

# Tax Memo

## Important Supreme Court Ruling on GAAR — Highlights

The Supreme Court of Canada (SCC) released its decision in **Jordan B. Lipson, Earl Lipson v. The Queen**<sup>1</sup> today. In a split decision, a majority ruled that the General Anti-Avoidance Rule (GAAR) in section 245 of the *Income Tax Act* (the Act) applied to a series of transactions that (unless the GAAR applied) had the result of allowing a taxpayer to deduct interest on a loan that was used, indirectly, to fund the purchase of a home.

This *Tax Memo* provides an overview of the **Lipson** case. PricewaterhouseCoopers will issue a more comprehensive *Tax Memo* shortly.

### What Happened?

Mr. Lipson and his spouse required \$562,500 of financing to acquire a home from an arm's length vendor. They engaged in the following transactions:

- Mrs. Lipson borrowed \$562,500 (the first loan) from a bank and used the funds to acquire shares of a family investment company (LipsonCo) from her husband for their fair market value;
- Mr. Lipson used the proceeds from the share sale to purchase the home; and
- Mr. and Mrs. Lipson borrowed \$562,500 from the bank (the second loan), secured by a mortgage on their new home, to repay the first loan.

On the sale of the shares to his spouse, Mr. Lipson did not elect out of the automatic rollover that applies on the transfer of property to a spouse. As a result:

- Mr. Lipson did not realize a capital gain on the sale to his spouse;
- under the "attribution rules" in the Act, any income or loss of the spouse relating to the shares (i.e., taxable dividends less interest expense) was treated as income or loss of Mr. Lipson; and
- in years in which the interest expense (deductible under paragraph 20(1)(c) of the Act) exceeded the dividends on the shares, the resulting loss was attributed to Mr. Lipson, as was any net dividend income in any year in which the dividends exceeded the interest expense.

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<sup>1</sup> **Jordan B. Lipson** and **Earl Lipson** are two appeals with essentially the same issues and facts. Jordan B. Lipson has agreed to abide by the result of the courts decisions in **Earl Lipson**, which is discussed in this *Tax Memo*.

## The Minister's Position

The Minister of National Revenue (Minister) applied GAAR to the transactions to disallow the interest expense in the hands of Mr. Lipson. The Minister and the taxpayer agreed that these were avoidance transactions, but disagreed on whether they resulted in a misuse or abuse as contemplated by GAAR.

## Lower Court Decisions

The Minister was successful in both the Tax Court of Canada (2006 DTC 2687) and the Federal Court of Appeal (2007 DTC 5172).

## Supreme Court of Canada Decision

The majority judgment (4 judges) found that the transactions in which Mrs. Lipson borrowed to buy shares of LipsonCo and obtained an interest deduction were not abusive, in and of themselves. However, to use the attribution rules in the Act to obtain the result that Mr. Lipson could deduct the interest expense was a misuse of those rules. Two separate dissenting opinions were delivered.

## For More Information

For more information on the implications of this decision, see our upcoming comprehensive *Tax Memo* on this case, "Important Supreme Court Ruling on GAAR — Reflections," and contact your Wilson and Partners or PricewaterhouseCoopers adviser:

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