The Joint Committee on Taxation of
The Canadian Bar Association

and

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Dear Mr. McGowan:

Subject: Avoidance of Tax Debts

This submission sets out comments of the Joint Committee on Taxation of the Canadian Bar Association and Chartered Professional Accountants of Canada ("Joint Committee") with respect to the Avoidance of Tax Debts proposals included in the draft legislation that was released on February 4, 2022.

Members of the Joint Committee and others in the tax community participated in the discussion concerning this submission and contributed to its preparation, including:

- Bruce Ball – CPA Canada
- Andrew Bateman – Felesky Flynn LLP
- Fabio Bonanno – CPA Canada
- Cathie Brayley – Miller Thomson LLP
- Kristen Duerhammer – KPMG Canada
- Ken Griffin – PwC LLP
- Anu Nijhawan – Bennett Jones LLP
- Jeffrey Shafer – Blake, Cassels & Graydon LLP
- Gwendolyn Watson – Torys LLP

If it would be helpful, members of the Committee would be pleased to discuss the issues in more detail.

Yours very truly,

David Bunn
Chair, Taxation Committee
Chartered Professional Accountants of Canada

Ian Crosbie
Chair, Taxation Section
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Submission of the Joint Committee on Taxation of The Canadian Bar Association and Chartered Professional Accountants of Canada
February 4, 2022 Draft Legislation on Avoidance of Tax Debts

INTRODUCTION

This submission sets out our comments and recommendations on the draft legislation released on February 4, 2022 relating to the Avoidance of Tax Debts proposals (primarily proposed subsection 160(5) and section 160.01 of the *Income Tax Act* (Canada) ("the Act").

These proposals were first conceptually introduced in the 2021 Federal Budget. The budget commentary contained several key statements on the intentions and goals of the proposals which provide important context to our submission:

- First, reference was made to "complex transactions that attempt to circumvent the tax debt avoidance rule [in section 160]."
- It was also stated that "this planning is often packaged with highly aggressive tax plans that attempt to eliminate the underlying tax liability of the transferor."
- Finally, reference was made to a "penalty for those who devise and promote such schemes."

These are important statements as they set out the overall objective of the proposals, objectives which the Joint Committee understands and agrees are important. It is clear that the proposed legislation is intended to apply in egregious situations; however, in our view, the proposals can be read as going beyond these legislative purposes and it is these areas that are the focus of our submission.

In our view, the foregoing statements from the 2021 Federal Budget support the following conclusions:

- The proposals are aimed at complex plans or schemes that are *designed* to circumvent the rules in section 160 (*i.e.,* a purpose test). The proposals are not intended to be based on a results test (*e.g.,* a series of transactions or events that impair the Canada Revenue Agency's ("CRA's") ability to collect a tax debt).
- The proposals are not intended to create a results test where there is no evidence of an intention to create a plan or scheme to achieve the result that arises.
- The penalty should apply to those who devise and/or promote the plan or scheme that is designed to circumvent section 160, and not to those who unknowingly participate in, or implement, such a plan or scheme. Again, the penalty should not apply based on a results test.

We will revisit these themes in more detail when dealing with the proposed legislation, but our overall recommendation is that the final legislation should remain true to the principles set out in the 2021 Federal Budget and these observations.

APPLICATION OF PROPOSED SUBSECTION 160(5)

Necessity for a Robust Purpose Test - Proposed Subparagraph 160(5)(a)(ii) and Paragraph 160(5)(b)

As described above, the 2021 Federal Budget comments demonstrate the key concept that proposed subsection 160(5) should apply to transactions only where there is a clear intention to frustrate or circumvent section 160 at the time the transfer of property occurs; the mere fact that a specific transaction results in section 160 not being applicable should not be sufficient. We respectfully submit that the current drafting of proposed subparagraph 160(5)(a)(ii) and paragraph 160(5)(b) is inconsistent with this legislative purpose.

As currently drafted, the proposals incorporate two related purpose tests:

- Proposed subparagraph 160(5)(a)(ii) provides that a condition to the application of paragraph (a) is where "*it is reasonable to conclude that one of the purposes* of undertaking or arranging the transaction or series of transactions is to avoid joint and several, or solidary, liability of the transferee and transferor for an amount payable under this Act"; and
- Proposed paragraph 160(5)(b) contains a similar purpose threshold: "*it is reasonable to conclude that one of the purposes* for the transfer of property is to avoid the payment of future tax debt by the transferor or transferee".

The use of the phraseology "one of the purposes", when utilized in conjunction with "it is reasonable to conclude", gives rise to a very low threshold and one which is inconsistent with the 2021 Federal Budget comments. In particular, since purpose is to be determined based on an objective test (as indicated by the words "it is reasonable to conclude"), where one of the results of a particular series of transactions or transfer of property, as applicable, would (without considering the proposed rules in new subsection 160(5)) be the non-application of section 160, the concern is that the CRA will rely on this result to support an assumption there was an avoidance purpose for the transactions or transfer of property. The consequence is that the provision could apply where a transaction or series of transactions has the result of avoiding section 160, even where that was not a *purpose* of the transaction or series of transactions.

Recommendation

Consistent with the legislative aim to preclude complex plans or schemes that are *designed* to circumvent the rules in section 160 (*i.e.,* a purpose test), the purpose test should be re-framed as a "one of the **main** purposes" test.

Further, the legislation should require clear evidence that one of the main purposes of the subject transactions or the transfer of property, as applicable, is the avoidance of section 160. Absent such evidence, the CRA should not be permitted to assume such a main purpose merely from the result of the transactions. It would be preferred that such a reference be included in the final legislation, but a statement in the explanatory notes or in CRA guidance could also be considered.

<u>Necessity for a Demonstrable Current or Future Anticipated Tax Debt – Proposed Subparagraph 160(5)(a)(ii) and Paragraph 160(5)(b)</u>

The commentary in the 2021 Budget indicates that the proposals are directed to a specific tax amount that is owing or would be owing but for the additional tax planning done as part of the series of transactions. Consistent with this legislative purpose, the provisions should not apply unless there is a "particular" future tax debt that is being avoided – *i.e.,* the proposals should not apply unless there is a demonstrable current or future tax debt of the transferor that would otherwise be avoided. We respectfully submit that the current drafting of proposed subparagraph 160(5)(a)(ii) and paragraph 160(5)(b) is inconsistent with this legislative purpose.

As currently drafted, the proposals incorporate references to a future tax debt as follows:

- Proposed subparagraph 160(5)(a)(ii) refers to a purpose to "avoid joint and several, or solidary, liability of the transferee and transferor for an amount payable under this Act"; and
- Proposed paragraph 160(5)(b) deems an amount that the transferor is liable to pay to have become payable in the taxation year of a property transfer if it is reasonable to conclude that one of the purposes for the transfer of property is to avoid the payment of "future tax debt" by the transferor or transferee.

In both cases, it does not appear that the references to "an amount payable under this Act" and "future tax debt" are linked specifically to a particular ascertainable tax debt that would otherwise arise, absent the impugned transaction or series, in respect of a particular taxation year. Of particular note, there appears to be no link between the actual tax debt and the impugned transaction.

An example of the over-breadth of the proposed language can be illustrated in various situations involving asset protection. Asset protection is a widely adopted practice in business to protect assets against non-tax liabilities of all types. For instance, many business enterprises will use a new corporation when entering into a new business venture to protect existing assets from potential risk. Consistent with the legislative purpose of the proposals, general risk planning which is not specific to a particular contemplated tax debt should not be subject to proposed subsection 160(5) (even if it adversely impacts the CRA's ability to collect tax debts that arise in the future in the normal course) unless there was a clear purpose to avoid the tax debt in question. The difficulty with the current draft proposals is illustrated in the following two examples:

Example A involving Spousal RRSP Contributions

- In 2022, Spouse A makes a $20,000 contribution to Spouse B's RRSP (the "spousal RRSP contribution"). One of the general purposes of the spousal RRSP contribution is to protect the $20,000 from potential future liabilities of Spouse A. In addition, Spouse A intends to deduct the spousal RRSP contribution in computing income to reduce (or "avoid") a tax liability that would otherwise arise in that year. Neither Spouse A nor B has a tax liability for 2022 and no other tax debt of either Spouse A or Spouse B can reasonably be anticipated at the time of the spousal RRSP contribution, other than future income taxes expected to arise in the normal course. In the context of proposed subsection 160(5), Spouse A is a "transferor" and Spouse B is a "transferee".

- A wholly-owned corporation of Spouse A (“Subco”) incurs a tax debt in 2024. Also in 2024, Spouse A receives a $50,000 dividend from Subco and becomes liable under section 160 for Subco's tax debt.

In this situation, it appears likely that it would be reasonable to conclude that one of the purposes of the 2022 spousal RRSP contribution is to avoid the payment of future tax debt by Spouse A (one of Spouse A’s potential future liabilities, as Spouse A expects to earn income in the normal course) and, potentially, by Spouse B (the sheltering from tax of future income earned in the RRSP). As a result, proposed paragraph 160(5)(b), as drafted, could apply to deem Spouse A’s liability for Subco's tax (as well as Spouse A’s tax on the dividend from Subco under section 160) to have become payable in 2022 when the $20,000 spousal RRSP contribution was made. As a result, Spouse B would also be liable under section 160 for $20,000 of these taxes. The application of the proposals in this situation to allow Spouse B to be assessed under section 160 would be inappropriate given that the spousal RRSP contribution is not part of a plan designed to circumvent section 160; in particular: (i) there is no relationship between the transfer (the RRSP contribution) and the tax liability arising from the dividend, and (ii) Spouse A has not transferred any assets to Spouse B during the year in which the dividend was received (so the tax liability could be collectible from Spouse A's assets).

Example B involving an Inter-Corporate Dividend

It is well established that the use of a holding company (“Holdco”) can provide additional asset protection when compared with the use of a single operating corporation (“Opco”) to carry on business. Under this planning and incorporating the rules applicable in subsection 55(2) and corporate law, Holdco is formed to hold the shares of a profitable Opco. As the Opco earns income, the after-tax “safe income” is paid as tax-free intercompany dividends by Opco to Holdco as shareholder. The dividend is set at an amount to ensure that it will not render the Opco insolvent. If funds are needed for operations, Holdco will generally make a loan to Opco. If dividends are paid regularly, this generally ensures that excess assets will not accumulate in Opco that could become exposed to potential business risk in the future, such as a lawsuit or a major business failure. As a specific example, assume that this planning has been used, and Opco has historically been profitable. The following transactions then occur:

- In 2022, Opco has material taxable income, and pays its corporate taxes owing. It pays a safe income dividend in 2022 to Holdco. Following the payment of the dividend, Opco is solvent and its business outlook is positive.

- In 2023, Opco has taxable income and corporate income tax is owing for the year. Opco invests its assets in shares of an unrelated corporate start-up venture (the “start-up”).

- During the first quarter of 2024, the start-up fails and its shares become worthless, resulting in a capital loss that cannot offset Opco’s taxable income for 2023. As a result, Opco has insufficient remaining assets to pay a portion of its income tax owing for 2023.

In this example, the application of proposed subsection 160(5)(b), including the reference to "future tax debt", is unclear when examined at the time Opco paid the last safe income dividend in 2022. The purpose of the 2022 safe income dividend was to distribute after-tax earnings and protect that property from future risks and liabilities in Opco, which could include future tax debts if the company were to become unable to pay such amounts; the avoidance of payment of a specific tax debt (including the 2023 corporate tax), however, was not a purpose. Opco was still solvent in 2022. The fact that some of the taxes owing for 2023 went unpaid was due to the unanticipated investment loss in 2024 and was not foreseen at the time of the 2022 safe income dividend. In this situation, in our view, it would not be appropriate for the proposals to apply, as the 2022 dividend was not for the purpose of avoiding a specific future tax debt.

These examples illustrate that the concept of avoiding payment of future tax debt is too vague and imprecise a condition for application of the deeming rule. In addition to normal-course asset protection transactions, a purpose for many non-arm's length transfers of property could instead be to reduce (and thus "avoid" payment of) future taxes, where the main purpose of the property transfer relates to (normal) commercial or otherwise legitimate transactions. Such transactions can, for example, in the case of cash transferred for the acquisition of assets, result in a tax deduction, directly or indirectly (through amortization of the cost of property acquired), for the transferor.

Recommendation

The references to "an amount payable under this Act" in proposed subparagraph 160(5)(a)(ii) and to "future tax debt" in proposed paragraph 160(5)(b) should be re-framed to refer to a demonstrable current or future anticipated tax debt of the transferor that would otherwise be avoided, determined at the beginning of the applicable series of transactions.
The explanatory notes should in addition clarify that a transaction or series of transactions which is implemented for the purposes of asset protection generally (as opposed to the avoidance of a particular tax debt) should not be subject to proposed subsection 160(5).
In addition, the phrases "future tax debt" and "an amount payable under this Act" should be defined to explicitly exclude amounts that are avoided or reduced directly or indirectly as a result of a cost or deduction permitted under the Act by virtue of the transfer of property.

Determination of Fair Market Value in Proposed Paragraph 160(5)(c)

Proposed paragraph 160(5)(c) is intended to address planning that attempts to avoid section 160 through a transaction or series of transactions that reduce the fair market value of consideration received for the property transferred in order to render all or a portion of a tax debt of the transferor uncollectible. There are, however, a number of drafting concerns with proposed clause 160(5)(c)(ii)(B).

Some of these can be illustrated by the following examples:

Example C Involving Shares Received as Consideration

- XCo is desirous of purchasing shares of an operating company ("Opco"). In 2023, XCo purchases shares of the holding corporation ("Holdco") which is the shareholder of Opco from a non-arm's length person ("ACo") for cash proceeds of $5M, equal to the fair market value of the Holdco shares at that time.

- XCo has an unrelated tax liability for 2023 of $4M. Holdco has no known tax liabilities.
- Following the acquisition, and as part of the series of transactions, Holdco distributes to XCo, as a dividend-in-kind, the shares of Opco that have a fair market value and tax cost at that time of $5M, with the result that the fair market value of the Holdco shares held by XCo becomes nominal.
- Subsequently, and for reasons unrelated to and not foreseen at the time of the acquisition and dividend-in-kind, XCo is unable to pay a portion of its tax liability of $4M.

In this example, consider the implications with respect to the transfer of property by XCo (the $5M of cash paid as the purchase price for the Holdco shares). The amount determined under proposed subparagraph 160(5)(c)(ii) is $5M, being:

- an amount equal to the fair market value of the cash at the time of the transfer ($5M) (variable A), *less*
- the lowest fair market value of the consideration given for the property (the Holdco shares) at any time during the applicable series of transactions ($nil) (variable B).

As a result, ACo, the non-arm's length person could be held liable for the full amount of XCo's unpaid tax, notwithstanding that the transfer of the Holdco shares took place at fair market value and the subsequent events which rendered XCo unable to pay its tax liability were not reasonably foreseeable at the time of the transfer. This result arises because proposed clause 160(5)(c)(ii)(B) does not take into consideration the impact of the dividend-in-kind on the value of the Holdco shares. This drafting concern could be alleviated by ensuring that clause (A) of variable B takes into account the fair market value of both the initial consideration received by the transferor (here, the Holdco shares) plus the fair market value of any other property received by the transferor, during the period referred to in clause (A), by virtue of the ownership of such initial consideration (otherwise than as proceeds of disposition).

Example D Involving Publicly-Traded Shares Received as Consideration

- Mr. Y purchases shares of a holding company ("Holdco") from a non-arm's length person ("Ms. Y") on October 31, 2022 for cash proceeds of $5M, equal to the fair market value of the Holdco shares at that time. The material asset of Holdco is comprised of a portfolio of publicly-traded securities, which has a fair market value of $5M at the time of the transfer.
- Mr. Y is acquiring Holdco with the intention of combining the investments in Holdco with others held in another company wholly-owned by him, YCo. Accordingly, Mr. Y's plan is to transfer the Holdco shares to YCo on December 31, 2022 and amalgamate the companies on January 1, 2023.
- Mr. Y has an unrelated tax liability of $2M for 2022, which becomes unpaid.
- Between November 1 and December 31, the value of Holdco's portfolio fluctuates, due to public market factors, decreasing to a low of $3M but recovering to $5M by the time of the transfer to YCo.

Under proposed paragraph 160(5)(c), because the transfer to YCo is part of the series of transactions that includes the acquisition of Holdco from Ms. Y, the value of the Holdco shares acquired by Mr. Y as consideration for the transfer of cash to Ms. Y would need to be measured throughout the duration of the series.

This example illustrates that the amount in clause (A) of variable B should not be the "lowest" fair market value in the period. If the consideration received on the transfer of property includes property whose value fluctuates, then, to the extent that a value decrease occurring during the period "reverses" by the end of the period such that the value of the consideration held by the transferor has not in fact diminished, there does not appear to be any policy reason why the transferee's potential liability under section 160 should be increased. This would extend to situations where the consideration property declines in value during the period, but is then substituted for other property that regains value by the end of the period. It should be sufficient to use the "lower" of the fair market value of the consideration at the time of the transfer and the fair market value of the consideration (or substituted property) at the end of the period. Furthermore, to the extent that a decline in value of property occurs during the period, solely attributable to external market forces, such a decline should not be taken into account at all.

Example E involving a Promissory Note Received as Consideration

- Assume a vendor ("Vendorco") has a tax liability.
- As part of a series of transactions, Vendorco sells assets having a fair market value of $3M to a non-arm's length corporation ("Subco"), in consideration of a promissory note having an equivalent principal amount and fair market value (the "Note").
- Following the asset sale, Vendorco assigns the Note to Parentco (the parent corporation of Subco) for fair market value consideration.
- Subco is then wound-up into Parentco and an election is made under subsection 80.01(4) to settle the Note for an amount equal to its cost amount to Parentco ($3M).

In this example, the amount determined under proposed subparagraph 160(5)(c)(ii) is an amount equal to the fair market value of the Note at the time of the asset sale ($3M) less nil, because the Note is cancelled as part of the series. This result arises notwithstanding that the proceeds paid by Subco and received by Vendorco on the asset sale were equal to fair market value and Venderco retains property with the same fair market value as a result of its transfer of the Note to Parentco. This drafting concern could be alleviated by ensuring that clause (B) of variable B applies only where the consideration received is cancelled or extinguished at a time it is held by the transferor and that, rather than using an amount of "nil", the amount in (B) is the fair market value of any other property received by the transferor, or the reduction of the fair market value of another debt of the transferor that arose prior to the series, as a consequence of the cancellation or extinguishment.

Recommendations

Our recommendations are as follows:

- ***Substituted property concept.*** Normal course commercial transactions can include the transferor disposing of the consideration received for cash or other property. Clause (A) of variable B should accordingly be modified to include reference to the fair market value of the initial consideration received, any substituted property, and any property received by the transferor by virtue of the ownership of such property (otherwise than as proceeds of disposition).

- ***Valuation at end of series rather than throughout series.*** Clause (A) of variable B should be modified to use the lower of the fair market value of the relevant property (i) immediately prior to the transaction or series of transactions, and (ii) immediately following the transaction or the end of the series of transactions.
- ***Decrease in FMV due to external factors.*** The formula does not appropriately consider circumstances where the fair market value of the consideration received decreases for reasons unrelated to the specific impugned transactions. In addition to the example above where the consideration consists of shares of a public company, another example would be consideration denominated in foreign currency which decreased in value due to foreign currency fluctuations. The provision should be modified to explicitly provide that declines in the fair market value of the consideration received that are outside of the parties' control should not be subject to the provision.
- ***Consideration cancelled for value.*** Proposed clause (B) of variable B refers to consideration being "cancelled or extinguished". This provision should not apply where, for example, the consideration is a promissory note which is cancelled, settled or repaid for value. Rather, in that situation, reference should be made to the fair market value of the property received on the settlement of the promissory note (*i.e.,* substituted property). The reference to nil in this provision should apply only where the consideration is cancelled or extinguished in circumstances where the transferor receives proceeds below the fair market value.

Arm's Length Test

Section 160 is conditioned on parties to a transaction not dealing at arm's length. Given the expansion to the regime evident in the proposals, and, in particular, the fact that proposed subparagraph 160(5)(a)(i) can apply to persons who deal at arm's length at some point during the applicable series, we believe it is important to clarify the meaning of non-arm's length.

Parties which deal factually at arm's length can be deemed to deal at non-arm's length for specific purposes as the consequence of rights arising under paragraph 251(5)(b). A common example is where Taxpayer A has a right under a purchase and sale agreement to acquire all of the issued and outstanding shares of Taxpayer B. Assume, for example, that such purchase and sale agreement is entered into but then terminated and replaced with an agreement whereunder Taxpayer A buys all of the assets of Taxpayer B (perhaps because Taxpayer A was reluctant to assume the risks of previous or expected tax liabilities of Taxpayer B). In such an example, although Taxpayer A and B deal at arm's length, an analysis would nevertheless need to be undertaken under proposed subparagraph 160(5)(a)(i) as a consequence of the existence of the paragraph 251(5)(b) rights during the same time frame.

Recommendation

To avoid this unnecessary complexity, particularly in *bona fide* arm’s length transactions where section 160 would otherwise have no application, and which does not, in our view, assist with the objective of the proposals, we recommend that there be an exception for non-arm's length status where such status arises solely as a consequence of the existence of rights described in paragraph 251(5)(b). Such an exception would be consistent with similar exceptions in paragraph 110.6(14)(b), subsection 212.1(1) and paragraph 6204(3)(a) of the Income Tax Regulations.

PENALTY PROPOSALS

General Application

Before providing more specific comments, it is useful to revisit what we believe are the key concepts that should be the basis of the proposed penalty. Based on the proposals first announced in the 2021 Federal Budget, the penalty should apply to planners and promoters who create tax schemes that have a purpose of circumventing section 160.

In our view, this means that, like the provision itself, the penalty should not apply based on a results test. Rather, the application of the penalty should be predicated on the transactions reflecting a clear intention to avoid the application of section 160.

In addition, the penalty should apply only to those who devise or promote the plan. The current wording in proposed subsection 160.01(2) refers to any person "who engages, participates in, assents to or acquiesces in" section 160 planning. Although there is an exclusion in proposed subsection 160.01(3) for a person that provides clerical services or secretarial services with respect to the section 160 avoidance planning, this exclusion is too narrow – it is entirely possible that a person may be more significantly involved in, for example, documenting the transaction, but without understanding the avoidance aspects of the plan as a whole (such as a corporate lawyer or valuator with no tax expertise).

Recommendations

Although the proposed legislation makes reference to plans or schemes where it is reasonable to conclude that one of the purposes for the transfer of property is to avoid the payment of future tax debt, a specific statement should be made that the penalty will not be applied exclusively based on a results test. It would be preferred that such a reference be included in the final legislation, but a statement in the explanatory notes or in CRA guidance could also be considered.

In proposed subsection 160.01(2), the reference to “every person who engages, participates in, assents to or acquiesces in section 160 avoidance planning” is too broad and should be more focused to apply to those who devise and promote the plan or scheme. The exclusion in subsection 160.01(3) is too narrow with the proposed wording of subsection 160.01(2) and may need to be broader depending on the final wording of that subsection.

Use of Third-Party Civil Penalty Concepts

In proposed section 160.01, some of the concepts used are based on the third-party civil penalties contained in section 163.2. According to paragraph 3 of Information Circular IC 01-1, *Third Party Civil Penalties*, “the objective of the third-party civil penalties is to deter third parties from making false statements or omissions in relation to income tax or goods and services tax/harmonized sales tax (GST/HST) matters."

We note that there is not a clear parallel between the third-party civil penalties and the proposed section 160.01 penalty. The civil penalties apply when the rules of the Act are incorrectly applied as opposed to aggressively applied. As an example, the Circular states in paragraph 24 that culpable conduct in a civil penalty context refers to conduct that is not simply an honest error of judgement or failure to exercise reasonable care and shows a wilful, a reckless or a wanton disregard of the law. In the context of a false statement or omission, these concepts make sense. However, how they will be applied in the context of proposed section 160.01 is not clear.

Recommendation

We believe that guidance is needed to help communicate how the key concepts in the third-party civil penalties will be applied in the context of proposed section 160.01. In particular, the meaning of culpable conduct in this context should be clearly articulated.

Specific Penalty Application

When reviewing the draft legislation in detail, it was not clear to us what specific conduct or actions would be subject to the penalty and whether the details were consistent with the original announcement made in the 2021 Federal Budget.

Recommendations

Given the uncertainty, we believe the following key concepts should be incorporated in the final legislation for the penalty:

- ***Culpable conduct should be present***. Those subject to a penalty must show a wilful, reckless or wanton disregard of the law. In this context, there should be specific proof that a person devised steps to frustrate the law.

- ***Exception for employees.*** The penalty should be levied at the planner/designer of the transactions, not to employees or others who are simply involved in the implementation. An exception for employees would be consistent with the civil penalty provisions.

- ***The penalty should apply only to plans or schemes that are subject to the proposed rules in paragraphs 160(5)(a) or (b)***. Given that proposed paragraphs 160(5)(a) and (b) are intended to apply to complex transactions that attempt to circumvent the existing rules in section 160, the penalty should apply only in situations where there was an attempt to circumvent section 160 and that section would not have applied but for the application of one or both of these proposed paragraphs.

  Further, where section 160 is otherwise found to apply (even in the absence of proposed paragraphs 160(5)(a) or (b)), it appears that the application of a penalty would be unwarranted because no tax has been avoided. In such a situation, it is unclear how one would determine that transactions were undertaken with the intent of avoiding the application of section 160, except where recourse to the proposed rules in paragraphs 160(5)(a) or (b) is required, as no "self assessment" steps under this section can be taken by a taxpayer. It would therefore be difficult to distinguish transactions that are simply subject to section 160 (and that should not be penalized) from those that were (unsuccessfully) intended to avoid section 160.

- ***The penalty should not apply as a result of the GAAR.*** If a plan or scheme does impair the CRA's ability to collect a tax debt but the proposed amendments to section 160 do not address the plan or scheme, then we assume that the general anti-avoidance rule (GAAR) could still be considered. If an assessment is sustained under the GAAR, this would be because the specific rules in section 160 did not otherwise apply. The application of a specific penalty under section 160.01 in such a situation would appear to be inconsistent with the scheme of the Act. Accordingly, the proposed penalty under section 160.01 should apply only where section 160 is applicable and would not have been applicable but for the provisions of paragraphs 160(5)(a) or (b).

- ***The application of the tax attribute transaction proposals should be more focused.*** Under the proposed wording, a tax attribute transaction means "a transaction or series of transactions in which a tax attribute – of a person that dealt at arm's length with a transferor or transferee immediately before the transaction or series of transactions – is used, directly or indirectly, to provide a tax benefit for the transferor." This reference is very broad since the tax attributes in question have an inherent tax benefit. Also, in the definition of "section 160 avoidance planning", reference is made to tax that would be payable by the transferor if not for a tax attribute transaction. This appears to suggest that a penalty could be applied in a situation where section 160 (as amended) itself does not actually apply because no tax payment has been avoided.

  Although not clear, it appears possible that the proposals could apply in an overly broad manner to circumstances where tax attributes are utilized in accordance with the rules of the Act. For example, uncertainty exists where a corporation has an expected tax liability and accelerates the acquisition of a commercial depreciable property for use in the current taxation year. Acquiring depreciable property for use late in the current taxation year rather than in the subsequent year so that capital cost allowance can be claimed to reduce current year income is a common tax planning step and presumably cannot be a target of these rules. This should be clarified.

- ***Application of the penalty should be subject to appropriate oversight.*** The proposed penalty is significant and should be subject to appropriate oversight before it is assessed. In paragraph 79 of IC 01-1, the CRA discusses the importance of ensuring procedural checks and balances are in place for third-party civil penalties so that no one person can direct the application of the penalties or otherwise inappropriately apply the penalties. In particular, a review committee was established. Similar steps should be taken for the penalty under proposed section 160.01. Even if it is determined that a review committee is not warranted, there should be a careful review at CRA's head office before any penalty under 160.01 is proposed, to ensure consistency in the application of this penalty.