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FCA finds GAAR does not apply to post-acquisition PUC step-up planning: *Univar Holdco Canada ULC v. The Queen*, 2017 FCA 207

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On 13 October 2017, the Federal Court of Appeal (FCA) released its decision in *Univar Holdco Canada ULC v. The Queen*, 2017 FCA 207, allowing the taxpayer's appeal and concluding that the general anti-avoidance rule (GAAR) in section 245 of the *Income Tax Act* (the Act) did not apply to the transactions that created cross-border tax attributes equal to the fair market value of a Canadian target company as part of a series of transactions that included its arm's length acquisition. In so concluding, the FCA held (at para. 21) that the exception contained in subsection 212.1(4) had not been abused because "the purpose of section 212.1 of the ITA [as it applied at the time of the transactions] was not to prevent the removal from Canada, by an arm's length purchaser of a Canadian corporation, of any surplus that such Canadian corporation had accumulated prior to the acquisition of control."

Facts and judicial history

CVC Capital Properties (CVC) in 2007 purchased the shares of Univar NV, the parent corporation of a multinational group that included Univar Canada, in an arm's length acquisition. The shares of Univar Canada had a paid-up capital (PUC) of $911,729 and a fair market value (FMV) of $889,000,000. CVC undertook a series of transactions immediately following the acquisition to create cross-border attributes equal to the FMV of Univar Canada.

Briefly, this was done through the incorporation and capitalization of Univar Holdco Canada ULC (UHC) followed by the creation and unwinding of a "sandwich structure" through which UHC acquired the shares of Univar Canada in a transaction that used the exception contained in subsection 212.1(4) of the Act. In these transactions, UHC issued shares with a PUC of $302,436,000 and a promissory note in the amount of $589,262,400 to its non-resident parent without triggering any deemed dividend or PUC-grind under section 212.1. As a result, UHC's US parent company could potentially extract $891,698,400 from Univar Canada, through UHC, by repayment of the promissory note and a return of capital on UHC's shares without the incidence of Part XIII tax.

The TCC concluded that the transactions were non-arm's length transactions and that section 245 of the Act applied because the series of transactions abused the exception found in subsection 212.1(4). The TCC rejected the taxpayer's argument that it could have undertaken alternative transactions that avoided the application of section 212.1 without reliance on subsection 212.1(4) of the Act on the basis that the taxpayer "did not implement this alternative structure and in tax law, form matters" (2006 TCC 159, para. 106). The TCC's abuse analysis relied significantly on the 2016 budget amendments to subsection 212.1(4), notwithstanding that these amendments were introduced long after the transactions in issue and, indeed, after the case was argued in the Tax Court, and on a comparison with section 84.1 of the Act.

The FCA decision

The FCA found that section 212.1 was introduced to prevent a non-resident person from indirectly extracting from Canada accumulated surplus in a Canadian corporation through a non-arm's length transaction. However, section 212.1 is limited in its application as it does not apply where the shares of a Canadian corporation are sold to an arm's length purchaser.

In reviewing the abuse analysis, the FCA rejected the trial judge's determination that comparable alternative transactions were not relevant. Rather, the FCA considered that comparable transactions were relevant to the GAAR analysis in determining whether the avoidance transaction was abusive.

The alternative transactions would have involved a foreign parent incorporating a Canadian acquisition company and financing it with debt in the amount of $589,262,400 and fully paid shares in the amount of $302,436,000 (i.e., equal to the promissory note and the PUC of the shares of UHC). The Canadian acquisition company would then directly purchase the shares of Univar Canada. This would permit the Canadian acquisition company to use Univar Canada's accumulated surplus to repay the promissory note and to make a return of capital equal to the PUC of the shares without triggering any withholding tax.

The FCA could not conceive how the GAAR would have applied to these alternative transactions given that the shares of Univar Canada would have been sold to an arm's length purchaser and section 212.1 of the Act would not have applied. According to the FCA (at para. 21), the text of section 212.1 and the alternative transactions "illustrate a clear dividing line between an arm's length sale of shares and a non-arm's length sale of shares." As the alternative transactions clearly illustrate, in an arm's length transaction the non-resident purchaser could provide funds to the Canadian acquisition company to fund the purchase price for the shares of the Canadian target, and following the closing, the Canadian acquisition company could use the surplus in the Canadian target to repay the purchaser the funds that were advanced. Consequently, the purpose of section 212.1 was not to prevent the removal from Canada by an arm's length purchaser the accumulated surplus of a Canadian corporation.

The FCA found that the shares of Univar Canada were acquired in the context of an arm's length transaction because at the time of the arm's length acquisition of Univar NV by CVC, the post-acquisition transactions involving UHC were clearly contemplated. Accordingly, the transactions involving the transfer of the shares of Univar Canada to UHC formed part of the same series of transactions by which control of Univar Canada was acquired by an arm's length purchaser. Thus, the FCA concluded that the purpose of section 212.1 had not been frustrated.

In addition, the FCA reviewed the trial judge's reliance on the 2016 proposed legislative amendments to support her conclusion that the GAAR applied. The FCA rejected the TCC's reliance on *Water's Edge Village Estates (Phase II) Ltd. v. The Queen*, 2002 FCA 291, to support the relevance of subsequent legislative amendments in a GAAR analysis. In that case, the taxpayer raised the subsequent amendments to argue that the GAAR should not apply since the amendments closed a loophole. The Court there rejected the taxpayer's argument after concluding that the transactions carried out were abusive of the scheme of the Act in effect when the transactions were carried out. Thus, according to the FCA (at para. 28), the decision did not "support the proposition that subsequent amendments to the Act will necessarily reinforce or confirm that transactions that are caught by the amendments would be considered to be abusive before the amendments are enacted." Here, the FCA rejected the subsequent amendments as support for the application of GAAR because the amendments were introduced 9 years after the transactions in issue and the Minister did not satisfy the Court that the transactions "clearly" frustrated the object, spirit and purpose of section 212.1 of the Act as it was written in 2007. Indeed, as the FCA noted (at para. 23), the Technical Notes and Budget Supplementary Information to which the trial judge referred that predated the 2016 amendments only referred to non-arm's length share sales and did not identify any concern with the removal of a Canadian target corporation's corporate surplus after an arm's length sale.

The FCA also dismissed the trial judge's comparison of section 212.1 with section 84.1 of the Act because both provisions only apply to a share sale to a non-arm's length purchaser, and in addition, section 84.1 only applies to vendors other than a corporation.

Lessons learned

The decision is welcome news to taxpayers that undertook similar planning prior to the 2016 amendments to section 212.1. Although this planning is no longer available to taxpayers, the Court's consideration of the relevance of subsequent amendments and of alternative transactions in its subsection 245(4) (abusive tax avoidance) analysis may be useful in considering the application of the GAAR in future cases. Importantly, the decision re-emphasizes that the onus is on the Minister to clearly demonstrate abusive tax avoidance based on the legislation as it applied at the time of the transactions in dispute.

The Minister, if she chooses to do so, has until 12 December 2017 to seek leave to appeal the FCA decision to the SCC.

Learn more

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