File number: _____

IN THE SUPREME COURT OF CANADA
(ON APPEAL FROM THE FEDERAL COURT OF APPEAL)

BETWEEN:

HER MAJESTY THE QUEEN

Applicant
(Appellant)

and

LOBLAW FINANCIAL HOLDINGS INC.

Respondent
(Respondent)

APPLICATION FOR LEAVE TO APPEAL
(Pursuant to paragraph 58(1)(a) of the *Supreme Court Act* and
subrule 25(1) of the *Rules of the Supreme Court of Canada,* SOR/2006-203)

VOLUME I

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PART I – STATEMENT OF FACTS

Overview

1. Wealthy Canadians avoiding taxation in Canada by parking investments in companies offshore, usually in tax havens or low-tax jurisdictions, erode our tax base. This continues despite Parliament's efforts to curb the practice. The cornerstone of those efforts is the *Income Tax Act*'s regime for capturing "foreign accrual property income" ("FAPI").

2. The proposed appeal provides this Court with its first opportunity to consider Canada's FAPI regime. The Federal Court of Appeal's decision has imperiled the collection of approximately $1.181 billion in tax, so far, by failing to properly articulate the anti-avoidance purpose that permeates this regime, by characterizing the regime as incentivizing offshore investment, and by mandating a restrictive interpretation to lower Courts tasked with considering these rules. These are issues of public importance.

3. The respondent established a controlled foreign affiliate in Barbados that held an investment portfolio on which it earned interest income on its own account using money received from its corporate group and its own retained earnings. In avoiding Canadian taxation of that affiliate's income, the respondent relied on an exemption from the FAPI rules that is available to financial institutions that meet specified criteria. One criterion requires that the foreign affiliate's business be conducted principally with persons with whom it deals at arm's length.

4. As recognized at first instance, the essence of the arm's length requirement compels an examination of all aspects of a foreign affiliate's business, both its source of funds and the use of its funds. The FAPI regime applied in this case, as the foreign affiliate's business was to invest funds received from its corporate group and it did not solicit any funding from arm's length persons.

5. The Federal Court of Appeal erred in interpreting the arm's length requirement by failing to give appropriate consideration to the anti-avoidance purpose of the FAPI regime, and

by virtually ignoring the receipt of funds side of the foreign affiliate's business. The Federal Court of Appeal treated the financial institution exemption as a broad tax incentive, rather than as the narrow exemption to the investment business anti-avoidance rule that it is. The result is an absurdity, as the decision permits precisely what the FAPI regime is intended to prevent.

6. The Federal Court of Appeal's interpretation provides a roadmap for Canadian financial institutions to avoid FAPI by parking investments offshore. Direction from this Court is needed to ensure the proper interpretation of the FAPI provisions.

FAPI: Canada's regime for taxing income earned by foreign affiliates

7. The charging provision of the FAPI rules is s. 91 of the *Income Tax Act* ("*Act*").[1] This provision requires Canadian taxpayers to include in income the FAPI of a controlled foreign affiliate on a current/accrual basis, regardless of whether the income has actually been distributed to the Canadian taxpayer. This has the effect of neutralizing the tax benefit that would otherwise occur when investment income is earned in a low-tax jurisdiction.

8. The FAPI rules are primarily anti-avoidance rules. They neutralize any Canadian tax advantage that taxpayers could otherwise achieve from earning highly-mobile income through a "controlled foreign affiliate" (generally, a foreign subsidiary that is controlled by Canadian taxpayer).

9. The FAPI regime reflects a deliberate choice that is critical to Canada's response to the problem of international tax avoidance; that is, Canada subjects to taxation a controlled foreign affiliate's income from activities that have little material or inherent connection to a foreign source.[2] One obvious example of highly-mobile income without an innate foreign-source connection is income from an actively-managed investment portfolio.

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[1] *Income Tax Act*, RSC 1985 c 1 (5th Supp), as amended, s 91.

[2] J Scott Wilkie, Robert Raizenne, Heather Kerr & Angelo Nikolakakis, "The Foreign Affiliate System in View and Review", *Tax Planning for Canada-US and International Transactions*

10. The reason for requiring Canadian taxpayers to report and include FAPI in income on a current basis is rooted in the interplay between two approaches, or policies, to taxing foreign-source income: "capital export neutrality" and "capital import neutrality".[3]

11. Capital export neutrality is concerned with ensuring that differences in tax rates in foreign jurisdictions do not influence investment decisions. It subjects the income earned in a foreign country (source country) to the same effective rate as domestic income. One method of achieving this is to tax the income of a foreign subsidiary in the hands of its parent on an accrual / current basis.[4]

12. Capital import neutrality is concerned with ensuring that, where a resident of a country (parent country) operates in another country (source country) through a foreign subsidiary, the parent country does not impose an additional layer of tax that could hamper the foreign subsidiary's ability to compete for business.[5] Capital import neutrality aims to facilitate the competitiveness of foreign subsidiaries by giving the source country the exclusive jurisdiction to tax so that the foreign subsidiaries can

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(Toronto: Canadian Tax Foundation, 1994) at 2:10-2:11, vol. III, tab 6(G) [Wilkie et al, "The Foreign Affiliate System"]; and Nick Pantaleo & J Scott Wilkie, "Taxing Foreign Business Income", *Business Tax Reform* (Toronto: Canadian Tax Foundation, 1998) at 8:11-8:12 [Pantaleo & Wilkie], vol. III, tab 6(H).

[3] Reasons for Judgment of the Tax Court of Canada [TCC Reasons], paras 219 and 233-34, vol. I, tab 2; Wilkie et al, "The Foreign Affiliate System", *ibid* at 2:56-2:57, vol. III, tab 6(G); Sandra Slaats & Penny Woolford, "The Evolution of the International Tax Rules" (2010) 58 (Supp) *Canadian Tax Journal* 225-42 at 228; Pantaleo & Wilkie, *ibid* at 8:7-8:8 and 8:11-8:12, vol. III, tab 6(H); and Angelo Nikolakakis & Penelope Woolford "Foreign Affiliate Dumping", *Report of Proceedings of the Sixty-Fourth Tax Conference* (Toronto: Canadian Tax Foundation, 2013) at 26:3, vol. II, tab 6(D).

[4] TCC Reasons, para 233, vol. I, tab 2; Wilkie et al, "The Foreign Affiliate System", *supra* note 2 at 2:23-2:24, vol. III, tab 6(G); Pantaleo & Wilkie, *supra* note 2 at 8:7-8:8, vol. III, tab 6(H); and Nick Pantaleo & Michael Smart, "International Considerations" in Heather Kerr et al, ed, *Tax Policy in Canada* (Toronto: Canadian Tax Foundation, 2012) at 12:26 and 12:28-12:29 [Pantaleo & Smart] , vol. III, tab 6(I).

[5] TCC Reasons, para 233, vol. I, tab 2; Wilkie et al, "The Foreign Affiliate System", *supra* note 2 at 2:24-2:25, vol. III, tab 6(G); Pantaleo & Wilkie, *supra* note 2 at 8:7-8:8, vol. III, tab 6(H); and Pantaleo & Smart at 12:26 and 12:28, vol. III, tab 6(I).

contend for business in that market against foreign counterparts at the same effective rate.[6]

13. The interaction between these neutralities illustrates the goals of Canada's foreign affiliate system and that the capital export neutrality limits the scope of the capital import neutrality in the *Act*. It also shows that Parliament's decision not to tax a Canadian corporation on its foreign affiliate's active business income does not negatively impact the affiliate's ability to compete in the international market by imposing an additional layer of tax. Foreign affiliates that earn highly-mobile investment income on their own account are generally beyond the scope of this objective. For such entities, s. 91 of the *Act* applies to remove the tax benefit from offshoring income to avoid Canadian tax.

The definition of "investment business"

14. The *Act* defines FAPI in s. 95(1) to include income from: property (which includes income from an investment business), businesses that are not active businesses, and non-qualifying businesses of the affiliate. The terms "active business" and "investment business" were first defined in 1995 (s. 95(1) of the *Act*)[7] in response to several Court decisions that had set too low a bar with respect to the amount of activity required to distinguish between active and passive income.[8] This low threshold was inconsistent with the goal of the FAPI provisions.

15. The "investment business" definition introduced the requirement that Canadian corporations include as FAPI the income from their controlled foreign affiliates carrying on an "investment business". An "investment business" was defined as any business the

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[6] Wilkie et al, "The Foreign Affiliate System", *supra* note 2 at 2:23-2:25, vol. III, tab 6(G); and Pantaleo & Smart, *supra* note 4 at 12:29, vol. III, tab 6(I).

[7] *An Act to amend the Income Tax Act, the Income Tax Application Rules and related Acts,* SC 1995, c 21, s 46(3) [*Amending Act*].

[8] *Canada Trustco Mortgage Co v Minister of National Revenue*, 53 DTC 5094, [1999] 2 CTC 308 (FCTD), aff'g [1991] 2 CTC 2728, 91 DTC 1312 (TCC), vol. II, tab 6(B); Jinyan Li, Arthur Cockfield & J Scott Wilkie, *International Taxation in Canada – Principles and Practices*, 3rd ed (Markham: LexisNexis, 2014) at 322-23, vol. II, tab 6(F) [Li, Cockfield & Wilkie, *International Taxation*].

principal purpose of which is to earn income from property, such as interest, dividends, or similar returns.

16. The "investment business" definition includes exemptions that apply to a discrete subset of foreign affiliates that are financial institutions (such as banks, trust companies, and insurance corporations) or that carry on certain types of activities (such as the development of real estate or the lending of money) and that meet specified criteria for how the business is conducted. The first criterion requires that the foreign affiliate's business be "other than any business conducted principally with persons with whom the affiliate does not deal at arm's length" (the arm's length test).

17. In keeping with the neutrality principles, the "investment business" definition ensures that the return from highly mobile capital is taxable even if the return is earned in a businesslike fashion.[9] The financial institution exemption was not meant to relieve from Canadian income tax the income of foreign affiliates that trade only on their own account using money from their corporate group and retained earnings.

18. As one commentator observed at the time of its enactment, the measures aimed to ensure that "persons with large pools of capital [could no longer] avoid FAPI by carrying on an active investment business." Noting the "few limited exceptions", the commentator concluded it should not be possible "to avoid Canadian tax by earning investment income in a foreign affiliate, *irrespective of the number of persons employed by the affiliate or the amount of business activity within the affiliate*"[10] (emphasis in original).

The income tax at risk

19. The Canada Revenue Agency estimates that, at present, there are ongoing audits and objections in respect of 14 Canadian multinational corporate groups, representing a total amount of tax at risk of approximately $1.181 billion (combined federal and provincial

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[9] Li, Cockfield & Wilkie, *International Taxation*, *ibid* at 322-23, vol. II, tab 6(F).

[10] Larry F Chapman, "Foreign Affiliate Amendments: Three Strikes and You're Done" (1995) 43:2 *Canadian Tax Journal* 433-446 at 2.

tax) that involve the arm's length issue. This includes the appellant and its foreign affiliate, Glenhuron.[11]

The facts on Loblaw Holdings's affiliate in Barbados

20. The following is a brief overview of the background facts, which are detailed at length in the Trial Judge's Reasons for Judgment and summarized by the Federal Court of Appeal ("FCA").

21. Loblaw Financial Holdings Inc. ("Loblaw Holdings") is a Canadian holding company wholly owned by Loblaw Companies Limited, which is a Canadian public corporation that is controlled by George Weston Limited (collectively, the "Loblaw Group"). Companies in the Loblaw Group are related and do not deal with each other at arm's length.[12]

22. In 1992, Loblaws Inc. was incorporated in Barbados as an international business corporation.[13] Its first business activities included receiving millions of US dollars in exchange for shares from related companies and investing funds in a related company.[14]

23. In late 1993, Loblaws Inc. changed its status to that of a Barbados offshore bank by obtaining a license under Barbados' *Offshore Banking Act* ("*OSBA*")[15] and changing its name to Glenhuron Bank Limited ("Glenhuron").[16]

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[11] Affidavit of Jim Randall, para. 5, vol. IV, tab 7(A).

[12] Reasons for Judgment of the Federal Court of Appeal [FCA Reasons], para 6, vol. I, tab 4; TCC Reasons, Appendix A – List of Persons Involved, vol. I, tab 2.

[13] TCC Reasons, paras 7, 13 and 17, vol. I, tab 2.

[14] TCC Reasons, para 14, vol. I, tab 2.

[15] FCA Reasons, para 8, vol. I, tab 4; *Offshore Banking Act* (Barbados), 1980, Cap. 325, vol. II, tab 6(A).

[16] FCA Reasons, para 8, vol. I, tab 4; *Loblaw Financial Holdings Inc v The Queen*, 2008 TCC 182 (Exhibit A-30(G), Certified Articles of Amendment, vol. IV, tab 7(F)) [Exhibit].

24. Glenhuron's constating documents restricted its business activities to "offshore banking" – defined in s. 4(1) of the *OSBA*[17] as having two elements: the receipt of foreign funds, and the use of foreign funds so received. Glenhuron's activities of receiving foreign funds (including receiving money in exchange for its shares[18]) and using the funds so received constituted the entirety of its offshore banking business.[19]

25. In 2002, the *OSBA* was repealed and replaced by the Barbados' *International Financial Services Act* ("*IFSA*").[20] Glenhuron's status became that of international bank under the IFSA, which defines international banking business in nearly identical terms to offshore banking.[21]

26. From 1993 to 2000, Glenhuron received approximately US$476 million from non-arm's length parties in exchange for shares (both preference and common) and for the assumption of interest-free loans owing to Loblaw Holdings by one of Netherlands' subsidiaries.[22] At no time did Glenhuron receive financing or funding from arm's length persons.[23]

27. With the money it received, Glenhuron conducted proprietary trading of highly mobile investments on its own account. It earned income primarily by investing in short-term paper (such as US government bonds), entering into interest rate and cross-currency swaps, making loans to US drivers for Weston bakery products, and from fees for managing investments for the Loblaw Group.[24] The objective for the short-term debt

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[17] Exhibit A-30(I), Certified Schedule 3 to the Articles of Amendment, vol. IV, tab 7(G).

[18] *Loblaw Financial Holdings Inc v The Queen*, 2008 TCC 182 (Transcript, Jones, volume 6, 1 May 2018 at 1039-1040 and 1048-1053, vol. IV, tab 7(C)) [Transcript].

[19] FCA Reasons, para 12, vol. I, tab 4; TCC Reasons, paras 153-154, vol. I, tab 2; Exhibit A-03(UU), Correspondence from Central Bank of Barbados to Glenhuron Bank, dated Dec. 19, 2011, vol. IV, tab 7(E).

[20] FCA Reasons, para 8, vol. I, tab 4; *International Financial Services Act* (Barbados), 2002, Cap. 325, s. 4(2) [*IFSA*].

[21] FCA Reasons, para 12, vol. I, tab 4; TCC Reasons, para 154, vol. I, tab 2; *IFSA*, *ibid* s 4(2).

[22] FCA Reasons, para 11, vol. I, tab 4.

[23] TCC Reasons, paras 31-32, 93, 274, vol. I, tab 2.

[24] TCC Reasons, paras 31-32, 93, 274, vol. I, tab 2.

securities was encapsulated by a Glenhuron employee as "to make as much money as possible for Mr. Weston."[25]

28. Glenhuron was liquidated in 2013 to provide Loblaw Holdings with approximately $1 billion to use in the purchase of Shoppers Drug Mart.[26]

29. During the years in issue, Glenhuron's capital was comprised of its share subscriptions with non-arm's length parties and retained earnings.[27]

The Tax Court's decision

30. For taxation years between 2001 and 2010, the Minister of National Revenue (the "Minister") reassessed Loblaw Holdings to include approximately $473 million of Glenhuron's income as FAPI on the basis that Glenhuron's business was an "investment business" pursuant to s. 95(1) of the *Act*, or in the alternative, that the general anti-avoidance rule ("GAAR") applied to deny Loblaw Holdings' claim that Glenhuron's income was exempt from taxation in Canada.

31. Loblaw Holdings appealed to the Tax Court, arguing that Glenhuron met the financial institution exemption to the "investment business" definition. At issue was whether Glenhuron met the conditions necessary to qualify for the exemption and, in the alternative, whether the GAAR applied to disallow Loblaw Holdings from claiming the exemption.

32. The trial judge found that the Minister's reassessments were correct – Glenhuron's business did not meet the arm's length test. As a result, Loblaw Holdings was liable for Canadian tax on Glenhuron's income from its "investment business" as FAPI.

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[25] TCC Reasons, para 93, vol. I, tab 2.

[26] FCA Reasons, para 14, vol. I, tab 4; Transcript, Berry, volume 3, 25 April 2018 at 435, ll 26-28, at 436, ll 1-7, vol. IV, tab 7(B); Transcript, Holland, volume 12, 10 May 2018 at 1972, ll 25-28 and 1973, ll 1-2, vol. IV, tab 7(D).

[27] FCA Reasons, para 18, vol. I, tab 4.

33. In concluding that Glenhuron's business was conducted principally with non-arm's length persons, the trial judge placed considerable weight on his factual finding that Glenhuron's business as a foreign bank was an "international banking business" – defined in Barbados law as the receipt and use of foreign funds.[28] The trial judge found that the receipt side of its business (funds received in exchange for shares issued to non-arm's length persons) was principally conducted with non-arm's length persons, and the use side of the business was conducted with input from its parent and related companies and without competing in the market.[29] Glenhuron's business was to earn money on its own money – money that was given to it by related parties.

34. The trial judge found Loblaw Holdings met the other technical requirements of the exemption. With regard to the GAAR, the judge stated, in *obiter*, that the transactions gave rise to a tax benefit that was abusive, but – he found that avoiding FAPI was one of the three purposes for entering the relevant series of transactions. This purpose was outweighed by the other two commercial purposes.[30]

The Federal Court of Appeal's decision

35. The only issues before the FCA were the trial judge's legal interpretation of the arm's length test, and his conclusion that Glenhuron's business was conducted principally with non-arm's length persons.

36. The FCA overturned the Tax Court's decision on the basis that it had erred in law in its interpretation of the arm's length test. Central to its analysis were the following conclusions:

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[28] The financial institution exemption from the "investment business" definition applies to a "foreign bank" as defined in s. 95(1) of the *Act*, which in turn refers to the definition of "foreign bank" in s. 2 of the *Bank Act*, SC 1991, c 46. The trial judge found Glenhuron was a foreign bank within the meaning of s. 2(a) of the *Bank Act* and, based on expert testimony, a bank according to the laws of Barbados (TCC Reasons, paras 202-04).

[29] TCC Reasons, paras 209-10, 238-48, vol. I, tab 2.

[30] TCC Reasons, para 307-08, vol. I, tab 2.

a. a formal, institutional approach should be taken to define a banking business, and such approach does not require a receipt of funds analysis for the purposes of the FAPI rules;[31]

b. whether an affiliate competes for business in a foreign market is not relevant for purposes of the arm's length test;[32] and

c. the "investment business" definition contains a gap for Parliament to fill because the very target of the definition – an investment portfolio held offshore – is exempted in this case.[33]

On this last point, the Court's adopted view of the objective of the FAPI regime, and the exemption in particular, was as a system intended to encourage Canadians to carry on active business outside Canada.[34]

PART II – QUESTIONS IN ISSUE

37. The only question in issue is whether the proposed appeal raises one or more matters of public importance such that this Court should grant leave to appeal.

38. This Court's articulation of the correct approach to the interpretation of the provisions within the FAPI regime such as the definition of "investment business", including the purpose of the FAPI regime in general, is needed to ensure that the regime's anti-avoidance purpose is not disregarded. This is an issue of public importance.

PART III – ARGUMENT

The FAPI regime's anti-avoidance purpose is an issue of public importance

39. In an era of heightened awareness of international tax avoidance, the FCA's transformation of this anti-avoidance regime, which targets the use of foreign

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[31] FCA Reasons, paras 53-57, vol. I, tab 4.
[32] FCA Reasons, para 58-60, vol. I, tab 4.
[33] FCA Reasons, para 86, vol. I, tab 4.
[34] FCA Reasons, para 73, vol. I, tab 4.

subsidiaries as a means to avoid Canadian tax, into an incentive to carry out proprietary investments abroad is an affront to Canadian taxpayers and undermines Canada's ability to protect its tax base.

40. In the words of Justice Bowman of the Tax Court of Canada (as he then was), the objective of the FAPI rules is, "to discourage Canadians from parking investments in offshore companies (usually tax havens), or, if they did, at least to require them to pay taxes currently on the income so generated..."[35] These offshore investments are highly mobile in that they have no real connection to the location in which they are made.

41. According to the modern approach to statutory interpretation, words of an act are to be interpreted in accordance with its text, context and purpose.[36] The FCA's flawed understanding of the purpose of the FAPI rules will constitute the basis for interpreting the myriad complex provisions implementing the FAPI rules.

42. Although the FCA makes passing reference to the anti-avoidance purpose of the FAPI rules, in its substantive analysis it found that the "fundamental purpose" of the FAPI rules is to apply only to passive income and that the FAPI scheme, and in particular the exception for regulated financial institutions, is intended to encourage Canadians to carry on active business outside Canada.[37]

43. The definition of "investment business" is also a core concept within the FAPI Rules and the FCA's decision will have an important impact beyond the foreign bank context. The exemption at issue applies not only to foreign banks but also to other types of businesses (such as: trust companies, credit unions, insurance corporations and traders or dealers in securities or commodities) and activities (such as: the development of real property for sale, the lending of money, the leasing or licensing of property, and the insurance or

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[35] *Trans World Oil & Gas Ltd v Canada* (1994), 95 DTC 260, [1995] 1 CTC 2087 (TCC) at para 34, vol. II, tab 6(C), aff'd [1998] 3 CTC 37 (FCA).

[36] *Canada Trustco Mortgage Co v Canada*, [2005] 2 SCR 601, 2005 SCC 54 [*Canada Trustco (2005)*]; *Placer Dome Canada Ltd v Ontario (Minister of Finance)*, [2006] 1 SCR 715, 2006 SCC 20 [*Placer Dome*].

[37] FCA Reasons, paras 19, 48, and 73, vol. I, tab 4.

reinsurance of risks).[38] The arm's length test is applicable across all of these businesses carried on by the foreign affiliate that seeks to rely on the exemption.

44. Often, these subsidiaries act as treasury centres for the multi-national group. Their function is to receive the group's surplus cash and invest it in highly liquid low risk investments to earn interest or dividend income in low tax jurisdictions. While the nature of the income earned is interest or dividends, these subsidiaries typically are actively engaged in the management of these portfolio investments. However, the activities of these subsidiaries are propriety in nature and the concern about capital import neutrality does not arise.

45. The CRA estimates that, together with the respondent's case, there are ongoing audits and objections in respect of 14 Canadian multinational corporate groups, representing a total amount of tax at risk of $1.181 billion that involve the arm's length issue. This sum includes amounts assessed or assessable under federal and provincial *Income Tax Acts*.[39]

The FCA's decision disregarded the anti-avoidance purpose of the FAPI rules

46. The FCA's findings as to the purpose of the FAPI provisions limit their application to what the FCA describes as "passive income", which disregards their broader anti-avoidance function. In doing so, the FCA disregards the broader anti-avoidance function of the FAPI regime, which is to prevent the avoidance of tax from profits on highly-mobile investments, regardless of whether they would otherwise be viewed as "passive income". This is a fundamental error, the effects of which could reach far beyond the financial instution exemption, as described above.

47. The "active – passive dichotomy" is an anachronism, harkening back to the period before the 1995 overhaul of the FAPI rules. The 1995 amendments to the *Act* – which included defining "investment business", "active business", "income from an active business" and

[38] *Act*, s 95(1) "investment business".
[39] Affidavit of Jim Randall, para. 5, vol. IV, tab 7(A).

"income from property"[40] – were Parliament's reaction to perceived abuses of the existing rules, and Court decisions which set too low a bar with respect to the amount of activity required to distinguish between active and passive income.[41] This low threshold was inconsistent with the goal of the FAPI regime, which is to prevent tax avoidance and the resultant erosion of the tax base caused by Canadians parking investments in offshore companies located in low tax jurisdictions.

48. These definitions were intended to remove a distinction between offshore investment portfolios and actively-managed offshore investment portfolios. By clarifying that profits on highly-mobile capital earned by a foreign affiliate in a businesslike manner were nevertheless subject to FAPI, the "investment business" definition in particular was aimed at ensuring that the capital import and export neutralities would apply in accordance with the objectives of the *Act*.[42]

49. The FCA's decision glosses over the role of purpose and context in statutory interpretation and relies largely on a strict literal approach that reverts back to the pre-*Canada Trustco (2005)* era where taxing statutes were interpreted strictly in accordance with the text without consideration of context or purpose.[43] This approach is at odds with the FCA's other recent decision in respect of the FAPI regime, *Barejo Holdings*, that decided the narrow issue of whether a financial instrument qualified as debt for the purpose of s. 94.1 of the *Act.*[44] In *Barejo Holdings*, the FCA acknowledged the purpose of the FAPI regime, and gave due regard to its fundamental objective: capital export

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[40] *Amending Act*, *supra* note 7, s 46(3) "investment business", "active business", "income from an active business" and "income from property".

[41] Canada, Parliament, House of Commons, Standing Committee on Public Accounts, "Twelfth Report" in *Minutes of Proceedings and Evidence*, 34th Parl, 3d Sess, No 48 (22 April 1993) at 48:6-48:7; Robert J Dart and David G Broadhurst, "Foreign Affiliates: Proposed Amendments" (1994) 42:4 *Canadian Tax Journal* 1115-1127 at 1115-1117; and Sandra E Jack, "The 1994 Amendments to the Foreign Affiliate Rules", *Report of Proceedings of Forty-Sixth Tax Conference* (Toronto: Canadian Tax Foundation, 1995) at 26:9 and 26:13, vol. III, tab 6(J).

[42] Li, Cockfield & Wilkie, *International Taxation*, *supra* note 8 at 322-23, vol. II, tab 6(F).

[43] *Canada Trustco (2005)*, *supra* note 36.

[44] *Barejo Holdings ULC v Canada*, 2020 FCA 47 at paras 86-87, leave to appeal sought, Court File No. 39147.

neutrality, i.e., taxing capital appreciation in a similar way whether it results from Canadian or foreign investments. The result in *Loblaw*[45] is a conflicting contemporaneous decision from the FCA as to the purpose of the FAPI regime.

50. These conflicting decisions produce an incoherent approach to the interpretation of these provisions going forward. The Courts must interpret legislation in accordance with its purpose, regardless of the length or complexity of a statute.[46] The *Loblaw* decision creates a precedent for the Courts to continue to disregard the anti-avoidance purpose of the FAPI regime. This could hinder the Government's ability to achieve its policy goals within the regime.

51. It is well recognized that the Government uses the *Act* to raise tax funds to cover government expenses while also functioning as a tool of economic and social policy.[47] Parliament also uses the *Act* as a tool to prevent the erosion of the Canadian tax base through the use of offshore affiliates. Its legislation must be interpreted in accordance with its context and purpose in the forefront and not simply pursuant to a literalist textual approach.

52. These concerns are echoed in commentary from the tax community in response to the FCA's decision. In *The Arnold Report* of the Canadian Tax Foundation, Brian J. Arnold remarks that the Courts have a responsibility to interpret and apply the law in accordance with its purpose.[48] The arm's length test is clearly intended to focus on the persons with whom the affiliate carries on its business activities. The test requires a substantive approach that examines all aspects of the affiliate's business, including its relationships with customers, rather than just the income earning aspects of the business.

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[45] FCA Reasons.

[46] Brian Arnold, "Why Does a Canadian Grocery Store Chain Need a Tax Haven Bank?", *The Arnold Report, Canadian Tax Foundation* (27 May 2020), online: <http://www.ctf.ca/> [Arnold, "Tax Haven Bank"], vol. II, tab 6(E).

[47] *Québec (Communauté urbaine) v Corp Notre-Dame de Bon-Secours,* [1994] 3 SCR 3, [1995] 1 CTC 241 at para 34.

[48] Arnold, "Tax Haven Bank", *supra* note 46, vol. II, tab 6(E).

53. The Canadian Accountant, an independent news source for the accounting profession, notes that the FCA's decision is "sure to benefit shareholders" and references tax fairness advocates (Spokespersons for Canadians for Tax Fairness, and the Canadian Taxpayers' Federation) who decry the decision.[49]

54. Public concern over the consequences of the FCA decision has also been expressed outside the tax community. On the media front, newspapers such as the National Post and the Chronicle Herald express concern over a lack of adequate measures for the taxation of corporations that avoid taxation in Canada by taking their money offshore.[50]

The FCA erred in relying on *Canadian Pioneer*

55. The FCA's focus on interpreting the conduct of "banking business" is out of place. The FCA relies on this Court's decision in *Canadian Pioneer*[51] for the maxim that the business of banking depends on formal factors, such as a license to use the term "bank" in the name of the entity, rather than substantive factors, such as the actual activities conducted. *Canadian Pioneer* is a constitutional case involving a dispute about the federal government's power to legislate with respect to banking in Canada, and was irrelevant to the issue in this case.

56. Reliance on *Canadian Pioneer* led the FCA to elide the substantive requirements of the financial institution exemption, which go beyond the question of what the business is to ask how the business is conducted. The conditions for the financial institution exemption include the requirements that the business of a foreign affiliate be conducted principally with arm's length persons, that the business be carried on as a financial institution (for example, a foreign bank or insurance company), and that the activities of the business be

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[49] "Loblaw wins appeal of $368 million Tax Court of Canada case", *Canadian Accountant* (26 April 2020), online: <http://www.canadian-accountant.com/>.

[50] Peter J Thompson, "Court of Appeal sides with Loblaw in $368 million tax case involving Barbados bank", *National Post* (27 May 2020), online: <https://nationalpost.com/>.

[51] *Canadian Pioneer Management Ltd v Labour Relations Board of Saskatchewan* (1979), [1980] 1 SCR 433, 107 DLR (3d) 1 [*Canadian Pioneer*].

regulated under the laws of the countries in which it carries on business. These are separate conditions.

57. A formal, institutional approach may be appropriate in interpreting the second and third conditions, but such an approach is inappropriate for the arm's length test, which is intended to focus on the persons with whom the affiliate conducts its business activities. The arm's length test is not satisfied by a formal institutional approach; it requires a substantive approach, which examines all aspects of the affiliate's business. By looking only to the form of the entity as a regulated foreign bank, the FCA effectively guts the arm's length requirement.

58. The FCA falls further into error by concluding that the activities, and particularly the receipt side of a foreign bank's business, are irrelevant. If Parliament intended that the test only capture the income earning aspects of the business, it would have drafted the provision to refer to income of the business, such as by stating "other than a business the *income of which* is derived principally from non-arm's length persons" (emphasis added).[52]

The FCA's decision leads to absurdity

59. The FCA's literal reading of the arm's length test leads to the absurd interpretation that the exclusion applies to banks that only take capital from related entities and invest it for their own account principally in highly liquid low risk investments.[53]

60. The FCA recognized that the very target of the legislation would escape the taxation net, and yet attributed the result to a legislative gap. This Court instructed in *Placer Dome* that the Courts should resist the temptation to conclude that there is a legislative gap where the literal reading of a provision's text does not appear to match the purpose of the legislation.[54]

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[52] Arnold, "Tax Haven Bank", *supra* note 46, vol. II, tab 6(E).

[53] Arnold, "Tax Haven Bank", *supra* note 46, vol. II, tab 6(E).

[54] *Placer Dome*, *supra* note 36 at paras 21-23 and 49.

61. Moreover, the FCA's interpretation violates the presumption against tautology as it ignores the distinct purpose that the arm's length test serves within the financial institution exemption. In the context of an exemption that applies only to certain types of businesses / business activities, and requires a certain level of activity, the arm's length test must necessarily advance a distinct requirement that has not already been tested by the other requirements. It requires that the foreign affiliate conduct business with persons that are external to the corporate group of which the affiliate is a member.[55]

62. This Court instructed in *Placer Dome* that every word in a statute is presumed to make sense and to have a specific role to play in advancing the legislative purpose.[56] The Courts should avoid adopting interpretations that render any portion of a statute meaningless or redundant. This proposed appeal would provide an opportunity for this Court to underline the significance of this principle.

The 2014 amendment does not cure the gap created by the FCA

63. In 2014, the Government announced an amendment to the "investment business" definition to add an additional requirement to the financial institution exemption.[57] In making the announcement, the Department of Finance stated:

> Certain Canadian taxpayers that are not financial institutions purport to qualify for the regulated foreign financial institution exception (and thus avoid Canadian tax) by establishing foreign affiliates and electing to subject those affiliates to regulation under foreign banking and financial laws. However, the main purpose of these affiliates is often to engage in proprietary activities – that is, to invest or trade in securities on their own account – and not to facilitate financial transactions for customers. It is not intended that the exception be satisfied in these circumstances.[58]

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[55] Li, Cockfield and Wilkie, *International Taxation*, *supra* note 8 at 323, vol. II, tab 6(F).

[56] *Placer Dome*, *supra* note 36 at para 45.

[57] *Economic Action Plan 2014 Act, No. 2*, SC 2014, c 39; Canada, Department of Finance, *Road to Balance: Creating Jobs and Opportunities* (Ottawa: Queen's Printer for Canada, 11 February 2014) at 343-345, [2014 Budget].

[58] 2014 Budget, *ibid* at 343.

This announcement confirmed that the exemption was not intended for entities that conduct proprietary trading on their own account. The *Act* was amended to include new subsection 95(2.11) to combat abuses by entities that were not *bona fide* financial institutions from seeking to qualify for the financial institution exemption to FAPI.

64. The new provision applies to taxation years that begin after 2014 and narrows the range of foreign affiliates who can qualify for the foreign financial institution exemption. Subsection 95(2.11) does not change the arm's length test.

65. The FCA referred to this amendment as addressing "a gap in the legislation". As the amendment did not address the arm's length test, the FCA's conclusion was incorrect. The amendment does not clarify the meaning of the words at issue in this application, but merely further limits the scope of entities who can take advantage of the exemption.

66. In introducing the enactment, Parliament did not foresee that the Courts would fail to give effect to the original purpose of the arm's length test. The FCA's interpretation has effectively gutted the application of the test by creating a legislative gap large enough to allow some of its intended targets to escape.

67. In essence, the FCA decision provides a roadmap for Canadian financial institutions to send their investments offshore while circumventing the FAPI rules. This Court's intervention is required to safeguard the integral role of the FAPI regime in anti-avoidance measures.

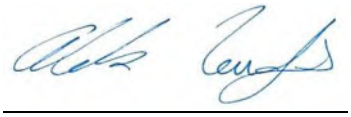
PART IV – COSTS

68. There is no reason why costs should not follow the cause in this matter.

PART V – ORDER SOUGHT

69. The applicant requests that this application for leave to appeal from the judgment of the FCA be granted with costs in the cause.

ALL OF WHICH IS RESPECTFULLY SUBMITTED THIS 19th day of June, 2020.



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PART VI – TABLE OF AUTHORITIES
(Authorities with hyperlinks)

			CITED AT PARAS
Statutory Provisions Relied On			
1. *An Act to amend the Income Tax Act, the Income Tax Application Rules and related Acts*, SC 1995, c 21			
(a) s 46(3) ("investment business", "active business", "income from an active business" and "income from property")			14, 47
2. *Bank Act*, SC 1991, c 46			
(a) s 2 ("foreign bank")	*English*	*Français*	33
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(a) s 91	*English*	*Français*	7, 13
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5. *International Financial Services Act* (Barbados), 2002, Cap. 325			
(a) s 4(2)			25
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6. *Barejo Holdings ULC v Canada*, 2020 FCA 47, leave to appeal sought, Court File No. 39147			49
7. *Canada Trustco Mortgage Co v Minister of National Revenue*, 53 DTC 5094, [1999] 2 CTC 308 (FCTD), aff'g [1991] 2 CTC 2728, 91 DTC 1312 (TCC)			14
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9. *Canadian Pioneer Management Ltd v Labour Relations Board of Saskatchewan* (1979), [1980] 1 SCR 433, 107 DLR (3d) 1			55
10. *Placer Dome Canada Ltd v Ontario (Minister of Finance)*, [2006] 1 SCR 715, 2006 SCC 20			41, 60, 62
11. *Québec (Communauté urbaine) v Corp Notre-Dame de Bon-Secours*, [1994] 3 SCR 3, [1995] 1 CTC 241			51

Government Documents

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PART VII – TABLE OF AUTHORITIES

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