

Case Comment: Antle Of Trusts and Shams

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On October 21, 2010, the Federal Court of Appeal rendered its decision (2010 FCA 280) in respect of the appeal by John Antle from his loss at the Tax Court of Canada (2009 TCC 465, CarswellNat 2792).

The case involved individual Canadians who attempted to use an offshore trust to obtain a tax benefit. Assessments were issued against the offshore trust and John Antle and were heard on common evidence.

It was an ambitious plan. The transaction before the court involved a Canadian resident husband who purported to transfer shares in a Canadian corporation to a trust resident in Barbados. The plan was to structure the trust as a spousal trust so that theoretically the transfer could occur on a rollover basis for Canadian income tax purposes. The offshore trust would then sell the shares to the wife at fair market value for a note. The wife would then sell the shares to a third party purchaser, and pay off the note to the offshore trust. The offshore trust would make a distribution of capital to the wife of the note proceeds, again theoretically so that the wife could receive that distribution of capital on a tax-free basis. Since Barbados does not tax capital gains, no tax would be paid on any of the transactions.

The taxpayers argued at the Tax Court of Canada that the trust, as a resident of Barbados, was entitled to rely on the exemption from Canadian income tax in respect of the gain on the sale of the shares pursuant to Article XIV(4) of the Canada-Barbados Income Tax Convention. The Crown did not dispute the contention that the trust was resident in Barbados. Rather, it raised a number of arguments regarding whether the trust had been validly constituted. After reviewing the evidence, Justice Miller of the Tax Court of Canada accepted the Crown's contention that the trust had never been settled so it never came into being. That being the case, the disposition of the shares to the third party purchaser was held to have been undertaken by the husband and the assessment against him for Canadian income tax on the capital gain was upheld.

That should have been the end of the matter but Justice Miller went on to provide a lengthy analysis of whether the general anti-avoidance rule (GAAR) could be applied, and whether the transactions constituted a sham. He concluded in obiter that GAAR was applicable to stop the husband from using the spousal rollover and the provisions of the Barbados treaty in an attempt to circumvent Canadian capital gains tax. Justice Miller also expressed the opinion in obiter that the trust was nevertheless not a sham.

The sole basis argued on behalf of the taxpayers at the Federal Court of Appeal was that the decision of the Tax Court of Canada was incorrect because it was based on "circumstances external to the trust deed". This was a somewhat surprising argument as one of the critical certainties that must be met to support the creation of a valid trust is certainty of intention. The Court of Appeal very quickly disposed of this argument citing several decisions in support of the proposition that "intention is determined by all of the evidence" including the conduct and the activities of the parties.

Justice Noël in rendering the decision for the Federal Court of Appeal agreed that the trust had never been properly constituted since, by admission, it was never the husband/settlor's intention to relinquish control of or discretion over the shares to the trustee.

While the finding that the trust had not been constituted was sufficient to dispose of the appeal, Justice Noël felt that it would be useful to address the trial judge's obiter opinion that the trust was not a sham.

The Court of Appeal took issue with the trial judge's finding that where the parties had "some legitimacy" to think the trustee had discretion over the shares, that was sufficient to conclude that there was no sham because it displaced the prerequisite element of intentional deception required to find a sham.

The Court of Appeal examined the factual findings made by the trial judge that demonstrated that the settlor and trustee "gave the false impression of the rights and obligations created between them". The Court of Appeal concluded the trial judge was bound to hold that the trust was a sham based upon those findings.

The Court of Appeal did not cite the ubiquitous quote from *Snook v. London West Riding Investments Ltd.* [1967] 1 All ER 518 at 528 that a sham constitutes:

acts done or documents executed by the parties to the sham which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create.

Rather the Court of Appeal effectively summarized that classic definition in concluding that to have a sham "it suffices that the parties to a transaction present it as being different from what they know it to be". That is sufficient to satisfy the element of intentional deception in the context of "sham".

This very concise description by the Federal Court of Appeal provides welcome guidance on the factual underpinnings necessary to support the application of the sham doctrine in Canadian tax law.

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