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Blaney McMurtry
BARRISTERS & SOLICITORS LLP

Blaneys on Business

"For many years the Canada Revenue Agency has attempted to stem the flow of transactions designed for what they describe as 'abusive tax avoidance'."

This newsletter is designed to bring news of changes to the law, new law, interesting deals and other matters of interest to our commercial clients and friends. We hope you will find it interesting, and welcome your comments.

Feel free to contact any of the lawyers who wrote or are quoted in these articles for more information, or call the head of our Corporate/Commercial group, Alex Mesbur at 416.593.3949 or amesbur@blaney.com.

TAXPAYERS REJOICE – AVOIDANCE IS STILL LEGIT

Paul L. Schnier

For many years the Canada Revenue Agency ("Revenue Canada") has attempted to stem the flow of transactions designed for what they describe as "abusive tax avoidance". These tax avoidance schemes have taken many forms, from tax shelters which have been created almost entirely for the purpose of producing tax deductions to large corporate transactions undertaken primarily (but not solely) to reduce taxes. All along, Revenue Canada has sought to defeat tax avoidance structures through the Courts. These attempts yielded few satisfactory results so, in 1988, the general anti-avoidance rule (GAAR) was introduced. Under the GAAR, Revenue Canada is entitled to characterize a transaction as an "avoidance transaction", which allows it to ignore the effects of specific provisions of the *Income Tax Act* and determine the tax consequences which those in Ottawa believe are appropriate. It took a while, but the Supreme Court of Canada has finally pronounced on the GAAR in two cases released very recently.

The first case, *Canada Trustco Mortgage Company v. The Queen*, involved a large sale-leaseback transaction. This form of transaction is a common one in which a corporation (the "lessor") acquires depreciable assets so that it may claim capital cost allowance as a deduction, and immediately leases these assets to another party. The main difference in the Canada Trustco case was that the lessor received a significant upfront cash payment on the lease, thereby almost entirely eliminating their risk.

The second case, *Mathew et. al. v. The Queen*, was more of a traditional tax shelter arrangement where taxpayers acquired interests in a partnership which sustained a significant tax loss (but not a cash loss) on a mortgage portfolio.

In its decisions, the Supreme Court of Canada referred to the legislation and pointed out that three elements must be present before the GAAR can apply:

1. there is a resulting "tax benefit", which is defined as a reduction, avoidance or deferral of tax;

2. the transaction is not arranged primarily for purposes other than to obtain the tax benefit; and

3. there was abusive tax avoidance.

This latter element is often referred to as the "object and spirit" test. In both of these cases, the first two elements were acknowledged so that the Court's decision was confined to a

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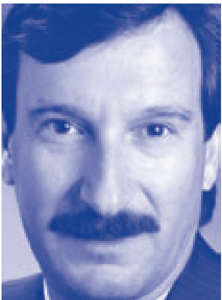

Paul L. Schnier chairs Blaney McMurtry's tax group. He restricts his practice to income tax law with emphasis on tax planning and implementation and advising as to the tax consequences of proposed transactions. He has advised a variety of public and private corporations on numerous domestic and international undertakings.

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determination of whether or not there was abusive tax avoidance.

Without going into the intricacies of the Supreme Court's decisions, the Court held in favour of Canada Trustco (the sale leaseback transaction) and against Mathew (the mortgage loss transaction). Commentators will be analysing these decisions at great length in order to pinpoint the fine line which is crossed when a transaction becomes abusive. However, we have a simple test: if a transaction is designed simply to produce a paper loss, it will likely not be successful, whereas if there is a real commercial transaction (albeit with an associated tax benefit), it is much more likely to be successful even if the tax benefit is the main purpose of the transaction.

The bottom line is that tax avoidance is still alive and well.

NEW ONTARIO LAW REQUIRES BUSINESSES TO MAKE FULLER DISCLOSURE ABOUT TERMS AND CONDITIONS OF CREDIT THEY EXTEND TO CUSTOMERS

Faithlyn Hemmings

If you run a business in Ontario that extends credit to customers, beware of new provincial law that substantially broadens your disclosure obligations regarding the terms and conditions of that credit.

The new law, the provincial *Consumer Protection Act, 2002* and its Regulations, took effect during the summer and it means that, if you haven't already, you would be well advised to carefully review:

- the initial disclosure statement that you give to your credit customers to ensure that it contains all the information now prescribed by the CPA and the Regulations, and
- your standard forms, consumer agreements and business practices to ensure that you are in compliance with the new legislation.

The new CPA essentially consolidates six core consumer protection laws – *Business Practices Act, Consumer Protection Act*, *Loan Brokers Act*, *Motor Vehicle Repair Act*, *Prepaid Services Act*, and the *Consumer Protection Bureau Act*.

In the process, it expands consumer rights and entitlements and, in the area of credit agreements, introduces new disclosure requirements that lenders must make to borrowers. This includes the disclosure of any brokerage fees that the borrower may have to pay either directly or indirectly.

As was the case under previous consumer legislation, lenders must provide borrowers with an initial disclosure statement that sets out specific information, depending on whether the credit being extended is for a fixed amount of money or amounts that can vary, such as in lines of credit.

Under the Regulations, there are some 21 information items that a lender must disclose to borrowers when extending fixed credit and 17 information items that must be disclosed to a borrower when extending open credit.

Some of the key new disclosure requirements for fixed credit that must be stated in the initial disclosure statement include:

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- The interest rate the borrower is obliged to pay and whether that rate is subject to change during the course of the agreement, (i) the initial interest rate, (ii) the manner of determining the interest rate payable at any time during the term of the agreement, and (iii) unless the amounts of the scheduled payment is adjusted to account for changes in the interest rates, the lowest interest rate at which the scheduled payment would *not* cover the interest that would accrue between consecutive scheduled payments based on the initial outstanding balance.

- The date on which interest begins to accrue under the credit agreement.

- Details with respect to grace periods.

- Details of any optional services (e.g. insurance) including the charge, the borrowers' right to terminate the optional service and the manner of exercising that right.

- Prepayment rights, charges and penalties.

- Default charges.

Some of the key new disclosure requirements for open credit that must be stated in the initial disclosure statement include:

- The date on which interest begins to accrue under the credit agreement.

- In the case of an agreement for a credit card, the manner in which interest is calculated.

- Details with respect to grace periods.

- Details of any optional services including the charge, the borrowers' right to terminate the optional service and the manner of exercising that right.

- Each period for which a statement of account will be delivered to the borrower.

- Default charges.

- The amount that the borrower will be charged in connection with the credit agreement in respect of, (i) the cost of searching vehicle records under the *Highway Traffic Act* in order to confirm the ownership or vehicle identification number of a vehicle, and the cost of obtaining the statements, or certified copy of a statement, containing information from the vehicle records.

If the borrower puts up personal property as security for the borrower's indebtedness under the credit agreement, the law also obliges the lender to describe the property that will be subject to the security interest. In addition, the lender must disclose the amounts that the borrower will be charged, as of the time that the disclosure statement is delivered, in respect of:

- the costs of professional services (e.g. appraisals) obtained for the purpose of confirming value, condition, location or conformity to law of the property,

- the cost of insurance of the property,

- the cost of registering a financing statement or financing change statement,

- the cost of registering in the land title registry system and notice of security interest, an

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extension notice or a certificate to discharge or partially discharge a notice of security interest, and

- the cost of searching or obtaining information from the land title registry system in relation to the security interest given by the borrower.

Remember however, that in addition to the new disclosure requirements, there are pre-existing disclosures that must be made. For fixed credit, these disclosure requirements include:

- The total of the advances to be made.
- The cost of borrowing.
- The interest rate payable under the agreement.
- The length of the term of the credit agreement.

For open credit, these disclosure requirements include:

- The initial credit limit.
- The minimum payment the borrower is required to make for each period or, if the minimum payment cannot be determined at the time of disclosure, the manner of determining the minimum payment.
- The annual rate of interest payable by the borrower and, if the rate of interest payable may change during the term of the credit agreement, the initial rate of interest payable and the manner of determining the annual rate of interest at any time during the term of the agreement.
- Each period for which a statement of account will be delivered to the borrower.

Given all of this, as we said at the outset, businesses that extend credit should carefully review their initial disclosure statement to ensure that it contains the information prescribed by the CPA and the Regulations. Additionally, these businesses should review their standard forms, consumer agreements and business practices to ensure compliance with the CPA and the Regulations. ■

WE ARE PLEASED TO ANNOUNCE

James Leech has joined the firm's Corporate/Commercial Group.

James completed his Law degree in 2004 at the University of Western Ontario, articled with Blaney McMurtry, and returned to the firm upon his call to the Bar in 2005.

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Blaneys on Business is a publication of the Business Law Department of Blaney McMurtry LLP. The information contained in this newsletter is intended to provide information and comment, in a general fashion, about recent cases and related practice points of interest. The information and views expressed are not intended to provide legal advice. For specific legal advice, please contact us.

We welcome your comments. Address changes, mailing instructions or requests for additional copies should be directed to Chris Jones at 416 593.7221 ext. 3030 or by email to cjones@blaney.com. Legal questions should be addressed to the specified author.

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