

General anti-avoidance rule (GAAR)

GAAR background and proposed amendments

The GAAR allows the Canada Revenue Agency (CRA) to assess tax when a taxpayer follows the letter of the law but not its object, spirit and purpose, causing a misuse or abuse of the Income Tax Act (ITA), related regulations and application rules, or a tax treaty. Amendments to the GAAR are currently before Parliament and are expected to impact transactions occurring on or after Jan. 1, 2024.

Navigating GAAR: Understanding affected transactions

1. **Capital gains surplus strips** aim to remove funds from a corporation in a tax-efficient manner by structuring the transactions to ensure they will be taxed as capital gains instead of dividends.
2. **Internal asset bumps** entail raising the tax basis of corporate assets to potentially lower the capital gain and increase the likelihood of a capital loss upon their sale.
3. **Internal loss planning and usage** involves strategically shifting losses within a corporate group to offset profits and minimize tax liabilities. Courts are already issuing decisions denying this type of planning.
4. **Freezing an estate when utilizing a family trust** entails freezing the current value of assets for the current asset owner and then attributing all future growth in the value of those assets to persons outside the trust.
5. **Capital gains exemptions are multiplied** by an individual aiming to benefit from the lifetime capital gains exemption, which allows them to exempt a certain amount of capital gains from tax without changing the beneficial owner of the underlying assets.

Commonalities among these transactions include the use of assets and corporate attributes that exist solely for tax purposes (e.g., for tax basis or tax loss) and a person maintaining control over assets after a transaction.

Amendments at a glance for middle market businesses

Preamble. The new preamble outlines the purpose of the GAAR and will act as an interpretive tool for applying the rule. It acknowledges the need for a balance between protecting the tax base and providing taxpayers with certainty.

Avoidance transaction. This type of transaction occurs when a main goal is to gain a tax benefit. Businesses must ensure they conduct transactions with genuine economic motives to prevent potential GAAR challenges. The proposed amendments capture a broader range of transactions compared to the current GAAR.

Economic substance. Businesses must prioritize transactions with genuine economic substance and commercial purpose and avoid tax-driven arrangements. They must ensure documentation of commercial purpose in case of CRA audits regarding potential misuse or abuse of the ITA.

Penalty and reassessment period. The proposed amendments introduce a penalty of 25% of the tax benefit obtained and a three-year extension of the reassessment period, which can be avoided through disclosure as outlined in the mandatory disclosure rules discussed at right. The penalty will not be charged in respect of transactions entered into before these amendments receive royal assent.



RSM's GAAR services include:

- Risk assessment
- Dispute representation



What about the mandatory disclosure rules?

The mandatory disclosure rules (MDR) are reporting requirements intended to assist the CRA in identifying aggressive and abusive tax planning, including planning that may trigger the application of the GAAR. Disclosure under the reportable transactions section of the MDR is not an admission that the GAAR applies to that transaction, but non-compliance with that section lowers the barrier for application of the GAAR.

The government has proposed that disclosure under the reportable or notifiable transactions sections of the MDR will exempt a transaction from the GAAR penalty and reduce the extended reassessment period.