, reflecting recapture in the amount of $116,591,744 and a taxable capital gain in the amount of $32,203,408. The minister's reassessment also resulted in a reduction of the suspended capital loss with respect to the disposition of the RAC Limited Partnership from $5,155,531 to nil. Specifically, the minister asserted that the use of the bumps, combined with the above-described rollovers, resulted in an increase in the ACB of Oxford's limited partnership interests in the limited partnerships that permitted Oxford to circumvent the application of subsection 100(1).

Tax Court of Canada Decision

Oxford was successful before the Tax Court in overturning the minister's GAAR assessment. The Tax Court held that Oxford engaged in a proper exercise of tax minimization without abusing the relevant provisions of the Act.[23]

The bulk of the Tax Court's analysis focused on the question of whether the above series of transactions amounted to an abuse of the provisions of the Act. Specifically, the court analyzed each of the material transactions undertaken by Oxford in the course of completing the series and the impact, if any, of each transaction on the application of subsection 100(1) (among other provisions).

Although the court found that the series of transactions did not constitute an abuse of the relevant provisions of the Act, it dismissed Oxford's assertion that the subject tax benefit was not attributable to a series of transactions that included an avoidance transaction.

Discussion of Court of Appeal Decision

Citing *Copthorne*[24] and *Canada Trustco*[25] as support, the Court of Appeal summarized the factors that must be present for the minister to support a GAAR assessment: (1) the presence of a tax benefit, (2) the presence of an avoidance transaction giving rise to such a benefit, and (3) such avoidance transaction being abusive.

Oxford conceded that the following constituted tax benefits for the purposes of the GAAR analysis: (1) the deferred tax on the accrued gains and recapture pursuant to subsection 97(2); (2) the bumps in the ACB of the limited partnership interests of the first-tier partnerships and second-tier partnerships pursuant to subsections 88(1) and 98(3), respectively; and (3) the reduction of tax payable on the sale of the partnership interests to the tax-exempt entity.

23 Supra note 20, at paragraph 217.

24 *Copthorne Holdings*, supra note 12.

25 *Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54.

The Tax Court had found that the sale of the limited partnership interests in the second-tier partnerships to the tax-exempt entities was part of a series of transactions that contained one or more avoidance transactions.[26] Oxford did not challenge this finding before the Court of Appeal.

Accordingly, the Court of Appeal framed the sole issue before it as whether the elimination of the capital gain on the sale of the partnership interests to the exempt entities by the use of the bumps and the consequential avoidance of recapture under subsection 100(1) frustrated this provision and the other provisions relied upon in order to achieve this result.[27]

To answer this question, the court considered that it was first obliged to determine the object, spirit, and purpose of the provisions giving rise to the tax benefit, and subsequently to determine whether the provisions, so construed, were frustrated by the tax benefit achieved.

The court emphasized that in a GAAR analysis, a court must adopt a unified textual, contextual, and purposive approach to determine the object, spirit, and purpose of the provisions, rather than adopt such a unified textual, contextual, and purposive approach to determine what the words of a statute mean in non-GAAR cases. In the case of a GAAR assessment, the analysis proceeds on the assumption that the tax benefit is properly obtained under the traditional approach, and it is only on a finding that section 245 applies that the minister may deny the tax benefit being sought.

Subsection 97(2) Rollovers

Oxford and its affiliates engaged in two transactions in the series where an election was made under subsection 97(2). An Oxford predecessor transferred the real estate properties to the first-tier partnerships pursuant to subsection 97(2), and the first-tier partnerships transferred the real estate properties to the second-tier partnerships, also pursuant to subsection 97(2). By electing at the tax cost of the real estate properties (the ACB in the case of non-depreciable capital property, such as land, and the UCC in the case of depreciable property, such as buildings), the transferor deferred the realization of any accrued capital gain and recapture in respect of such transfer. Absent such an election, subsection 97(1) would have deemed such transfers to have occurred at FMV, resulting in the realization of any accrued gain.

The Court of Appeal observed that since the transferee's deemed cost in the transferred property (ACB or UCC, as the case may be) is inherited from the transferor, tax on the accrued gain is not avoided; it is deferred.[28]

Oxford noted before the Court of Appeal that an accrued gain is not always merely deferred in a subsection 97(2) transfer; where a tax-exempt entity is involved, a taxable gain may not be subject to tax. Oxford cited the example of a partnership

26 Supra note 20, at paragraph 76.

27 Supra note 19, at paragraph 38.

28 Ibid., at paragraph 57, citing *Continental Bank of Canada et al. v. The Queen*, 94 DTC 1858, at 1872 (TCC); aff'd. 96 DTC 6355 (FCA).

with a tax-exempt entity that acquires appreciated capital property in exchange for a partnership interest, transacted pursuant to subsection 97(2). Depending on the terms of the partnership agreement, recapture on the sale of such a property might be allocated to the tax-exempt partner, such that all, or a portion, of the gain is not subject to tax. Such recapture would not be caught by subsection 100(1).

However, it should also be noted that the number of accrued gains is multiplied on any such rollover transfer. Whereas before the transfer a transferor had an asset with an accrued gain, after such a transfer pursuant to subsection 97(2), both the transferee and the transferor hold an asset with an accrued gain. The transferee holds the asset transferred from the transferor, with the same accrued gain. The transferor also holds an asset with an accrued gain after such a transfer, that asset being the interest in the partnership.

Conversely, the Tax Court found that subsection 97(2) permits tax to be "fully or partially avoided" upon the transfer of property to a partnership.[29] The Tax Court devoted considerable attention to the three-year holding period set out in subsection 69(11), and concluded that subsection 97(2) is not frustrated when deferred recapture goes untaxed, provided that the said three-year holding requirement is met. The Tax Court concluded that this three-year limitation period constitutes part of the object, spirit, and purpose of subsection 97(2), since Parliament would have been aware of the existence of subsection 97(2) at the time that it extended the application of subsection 69(11) to transfers of tax-exempt entities that occur within the three-year period. The Tax Court concluded that Parliament had implicitly recognized that transfers after this three-year period did not abuse subsection 97(2).[30]

It was accepted before the Court of Appeal that subsection 69(11) could not apply to the subject series of transactions since, even it were found to be applicable, the three-year holding period was respected. As well, the benefit attributable to the subject series of transactions was not obtained from the sale to a tax-exempt entity; rather, the benefit was obtained from the use of rollovers and bumps such that no gain was realized on the sale of a partnership interest to an entity that was tax-exempt (notwithstanding subsection 100(1)).

The Court of Appeal dismissed the Tax Court's reasoning relating to subsection 69(11), observing that subsection 69(11) was not specifically said to have been introduced to address subsection 97(2) rollovers, and its broad scope can apply to any series where a property is disposed of for less than FMV, regardless of whether a rollover under subsection 97(2) or any other provision is invoked. The Court of Appeal held that "there is no 'plausible and coherent plan' which could justify reading the three year time limitation set out in subsection 69(11) into subsection 97(2)."[31] In my view, this seems to be an unnecessarily restrictive approach to assessing the object, spirit, and purpose of subsection 97(2). A specific anti-avoidance

29 Supra note 20, at paragraph 107.

30 Ibid., at paragraph 193.

31 Supra note 19, at paragraph 65, citing *Copthorne*, supra note 12, at paragraph 91.

measure that addresses the effects of a subsection 97(2) rollover (albeit not specifically identified by section number) should presumably inform the object, spirit, and purpose of that rollover provision and can be used to assist in interpreting the scope of GAAR.

The Court of Appeal asserted that the only reason why Parliament would preserve the tax attributes of property that is rolled into a partnership is to allow for the eventual taxation of the deferred gains and latent recapture. Accordingly, the court concluded that the fact that deferred gains and recapture will never be taxed in the subject series frustrates the object, spirit, and purpose of subsection 97(2).[32] Again, this seems to be an oversimplification by the Court of Appeal. There are many presumably inoffensive circumstances where rolled property is not subject to tax. Because of the multiplication of accrued gains in a subsection 97(2) rollover, as described above, it is frequently the case that property with latent recapture will be rolled into a subsidiary, with the shares of the subsidiary being transferred between unrelated parties. The latent accrued gain on the shares in such circumstances, inherited from the latent accrued gain on the rolled assets, may be subject to tax. A third-party purchaser in such circumstances may be eligible to bump the ACB of the non-depreciable capital property pursuant to paragraph 88(1)(d) after such an acquisition to an amount equal to the consideration paid for the shares (subject to the detailed restrictions set out in section 88). Although such a purchaser would in all likelihood not be able to effectively bump the UCC of the depreciable property, the deferred gains on the non-depreciable capital property can be avoided, with tax instead being paid at the shareholder level.

Bump Provisions

The Court of Appeal described the bump mechanics in paragraphs 88(1)(c) and (d), and in subsection 98(3). A detailed analysis of these provisions is beyond the scope of this comment. However, the net effect of the bump provisions is that a shareholder or partner with relatively high basis in the shares of a subsidiary or a partnership interest, respectively, is permitted to effectively transfer a portion of such basis to the assets of the subsidiary or partnership on a windup of the subsidiary or partnership, as applicable.[33] The transfer mechanism was presumably included in the Act to limit circumstances where a buyer "loses" outside basis on the dissolution of a subsidiary or partnership. Absent a mechanism to transfer such outside basis to assets distributed on a dissolution, the Act would in certain circumstances tax the same gain twice. For example, a vendor of shares would presumably pay tax on the sale of such shares, with all or a portion of such gains being potentially attributable to the assets of the target company. If there is no provision to bump the assets of the target up to the purchaser's tax cost in the shares, such tax

32 Supra note 19, at paragraph 73.

33 A vertical amalgamation, as described in subsection 87(11), is generally treated as functionally equivalent to a windup for the purposes of the bump provisions in subsection 88(1).

basis will be lost on a windup of the target company since the shares will disappear and the low-basis assets will be acquired by the purchaser on the windup. A subsequent sale of low-basis assets would potentially give rise to tax, resulting in the same economic gain being taxed twice.

There is a complex series of anti-avoidance measures limiting the application of the bump under subsection 88(1). Notably, subparagraph 88(1)(c)(iii) generally prohibits a parent from bumping the cost of "ineligible property," which includes depreciable property. Accordingly, the bump provisions generally permit the transfer of basis only to non-depreciable capital property such as land, shares, and partnership interests. Assuming that the shares of the wound-up entity are held on capital account, this effectively allows the transfer of basis from one form of non-depreciable capital property (that is, the shares) to another form of non-depreciable capital property.

Similarly, paragraph 98(3)(c) prohibits the bumping of "ineligible property" of a partnership, including depreciable property, in the context of a partnership windup.

The Court of Appeal drew a policy distinction between the bumping of a depreciable property's UCC (in the case of a depreciable property for which capital cost allowance [CCA] has previously been claimed) and the bumping of the capital cost of depreciable property. In the former case, the latent recapture is subject to a 100 percent rate of inclusion in income, whereas in the latter case only 50 percent of any gain is included in income. If the policy for the bump is to transfer tax basis from shares or partnership interests held on capital account where such tax basis would otherwise disappear on dissolution, in favour of the distributed assets of the subsidiary or partnership, as the case may be, then the application of a bump to the capital cost of a depreciable property should not be concerning from a policy perspective; however, a bump in the UCC arguably creates a mismatch between the nature of the high-basis property that is being disposed of (shares or a partnership interest) and the type of property being bumped.

The Court of Appeal implies that the object, spirit, and purpose of the relevant provisions in this series were frustrated "because the bumps were used to effectively increase the UCC of depreciable property."[34] The court seems to have overreached with this statement, since the value of the UCC was not increased by Oxford at any point in the series. Although the ACB of the partnership interests was at various points in the series increased to the respective FMV of those interests, the applicable partnership continued to have low UCC in the underlying real estate properties. Although high basis in the respective partnership interests permitted the indirect transfer of the real estate properties between parties without incurring a tax cost, there was no bump in the UCC of the properties, thereby limiting such partnerships to claiming CCA based on the inherited (that is, "unbumped") UCC of the real estate properties. An actual increase in the UCC would be obtained only if the tax-exempt

34 Supra note 19, at paragraph 82.

entity sold the real estate property, a transaction that was not part of the series before the court.

Ultimately, the Court of Appeal concluded that "the bumps insofar as they allowed [Oxford] to avoid latent recapture on the depreciable property held by the partnerships frustrate the object, spirit and purpose of paragraphs 88(1)(c) and (d) and subsection 98(3)."[35]

Statutory Amendments

Both the Tax Court and the Court of Appeal were obliged to consider how statutory amendments to the subsection 88(1) bump provisions in 2012 ("the statutory amendments") affected the GAAR analysis.[36] The statutory amendments, particularly the introduction of subparagraph 88(1)(d)(ii.1), generally restricted the amount by which a partnership interest could be bumped to the amount of the FMV of the partnership that was attributable to non-depreciable capital property.

The Tax Court reviewed the highly detailed and technical bump regime as it existed prior to the introduction of the statutory amendments and concluded that there was no statutory ground for concluding that the 88(1)(c) and (d) bump of a partnership interest was limited on the basis of the types of assets held by such partnership.

The clear difference between the statutory limits on the bump room under the legislation as it existed prior to the statutory amendments and the legislation as it existed after the statutory amendments caused the Tax Court to conclude that the statutory amendments were not mere clarifications of the existing law, as the Department of Finance technical notes had indicated, but instead represented a material departure from the old regime.

The Court of Appeal disagreed with the reasoning in the preceding paragraph, indicating that the Tax Court was too heavily influenced by the wording of the former provisions rather than the provisions' object, spirit, and purpose. The Court of Appeal was of the view that in a GAAR analysis, where it is effectively conceded by the minister that the text of the Act does not prohibit the tax benefits obtained by a series of transactions, additional weight should be given to the object, spirit, and purpose of the former legislation to determine whether a statutory amendment results in a new provision or a clarification of the old provision for the purposes of a GAAR assessment. The Court of Appeal observed that the pre-amendment regime already drew a distinction between depreciable and non-depreciable property, and held that the use of tiered partnerships to bypass this distinctive treatment frustrates the reason for the distinction that these provisions already drew. Accordingly, the court held that when the prior law is construed with a focus on its object, spirit, and purpose, the statutory amendments do not operate as new law but instead codify what was already a limitation imposed by GAAR.

35 Ibid., at paragraph 97.

36 SC 2012, c. 31, section 18.

Although the Tax Court's reasoning is preferred, particularly when considering a complex statutory regime such as the 88(1)(c) and (d) bump regime, comfort can be taken that the Court of Appeal reached the above conclusion without placing any reliance on the budget supplementary information document that was issued by the Department of Finance in conjunction with the introduction of subparagraph 88(1)(d)(ii.1) and the statutory amendments. The publication purports to confirm that the statutory amendments are remedial and simply "clarify" the existing law.[37] The Court of Appeal observed that such documents had the potential to be self-serving statements that were published at a time when the minister was already challenging structures such as the subject series of transactions under GAAR. Accordingly, the Court of Appeal confirmed that the opinion expressed in this publication must be disregarded.[38]

Subsection 100(1)

There is a special computation of the capital gain applicable to certain sales of partnership interests under subsection 100(1), including most sales to tax-exempt purchasers. Under these provisions, the normal rate of inclusion for a capital gain (50 percent) applies to the portion of the gain realized on a sale of a partnership interest that is attributable to non-depreciable capital property held by the partnership. However, to the extent that the gain realized on the sale of the partnership interest is attributable to the value of other property, including depreciable property, paragraph 100(1)(b) provides for a 100 percent rate of inclusion.

The Tax Court declined to follow the Crown's interpretation that the object, spirit, and purpose of the provision was reflected in the statutory amendments. In rejecting the Crown's contention that the purpose of subsection 100(1) was to look through the partnership and impose tax on the latent recapture that would otherwise go unpaid by reason of its acquisition by a tax-exempt purchaser, the Tax Court held that a textual, contextual, and purposive analysis of subsection 100(1) does not support such a purpose. The Tax Court observed that if Parliament had intended such a result, it could have drafted subsection 100(1) to require a lookthrough, in a manner similar to the statutory amendments. Instead, the Tax Court found that the object, spirit, and purpose of the provision were reflected in the wording of the provision, emphasizing that the starting point is the capital gain otherwise computed under the Act, with a secondary determination as to what portion is taxable. The Tax Court found there was no frustration of subsection 100(1) where no taxable gain arose (for example, because of a bump to the partnership interest).

The Court of Appeal concluded that the Tax Court's adherence to the text of subsection 100(1) did not sufficiently address the question of the provision's object, spirit, and purpose. In answering the question of why subsection 100(1) brings 100 percent of certain gains into income, the Court of Appeal concluded that Parliament wanted tax to be paid on the latent recapture that would otherwise go

37 Canada, Department of Finance, 2012 Budget, Budget Plan, March 29, 2012, at 414.

38 Supra note 19, at paragraph 93.

unpaid on a subsequent sale of the depreciable property by a tax-exempt purchaser. Accordingly, the Court of Appeal concluded that the object, spirit, and purpose of subsection 100(1) were frustrated by the result achieved in the subject series of transactions since the latent recapture in the depreciable property held by the second-tier partnerships would go untaxed.

Ministerial Overreach

The minister's reassessment nullified the bumps and applied the 100 percent inclusion rate in paragraph 100(1)(b) to both the recapture portion and the capital gain portion of the increase in value attributable to the depreciable property. Although this result appears to be in accordance with the text of the provision, it is highly unfair since the taxpayer is effectively paying twice the rate of tax on the portion of the gain attributable to capital gain that would be paid if the partnership sold the depreciable property directly to a tax-exempt or other purchaser.

At the Court of Appeal, the Crown asserted that such a punitive level of taxation was consistent with the object, spirit, and purpose of subsection 100(1) because the 100 percent inclusion rate was intended by Parliament to "exact a price" on taxpayers in order to discourage the attempted avoidance of recapture.[39]

The Court of Appeal disagreed that subsection 100(1) was intended to produce a punitive result. It noted that in cases where the intended avoidance is limited to recapture, the 100 percent inclusion rate in paragraph 100(1)(b) merely matches the normal rate of recapture if the asset were sold directly. If the intention was to "exact a price," the provision would have been drafted to provide a penalty in such a scenario. The Court of Appeal also noted that the punitive component only appears to apply to depreciable property, and does not cover the other types of income inclusions covered by paragraph 100(1)(b).

In the same manner that the scope of property ineligible to be bumped under paragraphs 88(1)(c) and (d) appears to be overbroad from a policy perspective, including all depreciable property without providing an exception to bump the capital cost of such property (while limiting the opportunity to bump the UCC), the blanket inclusion under paragraph 100(1)(b) of all depreciable property, rather than just the portion of any accrued gain that is subject to recapture, is equally overbroad from a policy perspective.

The Court of Appeal found that the only manner in which the Crown could support such a punitive reassessment was to rely on a restrictive construction of the bump provisions and paragraph 100(1)(b), in each case relying exclusively on the text of the provisions and the corresponding blanket exclusion of depreciable property. The Court of Appeal indicated that it would not permit the Crown to "have it both ways."[40] In a GAAR context, the same interpretive approach should be applied to both the determination of the abuse and the consequential adjustments required in order to address it.

39 Ibid., at paragraph 103.

40 Ibid., at paragraph 117.

Accordingly, the Court of Appeal referred the reassessment back to the minister for consideration and reassessment on the basis that the subsection 100(1) inclusion was to apply only to the amount of recapture that Oxford had purportedly avoided, thereby excluding the portion of the capital gain attributable to the land (that is, non-depreciable property) and the gain on depreciable property in excess of the cost amount.

Conclusion

The Court of Appeal's overturning (in part) of the Tax Court decision highlights the different possible approaches to identifying the object, spirit, and purpose of legislation. As described in greater detail above, in many instances the Tax Court identified the object, spirit, and purpose of a provision in a manner that was more firmly rooted in the text of the provision in question, with the Court of Appeal taking a somewhat more policy-based approach to identifying object, spirit, and purpose.

Interestingly, a taxpayer that acquired a partnership interest in an arm's-length purchase for value where the subject partnership held depreciated capital property would be in an economically similar situation to Oxford if it subsequently sold the partnership interest in an arm's-length transaction to a tax-exempt entity. In this scenario, the hypothetical taxpayer would have a high ACB in the partnership interest (high outside basis) and the partnership might have a low ACB and UCC in its underlying property, including accrued recapture (low inside basis). If there were no gain on the sale of the taxpayer's partnership interest to a tax-exempt entity, the text of subsection 100(1) would not apply, since there would be no gain realized on the sale. Since the taxpayer in this scenario simply acquired a partnership interest and then sold the interest at no gain to a tax-exempt entity, in each case pursuant to arm's-length sales, it is difficult to identify an avoidance transaction, let alone a misuse or abuse for the purposes of a GAAR analysis. Yet, as with Oxford, this hypothetical taxpayer would not be liable for tax on the latent recapture.

Both Oxford and the above hypothetical taxpayer acquired an indirect interest in depreciated capital property; however, the hypothetical taxpayer acquired an interest lower down in the chain of ownership, thereby avoiding the need to engage in the rollover and bump transactions described above. Given this disparity, it seems that the Court of Appeal's focus on Oxford's failure to pay tax on the latent accrued recapture is misplaced. Rather than perceiving the sale of a partnership interest to a tax-exempt entity as the potentially problematic step in the series, it is the tax-exempt status of the purchaser that gives rise to the non-payment of tax on accrued recapture (should the purchaser eventually dispose of the property with the accrued recapture). Identifying which entities should benefit from tax-exempt status is a question of policy, and it is this question that appears to be at the root of the Court of Appeal's concern.

Oxford has filed leave to appeal the Court of Appeal's decision to the Supreme Court of Canada.

Andrew Stirling