Federal Court of Appeal

Cour d'appel fédérale

Date: 20240307

Docket: A-201-22

Citation: 2024 FCA 42

CORAM: **DE MONTIGNY C.J.**
GOYETTE J.A.
HECKMAN J.A.

BETWEEN:

3295940 CANADA INC.

Appellant

and

HIS MAJESTY THE KING

Respondent

Heard at Montréal, Quebec, on November 15, 2023.

Judgment delivered at Ottawa, Ontario, on March 7, 2024.

REASONS FOR JUDGMENT BY: GOYETTE J.A.

CONCURRED IN BY: DE MONTIGNY C.J.
HECKMAN J.A.

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REASONS FOR JUDGMENT

GOYETTE J.A.

[1] Gestion Micsau Inc. (Micsau), through its shares in 3295940 Canada Inc. (3295 or the appellant), held an indirect minority stake in a generic drug business. The majority owner began negotiations to sell the business to a third party. Thus, Micsau had to sell its stake in the business.

[2] Micsau wished to use the high tax cost in its 3295 shares. 3295's tax cost in the underlying business was much lower, so selling that stake through 3295 would have created a higher capital gain. Therefore, Micsau wished to sell its 3295 shares in order to use its high tax cost. For reasons I will explain below, Micsau could not sell its shares in 3295. Faced with these circumstances, Micsau initiated a series of transactions, which replicated the tax consequences of Micsau selling its 3295 shares.

[3] To borrow liberally from one author, what should then have been a "plain-vanilla tax-planning opportunity" whereby Micsau used its high cost to be taxed on its true economic gain ended up being, for the Tax Court of Canada, an abusive avoidance transaction by 3295: Eric Hamelin, "GAAR Applicable to the Circular Payment of Capital Dividends" (2023) 71:3 *Can Tax J* 859 at 868 [Hamelin].

[4] In light of the true nature and overall result of the series of transactions, there was no abuse of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (the Act). For the following reasons, I would allow the appeal.

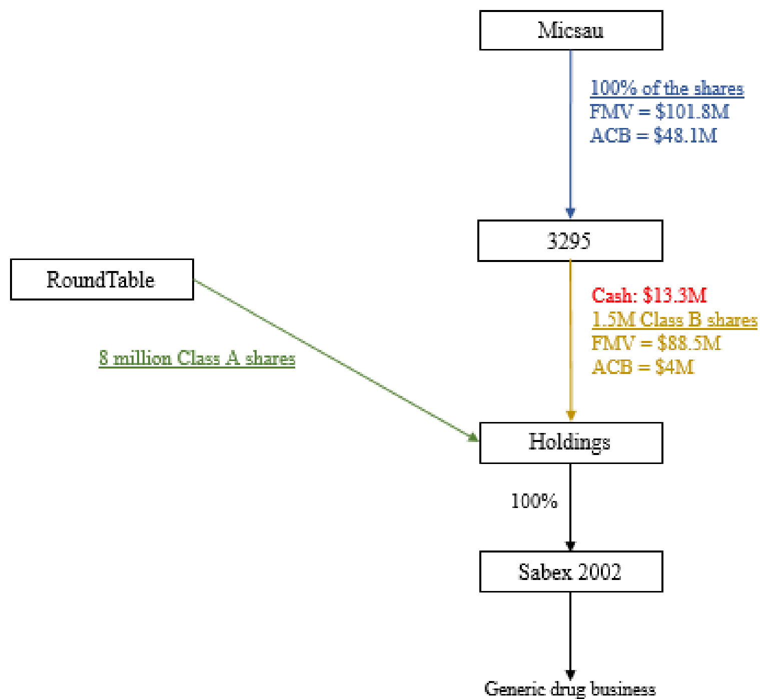
I. Factual Background

[5] Shakespeare once wrote that "brevity is the soul of wit". Much as I wish to implement this maxim, I must recount the facts in some depth. I omit certain minor details for simplicity. Keen readers may consult an even more fulsome recitation of the facts in the Partial Agreed

Statement of Facts (PASOF) attached to the Tax Court's decision. Unless otherwise specified, the facts are taken from the PASOF.

A. *Initial Situation*

[6] Before the series of transactions, the corporate structure was as follows.



[7] As illustrated, Micsau wholly owned 3295, and 3295 owned a minority stake in Holdings. RoundTable, an American investment fund, owned the remaining shares and thus controlled Holdings. Holdings owned an operating company (Sabex 2002), which carried on a generic drug business.

[8] As also illustrated, Micsau's shares in 3295 had an adjusted cost base (ACB) of $48.1M and a fair market value (FMV) of $101.8M. 3295's shares in Holdings had an ACB of $4M and a FMV of $88.5M. The difference between the ACB of the shares in Holdings and those in 3295 is due to a transaction that occurred two years before the relevant period when Micsau bought shares in 3295 from another shareholder and became 3295's sole shareholder. Micsau paid $47.46M for these additional shares. As for the difference between the FMV of the shares in Holdings and those in 3295, it is attributable to 3295 having $13.3M of cash.

B. *Roundtable Negotiates to Sell Holdings*

[9] In 2004, RoundTable began negotiations to sell 100% ownership of Holdings to a third party, Novartis Pharmaceuticals Canada Inc. (Novartis). One option for executing this sale was for Micsau to sell its shares in 3295 to Novartis. This option would have generated a capital gain of $53.7M ($101.8M – $48.1M). Comparatively, 3295 selling its shares in Holdings would have been inefficient: these shares' low ACB would have generated a capital gain of $84.5M ($88.5M – $4M). With this information in mind, Micsau's business and tax adviser submitted to RoundTable—which had the exclusive right to negotiate with Novartis and to make decisions regarding the sale to Novartis—the following alternative transactions:

a) *Micsau sells its shares in 3295 to Novartis*;

b) *3295 merges with Holdings*: This merger would create a new, amalgamated corporation (AmalCo). Micsau would have the same ACB in its AmalCo shares as its ACB in its 3295 shares. Micsau would sell its AmalCo shares;

c) *A tuck-under reorganization is undertaken*: Micsau would transfer its 3295 shares to Holdings in consideration for shares in Holdings on a taxable basis, allowing Micsau to use its high ACB in computing its resulting capital gain. Micsau would then sell its Holdings shares to Novartis. Holdings and 3295 would be in cross-ownership, but the cross ownership could be eliminated without additional tax through an amalgamation; or

d) *Micsau sells its 3295 shares to RoundTable*: RoundTable could then wind up 3295, the ACB of 3295's shares would transfer to the Holdings shares, and RoundTable would sell the Holdings shares to Novartis.

Under each of these options, Micsau would use its high ACB to realize a $53.7M gain, and Novartis would acquire 100% of the shares in Holdings.

(Transcript of hearing of September 8, 2020, Appeal Book, vol. 2 at 1032, 1034–36, 1040–43 [Sept. 8 Transcript]; Transcript of hearing of September 9, 2020, Appeal Book, vol. 2 at 1149–50 [Sept. 9 Transcript]; *3295940 Canada Inc. v. The Queen*, 2022 TCC 68 at para. 152 [TCC Reasons].)

[10] It appears that RoundTable, not wanting to impede the momentum of the sale, did not put the first three transactions to Novartis. Nevertheless, RoundTable said Novartis was unwilling to acquire the 3295 shares due to potential legacy liabilities. The last proposal involved RoundTable, not Novartis, acquiring shares in 3295. RoundTable rejected the proposal, saying it did not want to be left with a Canadian subsidiary (3295) following the sale of Holdings: Sept. 8 Transcript at 1032–35, 1043–44, 1067–68; Sept. 9 Transcript at 1114–15, 1153–55.

[11] Once Novartis and RoundTable agreed to terms for the sale of Holdings, Micsau's adviser was able to speak to Novartis. Assuming that Novartis did not want to acquire the 3295 shares directly or indirectly, the adviser proposed selling the shares of a new corporation: Sept. 8 Transcript at 1035; Sept. 9 Transcript at 1114–15.

[12] Novartis accepted the proposal in exchange for a $1.5M reduction of the purchase price: Sept. 9 Transcript at 1108–09. It is not clear from the evidence how this reduction of $1.5M was reflected in the numbers below. However, this is not material to the resolution of the issue before this Court.

[13] As a result, the following transactions occurred.

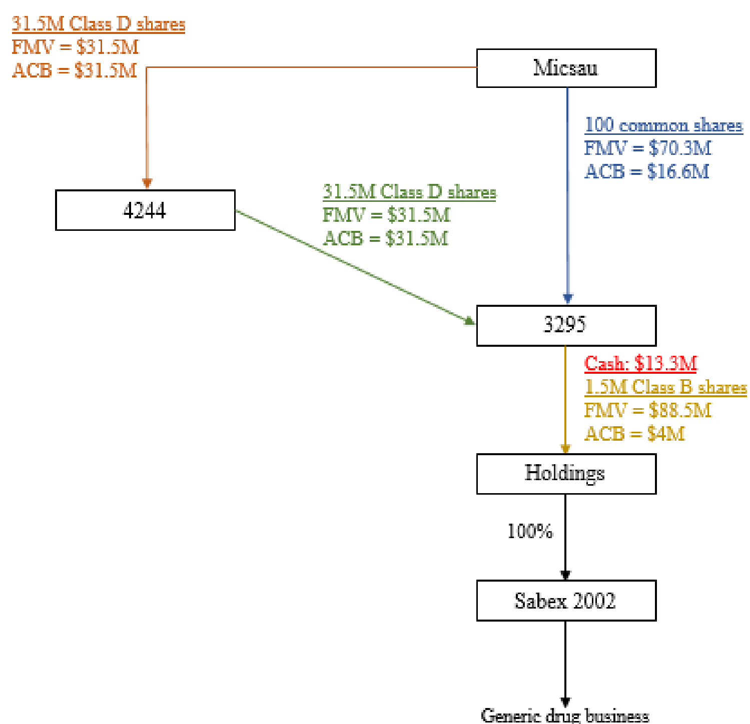
C. *Series of Transactions*

(1) Micsau creates 31.5M Class D shares

[14] Micsau exchanged its shares in 3295 for (1) Class D preferred shares with $31.5M of ACB and FMV and (2) 100 common shares with $16.6M of ACB and $70.3M of FMV. This had the effect of transferring a portion of Micsau's high ACB to the newly-created Class D shares.

(2) Micsau transfers the Class D shares to 4244

[15] Micsau transferred the Class D shares in 3295, for $31.5M, to a newly created subsidiary: 4244851 Canada Inc. (4244). In consideration, 4244 issued to Micsau Class D shares with an ACB and FMV of $31.5M. Micsau's Class D shares in 3295 had an ACB equal to the price at which it transferred those shares to 4244; consequently, this transaction created no capital gain. The resulting corporate diagram, which excludes RoundTable for simplicity, was as follows:



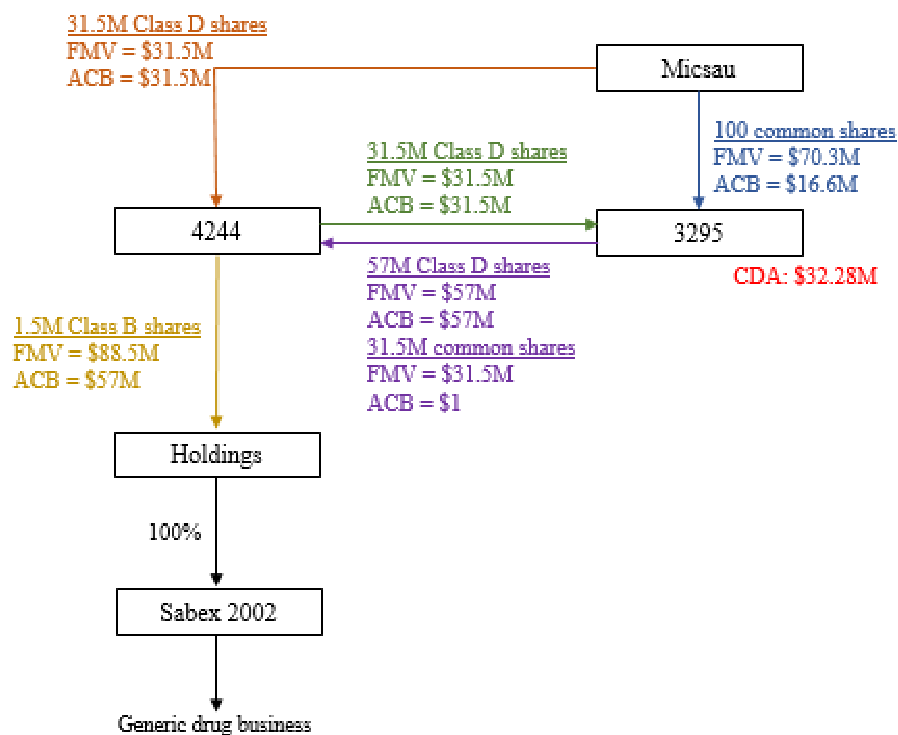
[16] I wish to pause here to note a foundational point. The proposal Novartis accepted was the sale of shares in a new corporation (4244) for $88.5M. As we will see, two "lots" of 4244 shares will be sold to Novartis. The first lot is the Micsau's 31.5M Class D shares in 4244.

(3) 3295 sells its Holdings shares to 4244

[17] 3295 transferred its Holdings shares, worth $88.5M, to 4244. To make this an even trade, 4244 issued $88.5M worth of shares: (1) 57M Class D shares, worth $57M and (2) 31.5M common shares, worth $31.5M. As the Act permits, 3295 elected to recognize, not $88.5M, but $57M in proceeds of disposition. Consequently, 3295 realized a $53M capital gain ($57M – $4M). That gain is roughly the gain Micsau would have realized if it had sold its 3295 shares to Novartis. Due to the election, 3295's shares in 4244 had $57M of ACB, which went to the 57M Class D shares. This left 3295's 31.5M common shares with no ACB.

[18] As the Act provides, half of 3295's gain was taxed, and half was added to 3295's Capital Dividend Account (CDA). The CDA represents amounts, including capital gains' non-taxable portion, which a corporation can distribute tax-free. Accordingly, 3295's capital gain increased the CDA balance by $26.5M, yielding a total CDA of $32.28M.

[19] The corporate diagram after these transactions was as follows:



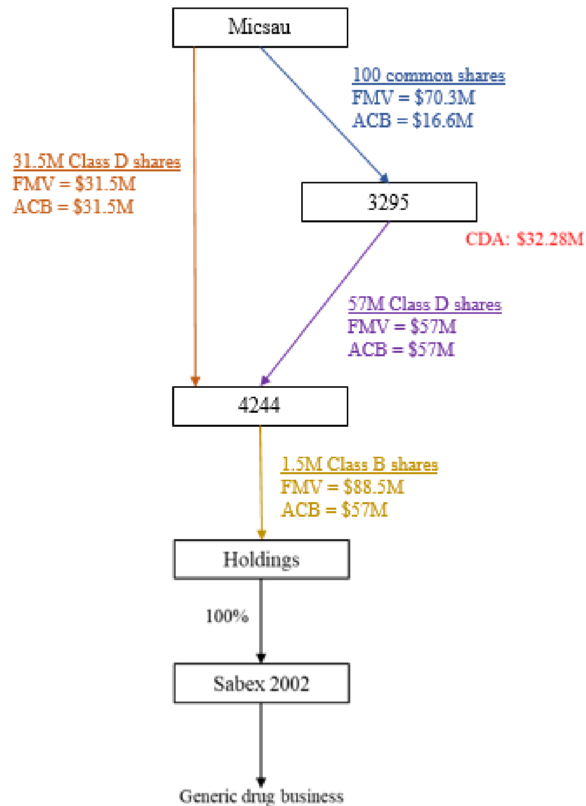
[20] I pause to note that the second "lot" of 4244 shares that will be sold to Novartis is the 57M Class D shares that 3295 acquired when it sold the Holdings shares to 4244.

(4) Eliminating the cross-ownership between 3295 and 4244

[21] Since Micsau had been told Novartis did not want to own shares in 3295 directly or indirectly, the series could not contemplate Novartis purchasing a company (4244) that was in a cross-ownership with 3295. Hence, 4244 and 3295 eliminated the cross-ownership before the sale to Novartis.

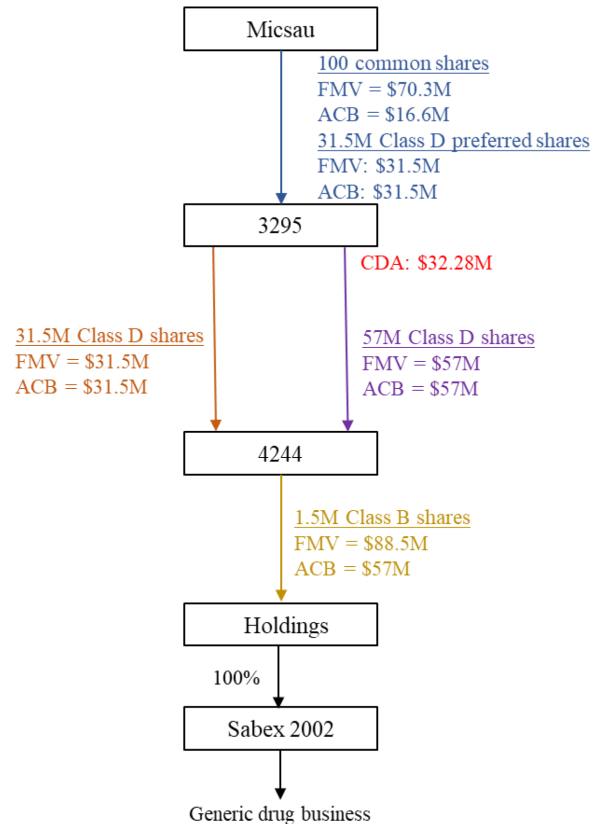
[22] It is important to recognize that eliminating the cross-ownership did not change the value of what Novartis wanted to purchase. Irrespective of the cross-ownership, the underlying drug business' value was $88.5M. That value was reflected in the two "lots" of shares: (1) Micsau's 31.5M Class D shares in 4244, worth $31.5M and (2) 3295's 57M Class D shares in 4244, worth $57M.

[23] The cross-ownership was eliminated through a cross-redemption. First, 3295 redeemed 4244's Class D shares for a promissory note of $31.5M. Under the Act, this resulted in 4244 being deemed to have received a $31.5M dividend from 3295. 3295 elected to treat this dividend as a capital dividend. Consequently, the dividend was not taxable, and 4244's CDA increased by $31.5M (with 3295's CDA decreasing correspondingly). Second, 4244 redeemed 3295's common shares, also for a promissory note of $31.5M. This resulted in 3295 being deemed to have received a $31.5M dividend from 4244. 4244 elected to treat this dividend as a capital dividend. Consequently, the dividend was not taxable, 4244's CDA balance was eliminated, and 3295's CDA was restored. Finally, 3295 and 4244 offset the two promissory notes. After these transactions, the corporate diagram was as follows:



(5) Micsau transfers its 4244 shares to 3295

[24] Micsau transferred to 3295 the first lot of shares—the 31.5M Class D shares in 4244. In exchange, 3295 issued 31.5M Class D shares to Micsau. The corporate diagram after these transactions was as follows:



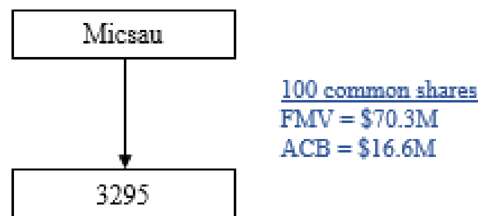
[25] As the diagram illustrates, 3295 owned all the 4244 Class D shares, which had $88.5M of FMV and ACB. These shares come from the two lots discussed above. The first lot, the 31.5M Class D shares, are the ones Micsau obtained by using its high ACB in the first steps of the series, described at paragraphs [14] and [15] above. The second lot, the 57M Class D shares, comprises shares on which 3295 paid full tax in step 3 of the series, described at paragraphs [17] and [18].

(6) 3295 sells both lots to Novartis

[26] 3295 sold all its shares in 4244 to Novartis for $88.5M. Because the shares' sale price and ACB were equal, 3295 realized no additional capital gain from this sale.

(7) 3295 sends Micsau $31.5M of cash

[27] Finally, 3295 redeemed, for $31.5M, the Class D shares it issued to Micsau in step 5 of the series, described in paragraph [24]. 3295 used the funds it received from Novartis on the sale. This transaction resulted in no tax liability. The corporate structure after the series of transactions can be illustrated as follows:



D. *The Minister's Reassessment*

[28] The Minister of National Revenue (Minister) reassessed 3295 pursuant to the General Anti-Avoidance Rule (GAAR) in section 245 of the Act. The GAAR applies when a series of transactions meets three requirements. First, a tax benefit must arise from the series of transactions. Second, there must be avoidance, meaning the series was undertaken primarily for the purpose of obtaining a tax benefit. Third, the avoidance must be abusive. Abuse occurs when the result of the series frustrates the object, spirit, and purpose of a provision of the Act or of the Act as a whole.

[29] The Minister's reassessment applied the GAAR to add a $31.5M of capital gain to 3295's income. The Minister said Micsau and 3295 carried out a series of avoidance transactions that resulted in a tax benefit—namely, a $31.5M reduction in the capital gain 3295 would have realized if it had directly sold its shares in Holdings to Novartis. The Minister said the series allowed 3295 to abuse:

a) the Act's regime regarding the taxation of capital gains, found in paragraphs 3(*b*), 38(1), 39(1)(*a*), and 40(1)(*a*);

b) the Act's scheme governing capital dividends provided for in subsections 83(2) and 89(1); and

c) subsection 55(2).

[30] Before reviewing the Tax Court's analysis, I will briefly summarize these provisions and the context in which they operate.

II. Overview of Allegedly Abused Provisions

A. *Capital Gains Regime*

[31] Capital gains represent the accrued economic gain a taxpayer realizes when she disposes of a capital asset: paragraph 39(1)(*a*). One calculates capital gains as the proceeds of disposition (POD) minus the adjusted cost base (ACB): subsection 40(1). For example, if a taxpayer buys a

capital asset for $100 and sells it for $150, she realizes a $50 capital gain; that is, $150 POD minus $100 ACB. Only half of capital gains are taxable: paragraph 38(*a*). Thus, in our example, the taxpayer's *taxable* capital gain is only $25; that is, half of the $50 capital gain.

B. *Capital Dividends*

[32] Parliament's objective is to tax half of capital gains, whether they are earned directly by an individual or indirectly through a corporation. Where a private corporation realizes a capital gain, the non-taxable portion is added to the corporation's Capital Dividend Account (CDA). As mentioned, the CDA represents amounts, including capital gains' non-taxable portion, which a corporation can distribute to its shareholders tax-free via capital dividends. Without this feature, the system would tax the non-taxable portion of the capital gain. When the distributing corporation pays a capital dividend to a corporate shareholder, the distributing corporation's CDA decreases by the amount of the dividend, and the corporate shareholder's CDA increases by that amount. These provisions are found in subsections 83(2) and 89(1).

C. *Subsection 55(2)*

[33] Subsection 55(2) operates in the context of the intercorporate dividend regime. Key to that regime is subsection 112(1), which says that a taxable dividend that a corporate shareholder receives from a Canadian corporation is deductible from that shareholder's income. As a result, the corporate shareholder receives this dividend tax-free. The rationale is that this dividend has

been paid from after-tax earnings; taxing it again in the hands of the recipient corporation would result in double taxation.

[34] Subsection 55(2) serves a dual purpose.

[35] First, it prevents "capital gains stripping". Capital gains stripping happens when a corporation, before its shares are sold, reduces its value by paying an intercorporate dividend to its corporate shareholder, thereby converting a capital gain into a tax-free intercorporate dividend. An example can illustrate the effect of subsection 55(2). Suppose ACo wholly owns BCo. BCo has an asset worth $100. BCo pays a $99 intercorporate dividend to ACo, which receives that dividend tax-free. ACo could then sell its shares in BCo to a third party for $1. Using this manoeuvre, ACo would turn a $100 sale into a $1 sale and, in so doing, transform what would have been a taxable capital gain into a tax-free intercorporate dividend. Subsection 55(2) prevents this sort of tax plan by deeming the $99 dividend to be part of ACo's capital gain from its sale of BCo's shares.

[36] Second, subsection 55(2) protects the tax-free flow of dividends attributable to income that has already been taxed in the corporation paying the dividend: *Canada v. Kruco Inc.*, 2003 FCA 284 at para. 32 [*Kruco*]. To continue with the previous example, if BCo had $10 of after-tax income, it could pay a $10 dividend to ACo prior to its sale. Subsection 55(2) would allow such a dividend. The underlying assumption is that dividends in excess of after-tax profits—in our example dividends in excess of $10—represent the untaxed appreciation of

capital assets: *Kruco* at para. 32; *Ottawa Air Cargo Centre Ltd. v. The Queen*, 2007 TCC 193 at para. 27, aff'd 2008 FCA 54.

[37] With this legislative context in mind, I now turn to the Tax Court's decision.

III. Tax Court Decision

[38] The Tax Court had to decide whether the GAAR applied to the series of transactions. 3295 conceded the first two elements of the GAAR: the existence of a tax benefit and avoidance. The only remaining issue was whether the series of transactions was abusive.

[39] The Tax Court ruled that the series abused subsection 55(2) and the scheme governing capital dividends: TCC Reasons at paras. 118, 120, 129–132, 144. The Tax Court found that the object, spirit, and purpose of subsections 55(2), 83(2) and 89(1), collectively, is to "prevent a taxpayer from using a tax-free dividend to avoid the capital gain inherent in the shares of a corporation that is attributable to an unrealized appreciation": TCC Reasons at para. 118. According to the Tax Court, the cross-redemption dividends between 3295 and 4244 were abusive because they circumvented subsection 55(2) and resulted in 3295 increasing the ACB of its shares in Holdings, even though subparagraphs 88(1)(*c*)(ii) and (iii) did not allow for such an increase: TCC Reasons at paras. 118, 120–123, 136–144.

[40] 3295 argued that the tax plan was not abusive because alternative transactions, described in paragraph [9] above, could have been implemented and resulted in less tax liability. The Tax Court said these alternative scenarios were not valid comparisons because "they related to the sale of the [3295] shares" and because "it was shown that the sale of Holdings' shares was essential": TCC Reasons at para. 159.

[41] Hence, the Tax Court dismissed the appeal and upheld the Minister's reassessment.

IV. Issue and Standard of Review

[42] The only issue is whether the series is abusive.

[43] The standard of review for GAAR cases on appeal depends on what stage of the abuse analysis a party challenges. The abuse analysis occurs in two stages. The first is to determine the object, spirit, and purpose of the provisions at issue. This first stage is a question of law, subject to correctness review by appellate courts: *Deans Knight Income Corp. v. Canada*, 2023 SCC 16 at para. 78 [*Deans Knight*]; *Canada v. Alta Energy Luxembourg S.A.R.L.*, 2021 SCC 49 at para. 50; *Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54 at para. 44 [*Canada Trustco*]; *Housen v Nikolaisen*, 2002 SCC 33 at paras. 8, 26–37 [*Housen*]. The second stage is to determine whether the transactions in issue are abusive. This inquiry is "necessarily fact intensive" and is thus reviewable only for palpable and overriding error, absent an extricable error of law: *Deans Knight* at para. 121; *Canada Trustco* at para. 44; *Canada v. Oxford Properties Group Inc.*, 2018 FCA 30 at para. 39 [*Oxford Properties*]; *Housen* at para. 10.

[44] A trial judge's failure to consider the overall result of a series of transactions is an extricable error of law. For instance, in *Oxford Properties*, this Court accorded no deference to the portion of the trial judge's abuse analysis that failed to consider the overall result of the series of transactions: *Oxford Properties* at paras. 107–113. Likewise, a trial judge's failure to consider the true, overall nature of a tax plan constitutes an error of law: *Canada v. Microbjo Properties Inc.*, 2023 FCA 157 [*Microbjo*]. In *Microbjo*, Noël CJ explained the point as follows:

> The Tax Court's failure to take into account the true nature of the plan amounts to an error of law. Indeed, as was explained by the Supreme Court in *Canada (Director of Investigation and Research) v. Southam Inc*., 1997 CanLII 385 (SCC), [1997] 1 S.C.R. 748, 144 D.L.R. (4th) 1 (paras. 39 and 41), a tribunal that fails to consider evidence that the law requires it to consider commits an error of law.
>
> (*Microbjo* at para. 74)

V. Analysis

[45] The Tax Court failed to consider the entire series of transactions and its overall result. This error of law led the Court to misconstrue the abuse analysis and improperly reject alternative transactions that would have confirmed that the series did not abuse subsection 55(2) or the scheme governing capital dividends.

A. *The Tax Court Misconstrued the Abuse Analysis*

[46] The Supreme Court and this Court have held that, to determine whether transactions forming part of a series are abusive, one must consider the "entire series of transactions" or its "overall result": *Lipson et al. v. The Queen*, 2009 SCC 1 at para. 34; *Copthorne Holdings Ltd. v. The Queen,* 2011 SCC 63 at para. 71 [*Copthorne*]; *Canada v. Landrus*, 2009 FCA 113 at paras. 66–67; *Birchcliff Energy Ltd. v. Canada*, 2019 FCA 151 at paras. 27–28 [*Birchcliff*]; *Oxford Properties* at paras. 106–110, 118–119.

[47] Here, the series' overall result did not shortchange the Minister. Before the series, a $53.7M capital gain would have been realized if Micsau had sold its 3295 shares to Novartis. After the series, a $53M capital gain was realized and taxed. Similarly, the difference between the capital gain taxed ($53M) and the purchase price paid by Novartis ($88.5M) did not escape taxation. It is simply the use of ACB legitimately acquired: $4M in the case of 3295, and $31.5M in the case of Micsau.

[48] Instead of considering the entire series of transactions and its overall result, the Tax Court limited its analysis to the moment in the series when 3295, through the cross-redemption capital dividend, could be said to have reduced the capital gain that it would have realized from disposing of its common shares in 4244 immediately before the dividend. However, had the Tax Court considered the entire series, it could have only concluded that the cross-redemption capital dividend did not reduce 3295's capital gain and, therefore, did not abuse subsection 55(2).

[49] A brief hypothetical illustrates that the cross-redemption did not decrease 3295's capital gain. Technically, Novartis could have purchased the 4244 shares without the cross-redemption

step at paragraph [23]. This would have transferred control of 4244 to Novartis, like the impugned series of transactions, and 3295's capital gain would have remained $53M ($57M POD minus $4M ACB). As for Micsau, it would have had no gain from the sale of its 31.5M Class D shares in 4244 because those shares' ACB was equal to their FMV. After Novartis' purchase, 4244 and 3295 could have eliminated the cross-ownership using a cross-redemption. Just as the cross-ownership did not increase the value of the drug business Novartis wanted to purchase, the cross-redemption did not decrease the value of the shares sold to Novartis.

[50] The Minister argues that the cross-redemption capital dividend decreased 3295's capital gain by $31.5M. I disagree. The $31.5M reduction the Minister complains about does not stem from the cross-redemption; it stems from selling the first lot of shares. These shares derived their FMV and ACB from Micsau lawfully isolating $31.5M of legitimately-obtained ACB and FMV into new, separate Class D shares.

[51] A more technically precise way of explaining the provenance of the $31.5M reduction the Minister complains about is as follows. Recall that the $88.5M of 4244 shares Novartis purchased came from two lots: the first lot was Micsau's 31.5M Class D shares, and the second lot was 3295's 57M Class D shares. The second lot, worth $57M, was properly taxed; the Minister concedes that point. The remaining contention relates to the first lot. This lot derived its $31.5M FMV and ACB from the series' first two steps, in which (1) Micsau isolated $31.5M of legitimately-obtained ACB and FMV into Class D shares, then (2) exchanged them for 4244 Class D shares, which also had $31.5M ACB and FMV. Just before the sale to Novartis, Micsau

transferred these 4244 shares to 3295, and 3295 sold that lot to Novartis for $31.5M. It follows that Micsau using its high ACB explains why the first lot did not create any capital gain; this has nothing to do with the cross-redemption capital dividend.

[52] To alleviate any doubt about the series' purpose and effect, it bears noting that instead of transferring its 4244 shares to 3295 for 3295 to sell to Novartis, Micsau could have sold its shares in 4244 directly to Novartis for $31.5M. Had Micsau done so, it would have received the $31.5M directly from Novartis, and 3295's gain would have remained $53M: Hamelin at 874. This different way of proceeding would have made it clear that the series' purpose and effect was to allow Micsau to use its high ACB, not to abusively reduce 3295's capital gain. Indeed, this purpose and effect correspond exactly to the appellant's tax planning documents: Appeal Book, Vol. 1, Tab F.5 at 829.

[53] To conclude: the series implemented the sale of shares in a new corporation, 4244, for $88.5M. The series involved 3295 receiving $57M and being taxed on a $53M capital gain ($57M POD minus $4M ACB). The series also involved Micsau receiving $31.5M while using $31.5M of its ACB. Before the series, Micsau's 3295 shares had an ACB of $48.1M and a FMV of $101.8M, and so had an accrued gain of $53.7M. After the series, Micsau received $31.5M from 3295, Micsau's ACB and FMV in 3295 was reduced by $31.5M, and Micsau's accrued gain in those shares remained $53.7M ($16.6M ACB and $70.3M FMV). Thus, Micsau stands to be taxed on $53.7M if it sells its 3295 shares after the series.

[54] Assessing the impugned cross-redemption capital dividend in the context of the entire series of transactions, as the Tax Court should have done, I fail to see how that transaction was abusive. I agree with 3295 that this series' overall result is consistent with the object, spirit and purpose of the capital gains regime as previously identified by this Court—that is, to tax real economic gains: *Triad Gestco Ltd. v. The Queen*, 2012 FCA 258 at paras. 40–42.

B. *The Tax Court Failed to Consider the Alternative Transactions*

[55] By failing to consider the entire series and its overall result, the Tax Court not only misconstrued the abuse analysis but also improperly rejected alternative transactions, which would have confirmed that the series is not abusive.

[56] Alternative transactions that a taxpayer might have carried out are considered in the course of GAAR analyses.

[57] For instance, in some cases, the existence of a tax benefit can only be established by comparing the tax consequences of the transaction or series actually carried out with the tax consequences of an alternative transaction that might have been carried out: *Canada Trustco* at para. 20; *Copthorne* at para. 35. A perfect example is the case at bar, in which 3295 conceded the existence of a tax benefit because selling its 1.5M Holdings shares without the series would have resulted in a higher capital gain.

[58] Similarly, courts consider alternative transactions' tax consequences when determining whether tax avoidance is abusive: Shawn D. Porter, "The Misuse and Abuse Exception: The Role of Alternative Transactions" in Brian J. Arnold, ed., *The General Anti-Avoidance Rule: Past, Present, and Future* (Toronto: Canadian Tax Foundation, 2021) at 275–286 [Porter], citing *Lehigh Cement Limited v. Canada*, 2010 FCA 124 at paras. 40–41; *Birchcliff* at paras. 31, 48; *Mathew v. Canada*, 2005 SCC 55 at para. 58. Alternative transactions are helpful in determining the object, spirit and purpose of the relevant provisions and, correspondingly, what the Act seeks to allow and prevent. As stated by Webb J.A. of this Court:

> In my view, these alternative transactions are a relevant factor in determining whether or not there has been an abuse of the provisions of the ITA [Income Tax Act]. If the taxpayer can illustrate that there are other transactions that could have achieved the same result without triggering any tax, then, in my view, this would be a relevant consideration in determining whether or not the avoidance transaction is abusive.
>
> (…) [T]he alternative means by which the same result could have been realized is a relevant consideration in determining whether or not the avoidance transaction was abusive.
>
> (*Univar Holdco Canada ULC v. Canada*, 2017 FCA 207 at paras. 19–20 [*Univar*])

[59] Here, 3295 asked the Tax Court to consider the four non-abusive alternative transactions, which would have allowed Micsau to use its high ACB in 3295. As mentioned, the Tax Court decided that these alternatives were not valid comparisons because "they related to the sale of the [3295] shares" and "it was shown that the sale of Holdings' shares was essential" with the consequence that the "purpose of the sale, the price and the business implications would have been different": TCC Reasons at paras. 159–160.

[60] The Tax Court's conclusion that the sale of the shares in Holdings was essential is inconsistent with the evidence and constitutes a palpable and overriding error: the shares Novartis purchased were not those in Holdings, but those in 4244. Further, nothing in the record suggests that the sale of shares in 4244 affected the purpose of the sale or the business implications of the transaction with Novartis. Indeed, Novartis obtained a $1.5M reduction of the sale price in exchange for its agreement to purchase the 4244 shares instead of the Holdings shares. It is quite possible that the same reduction would have taken place under the alternative transactions submitted by 3295, but those were never put to Novartis.

[61] More fundamentally, in deciding not to consider the alternative transactions, the Tax Court failed to take into account the series' overall result: Micsau used its high ACB, and a capital gain was realized, which was roughly equal to the capital gain Micsau would have realized from selling 3295 directly. In my opinion, the alternative transactions 3295 submitted are relevant because:

a) *They are available under the Act*. The fact that they were not presented to Novartis or that Novartis may have refused to proceed with them does not detract from the fact that the Act allowed for these transactions;

b) *They are not so remote as to be practically infeasible*. The alternative transactions 3295 submitted could realistically have been carried out. Had Novartis or RoundTable agreed, carrying out these alternatives would have been relatively easy;

c) *They have a high degree of commercial and economic similarity to the series at issue*: Porter at 270. The alternative transactions would have resulted in Novartis acquiring shares of a corporation whose underlying asset would be the generic drug business—exactly what Novartis in fact acquired;

d) *They generate tax consequences approximately as favourable as the series at issue*: The proposed alternatives would have enabled Micsau to use its ACB in the 3295 shares. This would have generated a capital gain of $53.7M—roughly the same gain that 3295 realized in our case; and

e) *They are not abusive of the GAAR*: *Univar* at para. 20; Porter at 277–279. The various alternative transactions would have enabled Micsau to realize its high ACB without attracting the application of the GAAR.

[62] Accordingly, the Tax Court erred in failing to consider the alternative transactions.

VI. Conclusion

[63] I would allow the appeal with costs in this Court and the court below, and set aside the judgment of the Tax Court. Rendering the judgment that the Tax Court should have rendered, I would allow 3295's appeal from the reassessment dated November 21, 2008, and refer the reassessment back to the Minister for reassessment on the basis that 3295 did not realize an additional capital gain of $31.5M in its 2005 taxation year.

"Nathalie Goyette"
J.A.

"I agree.
Yves de Montigny C.J."

"I agree.
Gerald Heckman J.A."

<u>FEDERAL COURT OF APPEAL</u>

<u>NAMES OF COUNSEL AND SOLICITORS OF RECORD</u>

DOCKET:	A-201-22
STYLE OF CAUSE:	3295940 CANADA INC. v. HIS MAJESTY THE KING
PLACE OF HEARING:	MONTRÉAL, QUEBEC
DATE OF HEARING:	NOVEMBER 15, 2023
REASONS FOR JUDGMENT BY:	GOYETTE J.A.
CONCURRED IN BY:	DE MONTIGNY C.J. HECKMAN J.A.
DATED:	MARCH 7, 2024

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