COURT OF APPEAL FOR ONTARIO

CITATION: Inter-Leasing, Inc. v. Ontario (Revenue), 2014 ONCA 575
DATE: 20140807
DOCKET: C57387

Weiler, Hourigan and Pardu JJ.A.

BETWEEN

Inter-Leasing, Inc.

(Appellant/Appellant)

and

The Minister of Revenue

(Respondent/Respondent)

In the Matter of the *Corporations Tax Act*, R.S.O. 1990, c. 40, as amended

Al Meghji, Monica Biringer, Caroline D'Elia and Adam Hirsh, for the appellant

Anita C. Veiga and Ryan Mak, for the respondent

Heard: May 13, 2014

On appeal from the judgment of Justice David Aston of the Superior Court of Justice dated June 26, 2013, with reasons reported at 2013 ONSC 2927.

Pardu J.A.:

[1] This appeal concerns the validity of a series of tax reassessments issued to Inter-Leasing by the Minister of Revenue under *Ontario's Corporations Tax Act*, R.S.O. 1990, c. C.40 (the "OCTA").

[2] Under the tax reassessments, Inter-Leasing is obliged to pay tax on certain interest payments it received during its 2001 to 2004 taxation years as well as interest on the arrears.

[3] Inter-Leasing appealed the tax reassessments. The appeal judge held that the interest income was “income from a business carried on in Canada” and that the Minister’s reassessment of corporate income tax was correct. Inter-Leasing now appeals to this court from that decision.

[4] If, as the Minister contends and the appeal judge held, Inter-Leasing’s interest income is properly characterized as “income from a business carried on in Canada”, it will owe corporate income tax on the income. If, as Inter-Leasing contends, it is income from property, the income will not be subject to corporate income tax.

[5] If this court concludes the appeal judge erred in characterizing the income and the income is instead income from property, Ontario raises two subsidiary issues: 1) whether Inter-Leasing is liable to pay corporate income tax in any event pursuant to the OCTA’s General Anti-Avoidance Rule (“GAAR”); and 2) whether Inter-Leasing is liable for the corporate minimum tax (“CMT”) on the income from property.

[6] For the reasons set out below, I conclude that Inter-Leasing’s interest income was not income from business but rather income from property. I also

conclude that Inter-Leasing is not liable for corporate income tax pursuant to the GAAR or liable for paying the CMT on its interest income.

Factual background

[7] During the relevant years, Inter-Leasing, which was incorporated in the British Virgin Islands, was a member of the Precision Group of companies, some of which are incorporated in Alberta for the purpose of providing services to the oil and gas industry.

[8] Before the transactions giving rise to this litigation, a number of Precision Group companies entered into a series of non-interest-bearing inter-corporate loans with one another. Following a corporate reorganization aimed at eliminating provincial tax, then payable to Alberta, the Precision Group's non-interest-bearing inter-corporate debts were converted into interest-bearing deeds of specialty debt, which were payable to Inter-Leasing. At the relevant time, the deeds were physically located in the British Virgin Islands.

[9] As a result of the re-organization, the Alberta corporations in the Precision Group paid interest on the replacement loans to Inter-Leasing and deducted the interest as an expense from their income for tax purposes. Inter-leasing received the interest income and declared it as income for the purposes of federal income tax, as it became a resident of Canada and therefore subject to comprehensive federal tax.

[10] Although Inter-Leasing was incorporated in the British Virgin Islands, by acquiring units in a limited partnership in Ontario, it established a “permanent establishment” in Ontario for the purpose of the OCTA.

[11] As a corporation incorporated outside Canada but with a permanent establishment in Ontario, Inter-Leasing was obliged to pay tax imposed by the OCTA pursuant to s. 2(2). Prior to 2005, s. 2(2) corporations were not subject to corporate income tax on income from property, only on income from business.

The appeal judgment

[12] The appeal judge began his analysis with a discussion of the legal principles to be applied. He noted that “[i]n general, interest income that is received on investments is considered to constitute income from property rather than income from business”: para. 27. However, he noted that there are two exceptions to the general principle: “where investments constitute an integral part of the taxpayer’s business activities; or (ii) where the activities associated with the generation of interest income are in and of themselves a business”: para. 27.

[13] In this case, he asked “[h]ow, if at all, were the debt instruments ‘employed and risked’ in whatever activity Inter-Leasing was engaged in?”: para. 28. He also asked “Are the refinancing activities associated with the generation of the interest a business on their own?”: para. 29.

[14] He further noted that where a taxpayer devotes extensive time and resources to managing investments, the taxpayer may be found to be involved in an investment business: para. 30.

[15] Turning to the facts of this case, the appeal judge considered the level of activity undertaken by Inter-Leasing to generate the interest income. He suggested, at paras. 30-31 of his reasons, that the level of activity undertaken by Inter-Leasing was insufficient to qualify the interest income as income from business:

> In this case, the facts which support the conclusion that the interest income is not business income from a business are these:
>
> (a) Inter-Leasing's Amended Memorandum of Association explicitly prohibited it from carrying on business in Canada, except in the capacity of a limited partner;
>
> (b) Inter-Leasing did not have any employees;
>
> (c) earning the interest income did not require Inter-Leasing to undertake any regular administrative activity or oversight;
>
> (d) Inter-Leasing did not have to manage any risk or make decisions in that regard[;]
>
> (e) Inter-Leasing had a single director throughout the taxation years;
>
> (f) Inter-Leasing earned the interest income from merely four debt instruments that were acquired and held throughout the taxation years with no turnover;

> (g) once the debts had been put in place as a result of the refinancing transactions, Inter-Leasing received one payment per year for the interest on each of the debts and simply turned around and advanced those funds to its parent Precision in the form of annual non-taxable dividends and non-interest bearing loans; and
>
> (h) the debts required no monitoring activity.

[16] Despite what the appeal judge described as the “passive nature of Inter-Leasing’s operations”, he ultimately concluded that the interest income “ought to be considered income from a business in Canada”: para. 34.

[17] He found that Inter-Leasing’s main function and purpose was to assist the Precision Group in attempting to reduce its taxes. He reasoned that Inter-Leasing’s interest income arising from the specialty debt instruments was income from business as it was “employed in” or was an integral part of its business:

> [34] Inter-Leasing’s *raison d’être* and principle function and purpose was to assist the Precision Group in attempting to legitimately reduce the after-tax cost of capital for companies within the Precision Group. It had no other object or activity to speak of. Even its investment in McMaster LP was a part of that enterprise. Inter-Leasing’s role was fundamental and critical to the accomplishment of an ongoing joint venture with the other companies in the Precision Group. That being the true nature of Inter-Leasing’s business, the transactions that it entered into, coupled with the subsequent administration and routing of the interest income earned, are core activities and ought to be considered income from a business in Canada.

[18] He reached this conclusion based on a list of facts set out at para. 33 of his reasons:

The facts in support of a conclusion that the interest income was an integral part of a business being carried on in Canada are as follows:

(a) Inter-Leasing is a corporation, not an individual, presumptively carrying on a business in pursuit of its own stated objects;

(b) It had a "permanent establishment" in Ontario;

(c) its sole director was an Ontario resident and its central management and control was situated in Canada as evidenced by its own federal tax returns;

(d) it did not carry on any business outside of Canada;

(e) it did not maintain any bank account outside of Canada and none of the money paid to it as interest and passed on to its Canadian parent ever left Canada;

(f) it entered into contracts and other legal transactions only in Canada;

(g) its only administrative activities took place in Canada;

(h) its Memorandum of Association states that its "sole purpose" is to hold investments such as debts and to earn income from property such as interest;

(i) the passive nature of its activity is a factor to take into account but not determinative. (In this case, a high level of activity was not required because the business purposes of Inter-Leasing were all capable of being fulfilled as a passive but critically essential partner in a joint venture with other affiliated corporations.)

(j) the core activity of Inter-Leasing is an investment holding business. The interest income is obviously within its own corporate objects and there is no reason to say that this interest income is not part of its core business activity; in fact, the main part of its core activity.

> (k) the Amended Memorandum of Association restricting it from carrying on any business in Canada (except investing in a limited partnership) is a voluntary, unenforceable and unenforced restriction. It is not necessary to characterize that document as a "sham". It is only necessary to look at what Inter-Leasing actually did rather than placing any weight on what it said it would not do.
>
> (l) Inter-Leasing represented itself to Ontario in its application for an extra-provincial licence and in its tax returns as an "investments holding company" and it also represented that its "major business activity" was "earning income from property" and "holding company". It is clear from the evidence that the interest income of Inter-Leasing falls within that self-description.
>
> (m) the Administrative Services Agreement with Precision and the other contracts and authorizations that Inter-Leasing executed are evidence of business activity in Ontario directly connected to the interest income in issue. It incurred expenses in running a business which included payment of annual fees to Precision, precisely to administer and account for the receipt and disbursement of the interest income in Canada.

[19] Although unnecessary given his conclusion that the interest income was income from business, the appeal judge also commented on the application of the GAAR. While not finally deciding the issue, his reasons suggest that he was persuaded that the GAAR would apply in the circumstances.

Issues

[20] There are four main issues on this appeal:

> 1. whether the appeal judge erred in law in concluding that the interest income was income from business rather than income from property;
>
> 2. if the interest income was income from property, whether it should be subject to corporate income tax by virtue of the GAAR;
>
> 3. whether income from the specialty debt instruments was subject to the CMT as “property situated in Canada”;
>
> 4. if the specialty debt instruments were not “property situated in Canada”, whether Inter-Leasing’s location of the specialty debts in the British Virgin Islands constituted CMT avoidance for purposes of the GAAR.

Analysis

Issue #1: Income from Business vs. Income from Property

[21] Canadian income tax legislation has long distinguished between income from business and income from property. Business income is generated by use of capital, management and labour. Income from property results from the use of capital and some degree of management.

[22] As discussed by the appeal judge, the jurisprudence has developed two approaches to drawing the line between these two sources of income.

[23] One approach is the “level of activity” test embodied in *Canadian Marconi Company v. R,* [1986] 2 S.C.R. 522, 33 D.LR. (4th) 481. In *Marconi*, the corporate taxpayer was a manufacturer of electronic equipment that was forced to sell a broadcasting division which operated a television and a radio station. It invested

the proceeds in short-term interest-bearing securities while it looked for a new business in which to invest the funds.

[24] The court applied the rebuttable presumption that income earned by a corporate taxpayer in the exercise of its authorized objects is income from a business: p. 531. It also described what has become known as the “level of activity” test, at p. 532:

> It is trite law that the characterization of income as income from a business or income from property must be made from an examination of the taxpayer's whole course of conduct viewed in the light of surrounding circumstances: see *Cragg v. Minister of National Revenue*, [1952] Ex. C.R. 40, *per* Thorson P. at p. 46. In following this method courts have examined the number of transactions, their volume, their frequency, the turnover of the investments and the nature of the investments themselves.

[25] In the circumstances, the court found that the presumption had not been rebutted. In reaching this conclusion, the court considered the large scale of investment activity involved in managing the investments, described as follows, at p. 526:

> Throughout the 1973 to 1976 period, the funds remained invested in short-term interest-bearing securities but considerable energy and effort was expended by CMC in order to obtain a maximum return. About twenty per cent of the working hours of the senior company officer placed in charge of the investments was taken up in the day-to-day management of these investments. Every Friday, this officer carefully reviewed all transactions made during the week and decided on the investment strategy for the following week. At any

> one time there were as many as twelve employees involved in the management of the investments. The extent of the activity of this staff in managing the investments and their vigilance in earning a maximum return from the funds is evident from the numerous purchases completed each year (201 in 1973, 218 in 1974, 241 in 1975 and 381 in 1976), the variation in the lengths of terms of deposits made and securities purchased according to the trend of market interest rates and the facts that seldom would the staff reinvest the funds realized from a sale in the same instrument. Finally, the funds available for investment and actually invested represented roughly one-half of CMC's total assets during the 1973 to 1976 period and the income earned from the investments constituted a significant percentage of the total income earned by CMC in each of the years in question – 21.4% in 1973, 52.7% in 1974, 35.4% in 1975 and 31.2% in 1976.

[26] Thus, considering Marconi's level of activity in managing its investments, the court was satisfied that Marconi was engaged in an investment business.

[27] A second approach to distinguishing between income from business and income from property was developed in *Ensite Ltd. v. R*, [1986] 2 S.C.R. 509, 33 D.L.R. (4^{th}) 491. Ensite carried on the business of manufacturing and selling automobile engines. It invested in a plant in the Philippines. Philippine law required that Ensite bring foreign capital into the country to finance the plant. Ensite developed an elaborate plan to protect itself from currency risks. Interest was collected on U.S. dollar deposits which were part of this plan.

[28] The court held, at pp. 520-21, that the interest was business income, as it had been employed and risked in Ensite's business:

> The test is not whether the taxpayer was forced to use a particular property to do business; the test is whether the property was used to fulfil a requirement which had to be met in order to do business. Such property is then truly employed and risked in the business. Here the property was used to fulfil a mandatory condition precedent to trade; it is not collateral, but is employed and risked in the business of the taxpayer in the most intimate way. It is property used or held in business. [Emphasis added.]

[29] In other words, rather than focussing on the level of activity, the focus in *Ensite* was on whether the property was “employed and risked” in the company’s business.

[30] In this case, the appeal judge considered both the *Marconi* approach and the *Ensite* approach.

[31] In my view, the rebuttable presumption articulated in *Marconi* – namely that income earned by corporations acting consistently with their objects is income from a business – is not helpful in determining whether Inter-Leasing’s interest income is from business or property.

[32] Ontario’s corporate taxation regime envisages that s. 2(2) corporations will be taxed on income from business but not on income from property. Presumably corporations will act within their objects. The legislative scheme expressly contemplates a corporation earning income from property and does not subject such a corporation to tax on that income.

[33] In any event, Inter-Leasing's objects specifically prohibit it from carrying on a business in Canada, except through a limited partnership.

[34] I also note that the presumption described in *Marconi* may have little application where the corporation has the "capacity and the rights, powers and privileges of a natural person": p. 530.

[35] As to the "level of activity" test from *Marconi*, I agree with the appeal judge's implicit suggestion that the level of activity associated with the once annual payment of interest on each of the four specialty debt instruments does not make this interest income from business. Rather, the factors set out at para. 31 of the appeal judge's reasons support a conclusion that the interest income paid to Inter-Leasing was income from property.

[36] Where the appeal judge erred was in his application of the *Ensite* test, which focuses on whether property was "employed or risked in" business. In my view, he made two errors.

[37] First, he erred in finding that Inter-Leasing was in the business of reducing the Precision Group's after-tax cost of capital and then reasoning that since the specialty debt instruments were essential to, and employed in, achieving that goal, interest on that income was income from business.

[38] Taxpayers may structure their affairs so as to reduce taxes payable. In *Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54, [2005] 2 S.C.R. 601,

the Supreme Court observed that taxpayers may employ sophisticated tax planning, at para. 12:

> The provisions of the *Income Tax Act* must be interpreted in order to achieve consistency, predictability and fairness so that taxpayers may manage their affairs intelligently. As stated at para. 45 of *Shell Canada Ltd. v. Canada*, [1999] 3 S.C.R. 622:
>
> > <u>[A]bsent a specific provision to the contrary</u>, it is not the courts' role to prevent taxpayers from relying on the sophisticated structure of their transactions, arranged in such a way that the particular provisions of the Act are met, on the basis that it would be inequitable to those taxpayers who have not chosen to structure their transactions that way. [Emphasis added.]
>
> See also *65302 British Columbia*, at para. 51, *per* Iacobucci J. citing P. W. Hogg and J. E. Magee, *Principles of Canadian Income Tax Law* (2nd ed. 1997), at pp. 475-76:
>
> > It would introduce intolerable uncertainty into the Income Tax Act if clear language in a detailed provision of the Act were to be qualified by unexpressed exceptions derived from a court's view of the object and purpose of the provision.

[39] Further, in *Duha Printers (Western) Ltd. v. Canada*, [1998] 1 S.C.R. 795, (159) D.L.R. (4th) 457, the Supreme Court noted that taxpayers may engage in transactions that have no other purpose than to reduce tax, at para. 87:

> It is well established in the jurisprudence of this Court that no "business purpose" is required for a transaction to be considered valid under the *Income Tax Act*, and that a taxpayer is entitled to take advantage of the Act

> even where a transaction is motivated solely by the minimization of tax*: Stubart Investment Ltd. v. The Queen*, [1984] 1 S.C.R. 536. Moreover, this Court emphasized in *Antosko*, supra, at p. 327 that, although various techniques may be employed in interpreting the Act, "such techniques cannot alter the result where the words of the statute are clear and plain and where the legal and practical effect of the transaction is undisputed".

[40] Here, Ontario's legislative regime treats corporate property income differently than corporate business income. To characterize Inter-Leasing's efforts to structure its affairs to take advantage of this difference as engaging in a business is to undercut the well-established jurisprudence that taxpayers may arrange their dealings and structures to reduce taxes.

[41] Second, while the appeal judge lists 13 different factors in support of his conclusion that the interest income was income from business, many of the factors listed are irrelevant to that conclusion. For instance, paragraphs (b) to (g) relate to where activities took place, which is irrelevant to characterizing the nature of the income. Similarly, the fact that "Inter-Leasing is a corporation … presumptively carrying on a business in pursuit of its stated objects" is not helpful in determining whether the income is from business or property. As explained above, the *Marconi* presumption is not helpful in the context of this case.

[42] I conclude that the interest paid to Inter-Leasing on the specialty debt instruments was not income from business. The level of activity associated with receipt of interest income is highly suggestive of income from property rather

than business. There was no other business in which income from the specialty debt instruments was employed or risked. And, as explained, other factors relied on by the appeal judge do not support his conclusion that the interest income was income from business.

Issue #2: Application of the GAAR

[43] The appeal judge determined that he did not need to decide whether the interest income was caught by the GAAR, which is part of the OCTA but nonetheless commented on the issue.

[44] He indicated that the purpose of s. 2(2) of the OCTA was to raise revenue and to define the tax base as broadly as possible in order to generate tax revenue. He suggested that the Precision Group's refinancing was inconsistent with the object, spirit and purpose of the tax provisions, as it had the effect of reducing tax payable.

[45] As I will explain, I do not accept the appeal judge's approach. In my view, Inter-Leasing's interest income is not subject to corporate income tax by virtue of the GAAR.

[46] The anti-avoidance measures in the OCTA provide a response to abusive tax avoidance. At the relevant time, the anti-avoidance measures were as follows:

Definitions

> 5. (1) In this section and in subsection 80 (3),
>
> "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 in good faith primarily for purposes other than to obtain the tax benefit, or
>
> (b) that is part of a series of transactions which would result directly or indirectly in a tax benefit but for this section, unless the transaction may reasonably be considered to have been undertaken or arranged in good faith primarily for purposes other than to obtain the tax benefit;
>
> "tax benefit" means a reduction, avoidance or deferral of tax or other amount payable by a corporation under this Act or under the *Income Tax Act* (Canada) or an increase in a refund of tax or other amount under this Act or under the *Income Tax Act* (Canada);
>
> …
>
> **Determination of tax consequences**
>
> (2) If a transaction is an avoidance transaction, the tax consequences to a corporation shall be determined in a manner that is reasonable in the circumstances in order to deny the tax benefit under this Act that would otherwise result directly or indirectly from the transaction, or from a series of transactions that includes the transaction.
>
> **Saving**
>
> (3) Subsection (2) does not apply to a transaction if it is reasonable to consider that the transaction would not result directly or indirectly in a misuse or abuse of the provisions of this Act, having regard to the provisions of this Act, other than this section, read as a whole.

[47] These provisions mirror the general anti-avoidance rules in s. 245 of the federal *Income Tax Act*, which have been dealt with at length by the Supreme Court of Canada: *Canada Trustco*; *Lipson v. Canada*, 2009 SCC 1, [2009] 1

S.C.R. 3; *Copthorne Holdings Ltd. v. Canada*, 2011 SCC 63, [2011] 3 S.C.R. 721.

[48] A number of general principles emerge from this jurisprudence.

[49] For the GAAR to apply, there must be:

> (1) a tax benefit resulting from a transaction or part of a series of transactions;
>
> (2) an avoidance transaction in the sense that the transaction cannot be said to have been reasonably undertaken or arranged primarily for a *bona fide* purpose other than to obtain a tax benefit and
>
> (3) abusive tax avoidance in the sense that it cannot be reasonably concluded that a tax benefit would be consistent with the object, spirit or purpose of the provisions relied on by the taxpayer.

[50] The onus is on the government to establish that the tax avoidance was abusive. If the existence of abusive tax avoidance is unclear, the benefit of the doubt goes to the taxpayer.

[51] As explained at para. 66 of *Canada Trustco,* courts must apply a purposive approach in interpreting the provisions giving rise to the tax benefit:

> 4. The courts proceed by conducting a unified textual, contextual and purposive analysis of the provisions giving rise to the tax benefit in order to determine why they were put in place and why the benefit was conferred. The goal is to arrive at a purposive interpretation that is harmonious with the provisions of the Act that confer the tax benefit, read in the context of the whole Act.

[52] After the object, spirit or purpose of a section is determined, a transaction may be found to be abusive in one of three ways described in *Lipson*, at para. 40:

> where the result of the avoidance transaction (a) is an outcome that the provisions relied on seek to prevent; (b) defeats the underlying rationale of the provisions relied on; or (c) circumvents certain provisions in a manner that frustrates the object, spirit or purpose of those provisions. [Citations omitted.]

[53] Some examination of the history of corporate taxation in Ontario is necessary to assess the object, spirit or purpose of s. 2(2) of the OCTA as it read before 2005.

[54] Each province, and the federal government, has the authority to impose a separate corporate tax. Some governments levy tax based on the place of incorporation; others use a place of residence or central management test.

[55] In 1959, Ontario adopted the place of incorporation test, unlike the federal government and all other provinces. It had the advantage of clarity of application, unlike the place of management or residence test, which depended on factual determinations and was more subjective.

[56] From 1959 until 2005, when Ontario changed its basis for corporate taxation, a corporation was subject to comprehensive taxation in Ontario only if it was incorporated in Canada and had a permanent establishment in Ontario. Corporations incorporated outside Canada with a permanent establishment in

Ontario were subject to tax in Ontario only on income from certain enumerated heads, including income from business carried on in Ontario.

[57] Differences in the thresholds for taxation as between the provinces or between a province and the federal government can give rise to gaps where some income escapes taxation and other income may be subject to double taxation.

[58] These risks of differential treatment have long been recognized. As observed in a 1999 federal Department of Finance paper on taxation[1]:

> The sharing of the major tax fields provides provincial governments with the flexibility that has become a central feature of the Canadian federation. However, it also means that the tax policies of various governments interact and hence may conflict. For example, if one province taxed on the basis of residence while another taxed on the basis of the source of income, an individual living in the first province but earning income in the second would be taxed twice. By contrast, someone living in the second province but earning income in the first would avoid tax completely. Co-ordination is required to avoid these consequences.

[59] In 2005, Ontario changed its threshold for corporate taxation to rely on residence rather than place of incorporation to avoid some of the problems associated with different taxation regimes. Ontario did not make this change retroactive.

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[1] Munir A. Sheikh & Michel Carreau, "A Federal Perspective on the Role and Operation of the Tax Collection Agreements" (Paper delivered at the Canadian Tax Foundation's Tax Policy Conference, Ottawa, 9 April 1999), at p. 13, available online at http://dsp-psd.pwgsc.gc.ca/Collection/F2-142-2000E.pdf.

[60] In this case, Ontario submits that the purpose of s. 2(2) of the OCTA was to level the playing field between corporations incorporated within and outside Canada so that each would pay income tax on income from business carried on in Canada. That may well be the case, but this ignores the deliberate decision not to tax corporations incorporated outside Canada on income from property.

[61] In *Copthorne Holdings Ltd. v. Canada*, the Supreme Court noted, at para. 110:

> [I]n some cases the underlying rationale of a provision would be no broader than the text itself. Provisions that may be so construed, having regard to their context and purpose, may support the argument that the text is conclusive because the text in consistent with and fully explains its underlying rationale.

[62] Here, the purpose of s. 2(2) of the OCTA was to tax corporations incorporated outside Canada with a permanent establishment in Ontario on income from business but not on from income from property. Where such a corporation structures its affairs to earn income from property rather than income from business, it has not produced a result the provision sought to prevent, defeated the underlying rationale of the provision or frustrated the object, spirit or purpose of the measure.

[63] The result of the Precision Group's refinancing is that the Alberta corporations can deduct the interest paid to Inter-Leasing for tax purposes. While Inter-Leasing must include the interest in its income for the purposes of federal

income tax, it is not subject to Ontario corporate tax for the years from 2001 to 2004 on that income.

[64] The following comments by Hunt J.A. in *Husky Energy Inc. v. Alberta,* 2012 ABCA 231, 66. Alta. L.R. (5th) 279, leave to appeal refused [2012] S.C.C.A. 411, are apt:

> [49] Here, the borrowers used the funds to run their businesses. Based on these cases, it would be a stretch to find abusive avoidance simply because a taxpayer took the benefit of another province's advantageous tax treatment. That proposition lies at the heart of Alberta's position and cannot be accepted. It is difficult to see how, therefore, these transactions could be considered abusive simply because the lender received more favourable tax treatment in another Canadian province. This is especially so since differing provincial tax policies are a fundamental part of the Canadian federation.

[65] Assuming Precision Group's transactions created a benefit or were an avoidance transaction, they were not abusive. There is no suggestion that the documents evidencing the transactions were a sham. Nor is there any suggestion that there was a failure to pay interest on the terms of the executed documents.

[66] The approach taken by the appeal judge - to define the purpose of the provision as to raise revenue and to define the tax base as broadly as possible - renders "abusive" any transaction that has the effect of reducing tax. I do not accept this approach.

Issue #3: CMT and the Situs Rule for Specialty Debt Instruments

[67] Ontario argues that even if Inter-Leasing is not subject to corporate income tax, it is liable to pay the corporate minimum tax.

[68] The CMT was introduced in Ontario's 1993 Budget to "ensure that large, profitable corporations do not use tax preferences to completely eliminate or unduly minimize their corporate income taxes": 1993 Ontario Budget, Supplementary Paper: *Improving Tax Fairness*: *A Corporate Minimum Tax for Ontario* (Toronto: Queen's Printer for Ontario, 1993) at p. ii.

[69] The nature of tax preferences was described at p. 7 of the same Budget paper:

> Tax preferences can take many forms including deductions, credits, exemptions and reduced tax rates. Tax preferences can create permanent or temporary (i.e., timing) differences between financial statement income and taxable income. Permanent differences result in permanent reductions of tax, while timing differences result in temporary deferrals of tax that can be expected to reverse over time.
>
> Permanent differences arise from items such as the tax-free portion of net capital gains, the Ontario Research and Development (R&D) Super Allowance and the Ontario Current Cost Adjustment (OCCA). Timing differences arise from items such as accelerated depreciation rates for tax purposes (i.e., capital cost allowance or CCA), and accelerated write-offs of R&D expenditures and certain resource deductions.

[70] The CMT is calculated based on the corporation's "adjusted net income": OCTA, s. 57.3(1). Net income is defined, in the case of a s. 2(2) company like Inter-Leasing, to be the net income calculated in accordance with generally accepted accounting principles, from: (1) carrying on a business in Canada, and (2) property situated in Canada or used in carrying on a business in Canada: OCTA, s. 57.1(2)(b).

[71] None of the adjustments to net income are relevant here. Given that it has already been determined that the interest on the specialty debt instruments was not income from business, the CMT would only attach to the income if it was from "property situated in Canada."

[72] Both parties accept that the specialty debt instruments were physically stored in the British Virgin Islands at all relevant times.

[73] At common law, a distinction is drawn between ordinary debts and specialty debts. Under conflict of law principles, an ordinary debt is generally situated where the debtor resides, whereas the "location of a specialty obligation is where the specialty is found at the time of the obligee's death": *Williams v. The King*, [1940] O.R. 403 (C.A.), at p. 416, [1941] 1 D.L.R. 22, at p. 34, aff'd [1942] A.C. 541 (P.C.).

[74] This long-standing principle for determining the location of a specialty debt, which arises from ecclesiastical law, was expressed by the Privy Council in an

1891 decision: *Commissioner of Stamps v. Hope*, [1891] A.C. 476, [1891-1894] All E.R. 315. The Privy Council explained the rule governing the *situs* or location of specialty debts, at pp. 481-82:

> …the distinction drawn and well settled has been and is whether it is a debt by contract or a debt by specialty. In the former case, the debt being merely a chose in action – money to be recovered from the debtor and nothing more – could have no other local existence than the personal residence of the debtor, where the assets to satisfy it would presumably be, and it was held therefore to be *bona notabilia* within the area of the local jurisdiction within which he resided; … and inasmuch as a debt under seal or specialty has a species of corporeal existence by which its locality might be reduced to a certainty, and was a debt of a higher nature than one by contract, it was settled in very early days that such a debt was *bona notabilia* where it was "conspicuous", i.e., within the jurisdiction within which the specialty was found at the time of death. [Citations omitted.]

[75] Ontario argues that the common law *situs* principle governing specialty debts should not apply in the context of modern corporate taxation, because it was developed in the different context of estate taxation, and because application of the principle facilitates the avoidance of taxes.

[76] It must be remembered, however, that corporations resident in Canada are taxed on their world-wide income for the purposes of federal income tax. In that context, the *situs* of the specialty debt may have no impact on liability for Canadian income tax.

[77] In this case, the question of the location of specialty debts arises in the narrower context of Ontario's decision to limit CMT to income from property "situated in Canada". It also follows from the decision to tax s. 2(2) corporations on income from business, and not on income from property, and to determine residence on the basis of place of incorporation.

[78] In *Friedman Equity Developments Inc. v. Final Note Ltd.*, 2000 SCC 34, [2000] 1 S.C.R. 842, the Supreme Court considered the factors relevant to a decision whether to change a rule of property or contract law, at para. 46:

> While our common law rules must be in step with the evolution of society as a whole, when examining a proposed change to a rule of property or contract law, we must also examine whether the rule is consistent or inconsistent with commercial reality. A rule may have a rationale which appears to be anachronistic while continuing to serve a useful commercial purpose. Our common law is replete with artificial rules which, although they may appear to have no underlying rationale, promote efficiency or security in commercial transactions. Such rules, in the circumstances where they apply, must be followed to create a legally recognized and enforceable right or obligation. Parties, therefore, structure their relations with these rules in mind and the rules themselves become part of commercial reality. Commercial relations may evolve in such a way that a particular rule may become unjust and cumbersome, and may no longer serve its original purpose. When the hardship which a rule causes becomes so acute and widespread that it outweighs any purpose that it may have once served, it is certainly open to a court to make an incremental change in the law. However, there must be evidence of a change in commercial reality which makes such a change in the common law necessary.

[79] Ontario argues that instead of the common law *situs* rule for specialty debt instruments, the court should apply a case by case analysis of the connecting factors linking Inter-Leasing and the debt instruments to Ontario.

[80] It relies on an approach put forward in *Williams v. Canada*, [1992] 1 S.C.R. 877, 90 D.L.R. (4th) 129, a case involving the *situs* of unemployment insurance benefits received by a member of an Indian Band for the purpose of the exemption from taxation under the *Indian Act,* R.S.C. 1970, c. I-6*.*

[81] In *Williams*, it was argued that the *situs* of the receipt of benefits should be determined in the same way as conflict of laws principles determine the *situs* of an ordinary debt (i.e., by the location of the debtor). However, the court held, at pp. 890-891, that simply adopting general conflicts principles "would be entirely out of keeping with the scheme and purposes of the *Indian Act* and the *Income Tax Act."*

[82] The court also addressed the argument that the court should apply a "connecting factors" test in determining the location of receipt of income, at pp. 891-2:

> The appellant suggests that in deciding the *situs* of receipt of income, a court ought to balance all of the relevant "connecting factors" on a case by case basis. Such an approach would have the advantage of flexibility, but it would have to be applied carefully in order to avoid several pitfalls. It is desirable when construing exemptions from taxation to develop criteria

> which are predictable in their application, so that the taxpayers involved may plan their affairs appropriately.

[83] Ultimately, the court concluded that an analysis based on category of property and type of taxation was most appropriate.

[84] Here, the Precision Group companies restructured their affairs in reliance on a long-standing common law principle. Ontario amended its basis for corporate taxation in 2005 so that the gaps in provincial taxation illustrated by this case no longer are relevant but declined to make the amendments retroactive.

[85] To change the *situs* of specialty debts for corporate tax purposes may have unforeseeable consequences, such as double taxation in both the place where the instruments are located and in the place of residence of the corporation.

[86] Clear rules to determine the *situs* of specialty debts promote certainty in their application. A case by case analysis of connecting factors in each case would have the reverse effect.

[87] I am not persuaded that a change in the application of the common law principle of *situs* of specialty debt instruments is necessary or appropriate.

Issue #4: CMT Avoidance and Application of the GAAR

[88] Finally, Ontario argues that situating the specialty debt instruments in the British Virgin Islands was an abusive transaction.

[89] I note that, as discussed above, the CMT was intended to apply to corporations who, because of preferences, paid an inadequate amount of corporate income tax. Amounts paid towards corporate income tax can be deducted from CMT. CMT paid in prior years can be credited against future corporate income tax.

[90] The appellant argues that the tax base for the CMT was never intended to be broader than the base for corporate income tax, and therefore that it cannot be abusive to have located the *situs* of the specialty debt instruments outside Canada.

[91] This submission ignores the fact the definition of net income for s. 2(2) corporations does explicitly broaden the tax base to include income from property situated in Canada.

[92] The rate of corporate minimum tax is 4%, compared to the corporate income tax rate of 12.5-14% for the relevant years. If corporate minimum tax was payable, it would be deductible from corporate income tax in future years.

[93] In the end, I am not satisfied that the mere location of the specialty debt instruments in the British Virgin Islands, violates the object, spirit or purpose of the CMT regime.

[94] In reaching this conclusion, a number of factors are significant.

[95] First, the rule governing the *situs* of specialty debts instruments is a long-standing and well-established rule.

[96] Second, the *situs* for the instruments was not arbitrary, but was a place to which the corporation had some link, namely, its place of incorporation.

[97] Third, the level of Inter-Leasing's activity in Ontario to generate the income from property was minimal.

[98] As observed in *Canada Trustco Mortgage Co. v. Canada*, at para. 42:

> [T]o search for an overriding policy of the Income Tax Act that is not anchored in a textual, contextual and purposive interpretation of the specific provisions that are relied upon for the tax benefit would run counter to the overall policy of Parliament that tax law be certain, predictable and fair, so that taxpayers can intelligently order their affairs.

[99] Given my conclusion that the CMT is not payable, it is unnecessary to address Inter-Leasing's alternative argument that Ontario could not re-assess for CMT when it delivered reassessments limited to demanding corporate income tax and interest on arrears created by the reassessment.

Disposition

[100] Accordingly, the appeals are allowed. The Minister is directed to vacate the reassessments and reverse the amounts added to the appellant's CMT tax base as "adjusted net income" for the purposes of the OCTA.

[101] The parties may make written submissions regarding costs, due from Inter-Leasing within 30 days of the release of this decision, and from Ontario within 20 days after receipt of Inter-Leasing's submissions.

Released: Aug 7, 2014

"KMW"

"G. Pardu J.A."
"I agree K.M. Weiler J.A."
"I agree C.W. Hourigan J.A."