



SUPREME COURT OF CANADA

CITATION: Canada v. Loblaw
Financial Holdings Inc., 2021
SCC 51

APPEAL HEARD: May 13, 2021
JUDGMENT RENDERED:
December 3, 2021
DOCKET: 39220

BETWEEN:

Her Majesty The Queen
Appellant

and

Loblaw Financial Holdings Inc.
Respondent

- and -

Attorney General of Ontario and Canadian Bankers' Association
Intervenors

CORAM: Wagner C.J. and Moldaver, Karakatsanis, Côté, Brown, Martin and
Kasirer JJ.

**REASONS FOR
JUDGMENT:** Côté J. (Wagner C.J. and Moldaver, Karakatsanis, Brown,
(paras. 1 to 75) Martin and Kasirer JJ. concurring)

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Her Majesty The Queen

Appellant

v.

Loblaw Financial Holdings Inc.

Respondent

and

**Attorney General of Ontario and
Canadian Bankers' Association**

Interveners

Indexed as: Canada v. Loblaw Financial Holdings Inc.

2021 SCC 51

File No.: 39220.

2021: May 13; 2021: December 3.

Present: Wagner C.J. and Moldaver, Karakatsanis, Côté, Brown, Martin and Kasirer JJ.

ON APPEAL FROM THE FEDERAL COURT OF APPEAL

*Taxation — Income tax — Assessment — Foreign accrual property income
— Financial institution exception — Arm's length requirement — Conducting business
— Canadian corporate taxpayer not including income earned by foreign subsidiary in*

Canadian tax return for several taxation years — Taxpayer claiming foreign subsidiary's activities covered by financial institution exception to rules for foreign accrual property income — Tax Court holding that exception does not apply because foreign subsidiary dealing principally with non-arm's length persons — Whether foreign subsidiary's business conducted principally with persons with whom it deals at arm's length — Whether parent corporation's injection of capital or corporate oversight relevant to arm's length test — Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.), s. 95(1) "investment business".

In 1992, Loblaw Financial Holdings Inc. ("Loblaw Financial"), a Canadian corporation, incorporated a subsidiary in Barbados. The Central Bank of Barbados issued a licence for the subsidiary to operate as an offshore bank named Glenhuron Bank Ltd. ("Glenhuron"). Between 1992 and 2000, important capital investments in Glenhuron were made by Loblaw Financial and affiliated companies ("Loblaw Group"). In 2013, Glenhuron was dissolved, and its assets were liquidated.

For the 2001, 2002, 2003, 2004, 2005, 2008 and 2010 taxation years, Loblaw Financial did not include income earned by Glenhuron in its Canadian tax returns as foreign accrual property income ("FAPI"). Under the FAPI regime in the *Income Tax Act* ("ITA"), Canadian taxpayers must include income earned by their controlled foreign affiliates ("CFAs") in their Canadian annual tax returns on an accrual basis if this income qualifies as FAPI. However, financial institutions that meet specific requirements benefit from an exception to the FAPI rules found in the definition of

“investment business” at s. 95(1) of the *ITA*. The financial institution exception is available where the following requirements are met: (1) the CFA must be a foreign bank or another financial institution listed in the exception provision; (2) its activities must be regulated under foreign law; (3) the CFA must employ more than five full-time employees in the active conduct of its business; and (4) its business must be conducted principally with persons with whom it deals at arm’s length.

Loblaw Financial claimed that Glenhuron’s activities were covered by the financial institution exception to the FAPI rules. The Minister disagreed with Loblaw Financial and reassessed it on the basis that the income earned by Glenhuron during the years in issue was FAPI. Loblaw Financial objected and appealed the reassessments. The Tax Court held that the financial institution exception did not apply, as Glenhuron’s business was conducted principally with non-arm’s length persons. In reaching its decision, the court considered the scope of Glenhuron’s relevant business, looking at its receipt of funds and use of funds. It included in its analysis all receipts of funds indiscriminately, treating capital injections by shareholders and lenders like any other receipt of funds. The Tax Court also viewed Glenhuron’s use of funds as the management of an investment portfolio on the Loblaw Group’s behalf and regarded the influence of the Loblaw Group’s central management as pervading the conduct of business because of the Loblaw Group’s close oversight of Glenhuron’s investment activities.

The Federal Court of Appeal disagreed with the Tax Court's interpretation of the arm's length requirement and with its analysis based on receipt and use of funds. It held that only Glenhuron's income-earning activities had to be considered. It also found that direction, support, and oversight by the Loblaw Group should not have been considered, because these interactions are not income-earning activities and thus do not amount to conducting business with the CFA. It concluded that Glenhuron was dealing principally with arm's length persons, and that Loblaw Financial was entitled to the benefit of the financial institution exception and did not need to include Glenhuron's income as FAPI. It referred the reassessments back to the Minister for reconsideration.

Held: The appeal should be dismissed.

Loblaw Financial was entitled to rely on the financial institution exception set out in s. 95(1) of the *ITA*. When the precise words of the arm's length requirement — “the business (other than any business conducted principally with persons with whom the affiliate does not deal at arm's length)” — are interpreted in accordance with the ordinary rules of statutory interpretation, it is clear that they do not encompass an assessment of capital contributions or corporate oversight. If capital and corporate oversight are excluded from consideration, Glenhuron's investment business activities were conducted principally with arm's length persons.

A parent corporation does not conduct business with its CFA when it provides capital and exercises corporate oversight. An ordinary and grammatical reading of the words “business conducted” conveys a different meaning than the word

“business” alone. The addition of the verb “conducted” emphasizes Parliament’s intent to focus on the active carrying out of business rather than on the establishment of prerequisite conditions that enable a foreign affiliate to conduct business. Raising capital is a necessary part of any business, and capital enables business to be conducted; but one would not generally speak of capitalization itself as the conduct of the business. The Court has repeatedly affirmed that there is a distinction between capitalization and the conduct of a business. The banking context does not change anything. There is undoubtedly a distinction between receiving funds from depositors and receiving funds from shareholders — depositors are clients of the bank, for whom the bank provides the services associated with holding their funds; shareholders are not.

The context of the FAPI regime confirms this reading. The entire function of the regime is to classify a foreign affiliate’s income. The financial institution exception to the definition of “investment business” and its arm’s length requirement are tied to this same function: identifying income for inclusion in FAPI. It thus makes considerable sense that Parliament intended these determinations to focus on activities more directly related to income generation than to capitalization, the distinction between income and capital being well established in tax law. The FAPI regime also shows why considering capitalization as part of conducting business for the purposes of the financial institution exception would create practical problems. The FAPI regime does not provide a method for assigning capital to the different businesses within a single corporation. Interpreting “business conducted” to include the capitalization of the business would make it necessary to somehow divide the debt and equity from

various sources (some arm's length and some not) and then assign the ensuing quotient to the various businesses conducted by a foreign affiliate. Parliament's failure to provide a method for distributing capital suggests that it did not have capital in mind. A further practical difficulty arises when considering the receipt of corporate capital in relation to newly formed CFAs. Since the Canadian parent will have provided some capital to set up the CFA, in most cases, this means that the CFA will fail the test in its early years when it is trying to build a customer base, because the ratio of corporate capital to other business receipts will likely be high. If taxpayers are to act with any degree of certainty, then full effect should be given to Parliament's precise and unequivocal words. The grammatical and ordinary meaning of the words "business conducted", read in the context and light of the purpose of the FAPI regime, clearly shows that Parliament did not intend capital injections to be considered.

Furthermore, there is no basis in the text, context or purpose of the arm's length requirement to support the Tax Court's consideration of corporate oversight as part of conducting business. Fundamentally, a corporation is separate from its shareholders. Its business may be conducted using money provided by shareholders or in accordance with policies adopted by the board of directors on behalf of the shareholders, but this does not change the fact that the corporation remains the party conducting business. Treating oversight by a parent corporation as shifting the responsibility for conducting business is also incompatible with the rest of the FAPI regime. The regime applies only where there is a *controlled* foreign affiliate. If there is

a CFA, there is necessarily corporate oversight by its parent. Parliament does not speak in vain; it would not have added an arm's length requirement if it could never be met.

Once corporate oversight and the capital investments received by Glenhuron are excluded, only Glenhuron's investment activities remain part of the business that is relevant for the application of the arm's length requirement. The most lucrative of those activities undertaken by Glenhuron were conducted at arm's length, amounting to at least 86 percent of its income during the years in issue. On the non-arm's length, Glenhuron's combined activities do not reach the "principally" threshold. The arm's length requirement was therefore met during the years in issue.

Cases Cited

Referred to: *Inland Revenue Commissioners v. Westminster (Duke of)*, [1936] A.C. 1; *Canadian Pioneer Management Ltd. v. Labour Relations Board of Saskatchewan*, [1980] 1 S.C.R. 433; *Smith v. Anderson* (1880), 15 Ch. D. 247; *Bennett & White Construction Co. v. Minister of National Revenue*, [1949] S.C.R. 287; *CIT Group Securities (Canada) Inc. v. The Queen*, 2016 TCC 163, [2016] 6 C.T.C. 2013; *Housen v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235; *Michel v. Graydon*, 2020 SCC 24; *Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54, [2005] 2 S.C.R. 601; *Placer Dome Canada Ltd. v. Ontario (Minister of Finance)*, 2006 SCC 20, [2006] 1 S.C.R. 715; *Tip Top Tailors Ltd. v. Minister of National Revenue*, [1957] S.C.R. 703; *Montreal Coke and Manufacturing Co. v. Minister of National Revenue*, [1944] A.C. 126; *R. v. Ulybel Enterprises Ltd.*, 2001 SCC 56, [2001] 2 S.C.R. 867; *R. v. Cole*, 2012

SCC 53, [2012] 3 S.C.R. 34; *R. v. Vu*, 2013 SCC 60, [2013] 3 S.C.R. 657; *R. v. Friesen*, 2020 SCC 9.

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International Financial Services Act, L.R.O. 2007, c. 325, s. 4(2) “international banking business”.

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APPEAL from a judgment of the Federal Court of Appeal (Woods, Laskin and Mactavish JJ.A), 2020 FCA 79, [2020] 3 F.C.R. 481, [2020] 4 C.T.C. 1, 2020 D.T.C. 5040, [2020] F.C.J. No. 511 (QL), 2020 CarswellNat 1300 (WL Can.), setting aside a decision of Miller J., 2018 TCC 182, [2019] 2 C.T.C. 2001, 2018 D.T.C. 1128, [2018] T.C.J. No. 136 (QL), 2018 CarswellNat 5099 (WL Can.). Appeal dismissed.

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The judgment of the Court was delivered by

CÔTÉ J. —

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I. Introduction

[1] This case concerns the foreign accrual property income (“FAPI”) regime under the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (“*ITA*”).¹ In essence, this regime provides that Canadian taxpayers, like the respondent Loblaw Financial Holdings Inc. (“Loblaw Financial”), must include income earned by their controlled foreign affiliates (“CFAs”) in their Canadian annual tax returns on an accrual basis if

¹ The relevant sections are reproduced in an appendix to these reasons.

this income qualifies as FAPI. However, financial institutions that meet specific requirements benefit from an exception found in the definition of “investment business” at s. 95(1) of the *ITA*. One of these requirements is that the CFA must conduct its business principally with persons with whom it deals at arm’s length, also called the “arm’s length requirement”. Only this requirement is at issue in this appeal.

[2] The FAPI regime is one of the most complicated statutory regimes in Canadian law. Although it has come before us after several years of diligent work by sophisticated auditors and legal counsel, the question in this appeal is remarkably straightforward. Does a parent corporation conduct business with its CFA when it provides capital and exercises corporate oversight? In my respectful view, the answer is an equally straightforward no.

[3] I wish to emphasize from the start that while the tenor of the Crown’s submissions is that Loblaw Financial has engaged in tax avoidance, the Crown did not raise any argument based on the general anti-avoidance rule (“GAAR”) before this Court. We are tasked only with interpreting the precise words of the arm’s length requirement — “the business (other than any business conducted principally with persons with whom the affiliate does not deal at arm’s length)” — found in the financial institution exception, in accordance with the ordinary rules of statutory interpretation. When these words are read in their grammatical and ordinary sense, in harmony with their context and the *ITA*’s objects, it becomes clear that they do not encompass an assessment of capital contributions or corporate oversight.

[4] If capital and corporate oversight are excluded from consideration, the vast majority of business was conducted between Loblaw Financial's foreign affiliate and persons with whom it was dealing at arm's length. Therefore, Loblaw Financial can avail itself of the financial institution exception. Given the text, context and purpose of the provision at issue, there is no reason for a court to deny Loblaw Financial the ability to arrange its affairs so as to minimize its tax payable. As Lord Tomlin famously said:

Every man is entitled, if he can, to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax.

(Inland Revenue Commissioners v. Westminster (Duke of), [1936] A.C. 1 (H.L.), at pp. 19-20).

II. Background

[5] Loblaw Financial is a Canadian corporation and an indirect wholly-owned subsidiary of Loblaw Companies Ltd., a Canadian public corporation controlled by George Weston Ltd. Loblaw Companies Ltd., George Weston Ltd., and their subsidiaries ("Loblaw Group") deal with one another on a non-arm's length basis.

[6] In 1992, Loblaw Financial incorporated a subsidiary in Barbados, Loblaw Inc. The Central Bank of Barbados issued a licence to Loblaw Inc. to operate as an offshore bank under Barbados' *Off-shore Banking Act*, L.R.O. 1985, c. 325 ("*Barbados OSBA*"), later replaced by the *International Financial Services Act*, L.R.O.

2007, c. 325 (“*Barbados IFSA*”). Loblaw Inc. was then renamed Glenhuron Bank Limited (“Glenhuron”) and was regulated by the Central Bank of Barbados. Glenhuron’s activities were required to be limited to those falling within the definition of “international banking business” in s. 4(2) of the *Barbados IFSA*.

[7] Between 1992 and 2000, the Loblaw Group made important capital investments in Glenhuron. Loblaw Financial injected nearly \$500 million by subscribing to shares, and a Dutch subsidiary invested \$142 million by subscribing to shares and \$133 million by providing interest-free loans.

[8] Glenhuron’s activities can be broken down into the following lines of business: (1) short-term debt securities; (2) asset management for a fee; (3) intercorporate loans; (4) independent operator loans; (5) interest rate and cross-currency swaps; and (6) equity forwards. Every party with assets under management by Glenhuron was related to it, except Waterman Insurance Inc. Nonetheless, many of Glenhuron’s lines of business involved investments with third parties. For example, Glenhuron bought most of its short-term debt securities from Salomon Brothers, Merrill Lynch, and Citibank. It entered into swaps agreements with other financial institutions as well (e.g., UBS, JP Morgan, Gen Re, and ABN AMRO). Moreover, these investments in short-term debt securities and these swaps agreements involving third parties were the most lucrative of its activities by far — representing at least 86 percent of its total income during the years in issue — and mobilized the largest proportion of its assets.

[9] Due to the success of its financial activities, Glenhuron was able to grow its asset base, primarily through an increase in its retained earnings from approximately \$100 million at the end of the 2000 taxation year to approximately \$700 million at the end of the 2010 taxation year. Its share capital remained stable during that period, decreasing from \$476 million to \$443 million following capital distributions and further injections.

[10] In 2013, Glenhuron was dissolved, and its assets were liquidated to provide Loblaw Companies Ltd. with funds for a major acquisition.

[11] The dispute between Loblaw Financial and the Crown concerns the application of the FAPI regime to the income earned by Loblaw Financial's foreign subsidiary Glenhuron. During the years in issue, Loblaw Financial did not include income earned by Glenhuron in its Canadian tax returns as FAPI. It claimed that Glenhuron's activities were covered by the financial institution exception to the FAPI rules, found in the definition of "investment business" at s. 95(1) of the *ITA*, so that Glenhuron's income could not be characterized as FAPI. As I will explain in further detail below, four requirements must be met for this exception to apply: (1) the CFA must be a foreign bank or another financial institution listed in the exception provision; (2) its activities must be regulated under foreign law; (3) the CFA must employ more than five full-time employees in the active conduct of its business; and (4) its business must be conducted principally with persons with whom it deals at arm's length.

[12] The Minister of National Revenue disagreed with Loblaw Financial. In 2015, the Minister thus reassessed Loblaw Financial for the 2001, 2002, 2003, 2004, 2005, 2008, and 2010 taxation years on the basis that the income earned by Glenhuron was FAPI. The following amounts were added as income realized by Loblaw Financial from its shares in Glenhuron:

Loblaw Financial Taxation Year	FAPI Reassessed (CAN Dollars)
2001	\$84,145,457
2002	\$95,522,133
2003	\$63,898,088
2004	\$43,602,018
2005	\$43,468,016
2008	\$128,948,511
2010	\$13,838,390

(2018 TCC 182, [2019] 2 C.T.C. 2001, at para. 145)

[13] Shortly thereafter, Loblaw Financial filed a notice of objection and then appealed the reassessments to the Tax Court of Canada.

III. Decisions Below

A. *Tax Court of Canada, 2018 TCC 182, [2019] 2 C.T.C. 2001 (Miller J.)*

[14] The first issue before the Tax Court was whether the financial institution exception applied during the years in issue. If so, Glenhuron's income would not need to be included as FAPI in Loblaw Financial's taxable income. The second issue was whether the GAAR precluded Loblaw Financial from availing itself of the exception.

[15] On the first issue, the Tax Court judge held that the financial institution exception did not apply. Although Glenhuron was a regulated foreign bank with more than five full-time employees, its business was conducted principally with non-arm's length persons. Therefore, only three of the four requirements were satisfied.

[16] In order to apply the arm's length requirement, the Tax Court judge first had to determine the scope of Glenhuron's relevant business. To do so, he relied on the definition of "international banking business" under Barbadian law. Pursuant to that definition, he saw Glenhuron's business as a Barbados international bank as being comprised of two basic elements: (1) the receipt of funds; and (2) the use of funds. In order to determine how these two elements fit within the arm's length test, the Tax Court judge turned to the purpose underlying the arm's length requirement. He found that the requirement is aimed primarily at promoting competition between foreign affiliates and other businesses in their respective foreign markets. Given this purpose, the judge opined that the *receipt side* should be given greater weight in the analysis, because this is the side of a banking business that involves the highest measure of competitiveness.

[17] On the receipt side, the Tax Court judge found that Glenhuron was overwhelmingly dealing with non-arm's length persons. In his analysis, he included all receipts of funds indiscriminately, thereby treating capital injections by shareholders and lenders like any other receipt of funds. As such, the judge compared the funds received from Waterman Insurance Inc. (the only arm's length person on the receipt

side) to the totality of assets under Glenhuron's management, including funds received from shareholders and lenders, and retained earnings reinvested by Glenhuron. He found that the funds received from arm's length persons were a mere drop in the ocean: never more than \$18 million a year in comparison to assets under management ranging from \$175 million to \$1.2 billion.

[18] On the use side, the Tax Court judge also found that Glenhuron was principally dealing with non-arm's length persons. First, he viewed Glenhuron's use of funds as, in essence, the management of an investment portfolio on the Loblaw Group's behalf, with the objective of making "as much money as possible for Mr. Weston" and for Loblaw (paras. 242 and 246). Second, he regarded the influence of the Loblaw Group's central management as "pervad[ing] the conduct of business" because of the Group's close oversight of Glenhuron's investment activities via derivative policies, regular reporting requirements, and regular attendance at board meetings (para. 247).

[19] Because Glenhuron was dealing principally with non-arm's length persons on both sides, the Tax Court judge held that the financial institution exception was not available. Therefore, Glenhuron's income derived from its investment business had to be included in Loblaw Financial's taxable income as FAPI for the years in issue, and the judge upheld the Minister's determination on that basis.

[20] The Tax Court judge also analyzed in *obiter* the second issue and held that the GAAR did not apply because Glenhuron's incorporation, name change, and licence renewals were not a series of avoidance transactions.

B. *Federal Court of Appeal, 2020 FCA 79, [2020] 3 F.C.R. 481 (Woods, Laskin and Mactavish J.J.A.)*

[21] Loblaw Financial appealed the Tax Court judge's decision pertaining to the arm's length requirement. For its part, the Crown did not cross-appeal the judge's findings on the other three requirements of the financial institution exception. Nor did the Crown challenge his decision about the GAAR. Therefore, the sole issue before the Federal Court of Appeal concerned the arm's length requirement.

[22] The Federal Court of Appeal disagreed with the Tax Court judge's interpretation of the arm's length requirement. According to the unanimous panel, the Tax Court judge's starting point was incorrect. The Federal Court of Appeal referred to this Court's decision in *Canadian Pioneer Management Ltd. v. Labour Relations Board of Saskatchewan*, [1980] 1 S.C.R. 433, as rejecting any substantive approach to defining "banking business" and as mandating a formal, institutional approach instead. Pursuant to that formal approach, what matters is whether the institution represents itself as a bank and is formally considered as such, not what specific activities are conducted in practice. The Federal Court of Appeal was therefore of the opinion that the Tax Court judge should not have relied on the Barbados statutory definition of "international banking business" describing the business of a bank as comprising two aspects — the receipt and use of funds.

[23] In passing, the Federal Court of Appeal also criticized the Tax Court judge's reliance on the purpose of fostering international competition in order to give

greater weight to the receipt of funds, describing it as an inappropriate reliance on “an unexpressed legislative intent” that had no place in the interpretation of a scheme “drafted with mind-numbing detail” (para. 58).

[24] Thus, the Court of Appeal preferred to rely on the traditional definition of “business” used in tax matters instead. That definition provides that “business” designates the activities that “occup[y] the time and attention and labour of a man for the purpose of profit” (para. 82, quoting *Smith v. Anderson* (1880), 15 Ch. D. 247 (C.A.), at p. 258, and referring to s. 248(1) “business” of the *ITA*). It followed that only Glenhuron’s income-earning activities had to be considered.

[25] The Federal Court of Appeal added that direction, support, and oversight by the parent corporation should not have been considered by the Tax Court judge, because these interactions are not income-earning activities and thus do not amount to “conducting business with” the CFA. Moreover, capital investments made by the Loblaw Group were not part of Glenhuron’s business as they did not occupy Glenhuron’s time and attention in any meaningful way. Their exclusion was “consistent with long-standing jurisprudence which draws a distinction between ‘capital to enable [people] to conduct their enterprises’ and ‘the activities by which they earn their income’” (para. 85, quoting *Bennett & White Construction Co. v. Minister of National Revenue*, [1949] S.C.R. 287, at p. 298 (text in brackets in original)).

[26] Having determined the scope of the business that must be considered for the purposes of the arm’s length requirement, the Federal Court of Appeal then

analyzed Glenhuron's income-earning activities and found that Glenhuron was dealing principally with arm's length persons. Indeed, short-term debt securities, cross-currency swaps, and interest swaps — all activities conducted with arm's length persons — were the most lucrative activities undertaken by Glenhuron and those in which most of its assets were invested. Therefore, Loblaw Financial was entitled to the benefit of the financial institution exception and did not need to include Glenhuron's income as FAPI. The only exception was the fee income earned from managing investments for non-arm's length persons, which the parties had conceded was FAPI as it was deemed by s. 95(2)(b) to be income from a "business other than an active business". For these reasons, the court allowed the appeal and referred the reassessments back to the Minister for reconsideration on the basis that only the fee income earned by Glenhuron from its management of Loblaw Group's assets was FAPI.

IV. Issue

[27] In this appeal, the sole issue is whether Glenhuron conducted business principally with persons with whom it was dealing at arm's length during the taxation years in issue. If it did, Loblaw Financial can avail itself of the financial institution exception, and the portion of Glenhuron's income that is not caught by s. 95(2)(b)(i) will not be FAPI. Since there is no dispute as to the activities carried on by Glenhuron, the appeal boils down to what it means to conduct business, a narrow question of statutory interpretation.

V. Analysis

A. *FAPI Regime*

[28] The FAPI regime is regarded as one of the most complex tax schemes, with hundreds of definitions, rules, and exceptions that shift regularly. Given this complexity, I will limit myself to a broad description of this regime, and some intricate subtleties will be omitted in the process.

[29] Some Canadian taxpayers find it more attractive to park their passive investments in low-tax jurisdictions and earn income there through non-resident corporations, rather than to earn investment income directly in Canada and be subject to higher taxes (N. Pantaleo and M. Smart, “International Considerations”, in H. Kerr, K. McKenzie and J. Mintz, eds., *Tax Policy in Canada* (2012), 12:1, at p. 12:14). The FAPI regime seeks to remove this advantage by requiring Canadian taxpayers to include, as income from their shares, certain types of income earned by their CFAs² in their annual tax returns in Canada on an accrual basis (s. 91(1) of the *ITA*; B. Holmes and I. Gamble, *The Foreign Affiliate Rules* (2020), at p. 81). The *ITA* provides, however, for several mechanisms to prevent double taxation (e.g., ss. 91(4) and 91(5)).

[30] Because FAPI is calculated on an accrual basis, the regime creates an exception to the deferral approach to the taxation of shareholders. Shareholders do not

² See the definitions of “controlled foreign affiliate” and “foreign affiliate” in s. 95(1) of the *ITA*.

ordinarily pay tax on income earned by the corporation whose shares they own until this income is distributed as dividends. Under the FAPI regime, however, shareholders are taxed on the undistributed income earned by their CFAs as it is earned. They are thus denied the benefit of deferral (V. Krishna, *Halsbury's Laws of Canada: Income Tax (International)* (2019 Reissue), at HTI-15).

[31] Importantly, the FAPI regime does not apply to all types of income. Broadly speaking, the *ITA* considers passive income (e.g., dividends, interests, royalties, and capital gains) to be FAPI and active income not to be FAPI. The interplay between the principle of capital export neutrality and the protection of the competitiveness of Canadian businesses operating internationally explains this distinction (Office of the Auditor General, *Report of the Auditor General of Canada to the House of Commons, 1992* (1992), at pp. 51-52). Capital export neutrality seeks to make “[i]nvestors . . . pay the same rate of tax on income from foreign investment as on income from domestic investment” (Pantaleo and Smart, at p. 12:25). As a consequence, taxpayers face neither an advantage nor a disadvantage in investing locally or abroad, as the two are fiscally equivalent. If this principle were applied absolutely, however, it would cripple the competitiveness of Canadian businesses and weaken Canada’s economic prosperity. Indeed, imposing an extra layer of Canadian taxes in addition to foreign taxes on Canadian corporations conducting business abroad could place them at a competitive disadvantage in comparison to other foreign corporations paying only local, foreign taxes (Department of Finance, *Tax Measures: Supplementary Information* (1994), at p. 33).

[32] However, this distinction between active and passive income is not watertight, with certain active income considered to be FAPI and certain passive income excluded (Pantaleo and Smart, at pp. 12:11 and 12:13). Moreover, the *ITA* provides detailed definitions of types of income, whose meaning may sometimes differ from their ordinary meaning (Holmes and Gamble, at p. 187). It is therefore crucial to focus the analysis on the specific requirements that apply under the relevant definitions and exclusions to determine whether income is FAPI (*CIT Group Securities (Canada) Inc. v. The Queen*, 2016 TCC 163, [2016] 6 C.T.C. 2013, at para. 89).

[33] FAPI encompasses four broad categories of income earned by CFAs: (1) income from property; (2) income from a business other than an active business; (3) income from a non-qualifying business; and (4) taxable capital gains realized on the disposition of non-excluded property (s. 95(1) “foreign accrual property income”). The relevant categories here are the first two.

[34] The category of “income from a business other than an active business” covers any business that is deemed by s. 95(2) not to be active (s. 95(1) “income from an active business”). The only relevant deeming provision here is s. 95(2)(b)(i), which deems the provision of services to related entities for a fee to be a separate business and the income derived from that business to be FAPI. Managing assets of related entities for a fee would be captured by this rule (s. 95(3)). The purpose of this deeming provision is “to eliminate any tax advantage that might otherwise be obtained by (i) having a foreign affiliate provide services to a Canadian business, thereby shifting

a portion of the business's profits to another jurisdiction, or (ii) having one foreign affiliate provide services to another foreign affiliate that earns FAPI, thereby reducing the FAPI" (Holmes and Gamble, at p. 274).

[35] The main category at issue in this appeal is "income from property", which includes a CFA's income from an investment business (s. 95(1) "income from property"). The definition of "investment business" was added in 1995 amendments to the FAPI regime. Prior to the amendments, the distinction between active and passive income was left to the courts to define, a situation that was criticized in a 1992 Auditor General Report as providing "no reasonable assurance that the [FAPI] rules will apply in all circumstances where they should" (Office of the Auditor General, at pp. 48-49). Parliament responded by introducing the concept of "investment business", the income from which would be included in income from property. What constitutes an investment business is defined broadly, encompassing any "business carried on by the affiliate . . . the principal purpose of which is to derive income from property (including interest, dividends, rents, royalties or any similar returns or substitutes therefor)" (s. 95(1), definition of "investment business").

[36] Parliament created safe harbours or exceptions to this broad definition of "investment business", including the financial institution exception at issue in this appeal. As I will discuss further below, Parliament must have been aware, however, that treating all income earned from an investment business carried on by a CFA as FAPI risked crippling the international competitiveness of Canadian financial

institutions. Therefore, Parliament enacted the financial institution exception to exclude investment income realized by a CFA that is a financial institution from FAPI, provided that the following requirements are met:

1. Type of financial institution: The CFA carries on business as a foreign bank, a trust company, a credit union, an insurance corporation, or a trader or dealer in securities or commodities.
2. Oversight by a regulatory body: The CFA's activities are regulated under foreign law.
3. Threshold level of activity: The CFA employs more than five full-time employees or the equivalent thereof in the active conduct of the business.
4. Arm's length requirement: The CFA's business is not "conducted principally with persons with whom the [CFA] does not deal at arm's length".

(s. 95(1), definition of "investment business")

[37] When these four requirements are met, the income from the investment business retains its character as active business income and is therefore not FAPI. However, satisfying these four requirements may not always be sufficient to avail oneself of the financial institution exception. Where the CFA is a regulated financial

institution and carries on a business the principal purpose of which is to derive income from trading or dealing in indebtedness, the income derived from these activities is deemed to be income from property and thus FAPI, *unless* the Canadian taxpayer is a financial institution resident in Canada or the parent or subsidiary of such a Canadian financial institution (s. 95(2)(1)(iv); see J. Yeung, “Trading or Dealing in Indebtedness Offshore: Paragraph 95(2)(1) Revisited” (2011), 59 *Can. Tax J.* 85, at pp. 89-90). In effect, only CFAs related to Canadian financial institutions are permitted to deal in indebtedness without attracting the FAPI rules.

[38] In 2014, Parliament revisited the financial institution exception and preferred to toughen its requirements instead of repealing it (s. 95(2.11); see Holmes and Gamble, at pp. 1361-65). The condition that the taxpayer be a Canadian financial institution, or be related to such an institution, that was applicable only when the CFA was trading or dealing in indebtedness was extended to every case where a taxpayer invokes the exception. Additionally, the Canadian financial institution must either (1) have a minimum of \$2 billion in equity, or (2) have more than 50 percent of its taxable capital employed in Canada in business activities regulated by a financial authority. This amendment limits access to the exception to taxpayers that are heavily involved in financial affairs, thereby excluding those for whom it is mostly a side business. However, these amendments were not retroactive and do not apply to this case.

[39] It is not disputed that s. 95(2)(1) does not preclude Loblaw Financial from availing itself of the financial institution exception, because Loblaw Financial is the parent of a Canadian bank, the President's Choice Bank. Nor are the financial institution, oversight, and activity level requirements of that exception disputed. Therefore, this appeal concerns only the interpretation and application of the arm's length requirement under s. 95(1).

B. *Arm's Length Requirement*

(1) Introduction

[40] The dispute in this case comes down to the meaning of the phrase "business conducted principally with" within the arm's length requirement, and specifically whether providing corporate capital and exercising corporate oversight amount to conducting business with a foreign affiliate. The question of what type of activities Parliament intended to be included in determining whether a business is conducted principally with non-arm's length persons is a question of law. The standard of review is accordingly correctness (*Housen v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235).

[41] This narrow question of statutory interpretation requires us to draw upon the well-established framework that "statutory interpretation entails discerning legislative intent by examining statutory text in its entire context and in its grammatical and ordinary sense, in harmony with the statute's scheme and objects" (*Michel v. Graydon*, 2020 SCC 24, at para. 21). Where the rubber hits the road is in determining

the relative weight to be afforded to the text, context and purpose. Where the words of a statute are “precise and unequivocal”, their ordinary meaning will play a dominant role (*Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54, [2005] 2 S.C.R. 601, at para. 10). In the taxation context, a “unified textual, contextual and purposive” approach continues to apply (*Placer Dome Canada Ltd. v. Ontario (Minister of Finance)*, 2006 SCC 20, [2006] 1 S.C.R. 715, at para. 22, quoting *Canada Trustco*, at para. 47). In applying this unified approach, however, the particularity and detail of many tax provisions along with the *Duke of Westminster* principle (that taxpayers are entitled to arrange their affairs to minimize the amount of tax payable) lead us to focus carefully on the text and context in assessing the broader purpose of the scheme (*Placer Dome*, at para. 21; *Canada Trustco*, at para. 11). This approach is particularly apposite in this case, where the provision at issue is part of the highly detailed and precise FAPI regime. I must emphasize again that this is not a case involving a general anti-avoidance rule. The provision at issue is part of an exception to the definition of “investment business” within the highly intricate, highly defined FAPI regime. If taxpayers are to act with any degree of certainty under such a regime, then full effect should be given to Parliament’s precise and unequivocal words.

[42] Indeed, we are concerned here with whether Glenhuron’s business (other than its business of managing assets for non-arm’s length persons) met the conditions of the financial institution exception. As mentioned above, this exception is found in the definition of “investment business” at s. 95(1) of the *ITA*:

investment business of a foreign affiliate of a taxpayer means a business carried on by the affiliate in a taxation year (other than a business deemed by subsection 95(2) to be a business other than an active business carried on by the affiliate) the principal purpose of which is to derive income from property (including interest, dividends, rents, royalties or any similar returns or substitutes therefor), income from the insurance or reinsurance of risks, income from the factoring of trade accounts receivable, or profits from the disposition of investment property, unless it is established by the taxpayer or the affiliate that, throughout the period in the year during which the business was carried on by the affiliate,

(a) the business (other than any business conducted principally with persons with whom the affiliate does not deal at arm's length) is

(i) a business carried on by it as a foreign bank, . . . the activities of which are regulated under the laws

...

(B) of the country in which the business is principally carried on, or

...

(c) the operator employs

(i) more than five employees full time in the active conduct of the business, or

(ii) the equivalent of more than five employees full time in the active conduct of the business taking into consideration only

...

[Emphasis added.]

[43] The parties agree that the words “the business (other than any business conducted principally with persons with whom the affiliate does not deal at arm’s length)” require a court to consider with whom the affiliate conducted business and whether those persons were at arm’s length. The central issue in this appeal is whether

a parent corporation's injection of capital or corporate oversight are relevant to the arm's length test.

(2) Receipt of Equity and Debt Capital

[44] The Crown argues that the meaning of conducting business can be understood by reference to Barbadian law. Section 4(2) of the *Barbados IFSA* and s. 4 of the *Barbados OSBA* define the business of an international bank as including both the receipt of foreign funds and the use of such foreign funds to provide financial services. However, we are not concerned with Barbadian law in this case. Our task is to discern what the Parliament of Canada intended by the words "other than any business conducted principally with persons with whom the affiliate does not deal at arm's length". The Crown has failed to provide any persuasive reason why the Barbados Parliament's understanding of international banking business is in any way reflective of the Parliament of Canada's understanding of conducting business. As I said above, we must discern the Parliament of Canada's intent by examining the text of the *ITA* in its entire context and in its grammatical and ordinary sense, alongside the statute's scheme and objects.

[45] The Crown also argues that conducting business should be given a wide meaning based on s. 248 of the *ITA*, which defines "business" in broad terms as including "a profession, calling, trade, manufacture or undertaking of any kind whatever" (A.F., at para. 71). I agree that the definition of "business" in s. 248 is broad and not restricted to income-generating activities. However, we are not concerned with

the word “business” alone. In my view, an ordinary and grammatical reading of the words “business conducted” conveys a different meaning than the word “business” alone. The addition of the verb “conducted” emphasizes Parliament’s intent to focus on the active carrying out of the business rather than on the establishment of prerequisite conditions that enable a foreign affiliate to conduct business.

[46] Raising capital is a necessary part of any business, and capital enables business to be conducted. But one would not generally speak of capitalization itself as the conduct of the business. Our Court has repeatedly affirmed that there is a distinction between capitalization and the conduct of a business. As Justice Rand wrote, “[t]he capital machinery within and by means of which the business earning the income is carried on is distinct from that business itself” (*Tip Top Tailors Ltd. v. Minister of National Revenue*, [1957] S.C.R. 703, at p. 710; see also, *Bennett & White Construction Co.*, at pp. 290-92). In *Montreal Coke and Manufacturing Co. v. Minister of National Revenue*, [1944] A.C. 126 (P.C.), Lord Macmillan similarly stated: “Of course, like other business people, they must have capital to enable them to conduct their enterprises, but their financial arrangements are quite distinct from the activities by which they earn their income” (at p. 134). In fact, it would be quite unnatural to speak of a corporation as conducting business with its shareholders or lenders. A more natural reading of the phrase was provided by the Canada Revenue Agency’s (“CRA”) Rulings Directorate in 2000, when it said:

... we consider business generally to be conducted with business clients and business clients are generally persons for whom services are performed

or to whom products are sold in exchange for monetary consideration. A person who invests funds in the shares of a corporation or loans funds to the corporation is generally not considered a client of the corporation's business. [Emphasis added.]

(Foreign Affiliates — Investment Business, Ruling No. 2000-0006565, June 22, 2000)

[47] The Crown also argues that the fact that Glenhuron is a bank changes the meaning of conducting business in this context because it is part of a bank's business to accept deposits. However, I do not believe the banking context changes anything. Every corporation needs capital, not just banks. And there is undoubtedly a distinction between receiving funds from depositors and receiving funds from shareholders. Depositors are clients of the bank, for whom the bank provides the services associated with holding their funds. Shareholders are not.

[48] The context of the FAPI regime puts my reading beyond doubt since the entire function of the regime is to classify a foreign affiliate's income. In the case of business income, Parliament chose to go further, dividing a foreign affiliate's activities into separate "businesses" based on the type of income they earn. Income from certain businesses is included in FAPI, while income from others is not. However, the fact that Parliament chose to divide according to business streams does not alter the fact that, at its core, the FAPI regime remains focused on classifying income. This is why Parliament defined "investment business" as a business whose principal purpose is to "derive income from property (including interest, dividends, rents, royalties or any similar returns or substitutes therefor), income from the insurance or reinsurance of

risks, income from the factoring of trade accounts receivable, or profits from the disposition of investment property”. The financial institution exception to the definition of “investment business” and its arm’s length requirement are tied to this same function: identifying income for inclusion in FAPI. It thus makes considerable sense that Parliament intended these determinations to focus on activities more directly related to income generation than to capitalization, the distinction between income and capital being well established in tax law (V. Krishna, *Income Tax Law* (2nd ed. 2012), at pp. 80-84).

[49] The FAPI regime also shows why considering capitalization as part of conducting business for the purposes of the financial institution exception would create practical problems. The FAPI regime may divide a single foreign affiliate into multiple businesses — as it does for Glenhuron. However, the FAPI regime does not provide a method for assigning capital to the different businesses within a single corporation. If we were to interpret “business conducted” to include the capitalization of the business, it would be necessary to somehow divide the debt and equity from various sources (some arm’s length and some not) and then assign the ensuing quotient to the various businesses conducted by a foreign affiliate. Parliament’s failure to provide a method for distributing capital suggests that it did not have capital in mind. Furthermore, this is simply not how money is normally handled. Money being fungible, capital received is unlikely to be earmarked so that it becomes possible to trace back which capital investment relates to which line of business.

[50] A further practical difficulty arises when considering the receipt of corporate capital in relation to newly formed foreign affiliates. FAPI only applies to a CFA. By definition, the Canadian parent will have provided some capital to set up the CFA. In most cases, this means that the CFA will fail the test in its early years when it is trying to build a customer base, because the ratio of corporate capital to other business receipts will likely be high.

[51] Turning to the purpose of the arm's length requirement, the Crown argues that the FAPI regime is primarily a series of anti-avoidance rules that are targeted at preventing taxpayers from using CFAs resident in low-tax jurisdictions to avoid Canadian tax. While the Crown acknowledges that the financial institution exception reflects Parliament's intent not to stifle the ability of foreign subsidiaries to compete outside Canada, in the Crown's view, the purpose of the arm's length requirement remains anti-avoidance. Since nothing about Glenhuron's business activities required it to be located in Barbados, letting it fall within the financial institution exception would defeat this anti-avoidance purpose and allow Loblaw Financial to avoid FAPI that would otherwise arise.

[52] The Tax Court judge adopted a slightly different understanding of the purpose of the arm's length requirement. He found that the rationale underlying this requirement is competition, that is, ensuring that only foreign affiliates which compete in their respective foreign markets are able to avail themselves of the financial institution exception (para. 238). This focus on competition led him to emphasize

capitalization due to his understanding of the banking business as being centred around receiving funds (para. 238).

[53] The Federal Court of Appeal adopted yet another understanding of the purpose of the arm's length requirement. Rather than searching for the purpose of this requirement individually, the court considered it as one of several requirements needed to qualify for the financial institution exception. It found that, when looked at as a whole, the several requirements of the financial institution exception are designed to further the fundamental purpose of the FAPI regime, which is to apply only to passive income (para. 48).

[54] Unsurprisingly, there is no direct evidence concerning the purpose of the arm's length requirement. But all the evidence we do have points towards Parliament attempting to balance two conflicting goals by drawing the line at passive income. In the 1969 *Proposals for Tax Reform* white paper, Minister of Finance Benson recognized the need to support the ability of Canadian businesses to compete abroad by ensuring that Canada does not impose tax on a foreign subsidiary's income in addition to the tax of the source country. He simultaneously recognized the need to protect Canada's tax base by preventing possible abuse involving non-*bona fide* business operations (paras. 6.9 and 6.20-6.21).

[55] In 1992, the Department of Finance reaffirmed these two conflicting goals in response to a report by the Auditor General that expressed concern over Canada's existing legislation regarding foreign affiliates. The Department of Finance stated:

... Canada has had to struggle with two conflicting goals. The goal of economic efficiency argues for a system which preserves capital export neutrality. This is achieved when foreign source income is subject to the same effective tax rate as domestic source income, leaving taxpayers indifferent, at least from a tax perspective, as to whether they invest inside or outside of Canada. Conversely, the goal of competitiveness argues for capital import neutrality. This requires that a Canadian investing in a foreign country be subject to tax at the same effective rate as a resident of that country. From a tax perspective, this ensures a level playing field between Canadian and non-Canadian businesses operating internationally.

In a world where countries maintain different tax systems, it is impossible to achieve both capital import and capital export neutrality. Accordingly, Canada has opted for a system that ensures capital export neutrality with respect to certain types of income and capital import neutrality with respect to other types of income. Specifically, in the case of passive income (i.e., investment income such as interest, dividends and rent) the tax policy concern is that taxpayers will attempt to shelter income in tax haven countries in order to defer the payment of Canadian tax. As a result of this concern, the Income Tax Act contains what are commonly referred to as the Foreign Accrual Property Income (FAPI) rules. The FAPI rules are intended to ensure that passive income earned by certain foreign affiliates is accrued and subject to Canadian tax on a current basis (i.e., annually), thereby eliminating the potential for deferral and hence the tax incentive to shift income offshore.

Conversely, in order to preserve the international competitiveness of Canadian businesses, active business income that is earned offshore by a foreign affiliate is not required to be accrued and is subject to tax only in the foreign jurisdiction. [Emphasis added.]

(Office of the Auditor General, at pp. 51-52)

[56] Similarly, in announcing the 1995 amendments to s. 95(1) and the introduction of the “investment business” definition, the Department of Finance noted that the rules relating to foreign affiliates “seek to ensure that Canadian companies carrying on business outside Canada through their foreign affiliates are not placed at a disadvantage under the Canadian tax system vis-à-vis multinational companies based in other countries with which they have to compete”, but “[o]n the other hand, the rules

also seek to ensure that foreign affiliates cannot be used to shelter passive income, or income that has been diverted from Canada, from Canadian tax” (*Tax Measures: Supplementary Information*, at p. 33). Given these materials, I conclude that the specific provisions relating to FAPI were enacted to serve Parliament’s broader purpose of balancing capital export neutrality and the protection of the competitiveness of Canadian businesses operating abroad by targeting passive income. I have no information showing that the arm’s length requirement has a specific purpose of anti-avoidance or promotion of international competitiveness.

[57] I thus agree with the Federal Court of Appeal that to the extent that the Tax Court judge’s analysis imposed a requirement that Glenhuron compete for customers with other players in the Barbadian banking market, this was an example of inappropriately inferring an unexpressed legislative intent (para. 58).

[58] Had Parliament desired to focus more extensively on competition, it had the opportunity to say so. As the Federal Court of Appeal said, the FAPI scheme is drafted with “mind-numbing detail” (para. 58). We cannot assume that Parliament intended to include a competitiveness requirement but simply neglected to express its intent textually, especially when it has done so elsewhere in the FAPI regime. Indeed, in 1995, it enacted s. 95(2)(a.3), which provides that income derived from Canadian indebtedness and lease obligations is FAPI unless more than 90 percent of the affiliate’s gross revenue from indebtedness and lease obligations is derived from arm’s length non-Canadian sources. At the same time, Parliament also enacted an exception to

s. 95(2)(a.3). In order for this exception to apply, s. 95(2.4)(b) imposes several conditions, including both an arm's length requirement and a competition requirement. The foreign affiliate must have a "substantial market presence" in a country and "compete" with a person that is resident and likewise has a "substantial market presence" in the country.

[59] The language of s. 95(2.4)(b) reinforces that there is no reason to believe competition for customers is a necessary indicium of arm's length dealings. Pursuant to the legal maxim *expressio unius est exclusio alterius* ("to express one thing is to exclude another"), one can interpret the competition requirement of s. 95(2.4)(b) as an implied exclusion of such a requisite for the financial institution exception at s. 95(1) (*R. v. Ulybel Enterprises Ltd.*, 2001 SCC 56, [2001] 2 S.C.R. 867, at para. 42). The necessary inference to be drawn from the express language of s. 95(2.4)(b) is that Parliament chose not to include a competition element in the financial institution exception.

[60] As for the Crown's allegation that the purpose of the arm's length requirement is anti-avoidance, this similarly amounts to an attempt to create a specific anti-avoidance rule absent any expressed legislative intent. To permit this argument to succeed would require us to rewrite the legislation. In the words of McLachlin C.J. and Major J., "[w]here Parliament has specified precisely what conditions must be satisfied to achieve a particular result, it is reasonable to assume that Parliament intended that taxpayers would rely on such provisions to achieve the result they prescribe" (*Canada*

Trustco, at para. 11). It is not necessary, for the purposes of this appeal, to determine the specific purpose of the arm's length requirement. Accordingly, I will leave this issue for another day.

[61] I again reiterate that if taxpayers are to act with any degree of certainty, then full effect should be given to Parliament's precise and unequivocal words. The grammatical and ordinary meaning of the words "business conducted", read in the context and in light of the purpose of the FAPI regime, clearly shows that Parliament did not intend capital injections to be considered. Again, this is a view that the CRA itself previously shared. In a 1995 Ruling, the CRA said that the criteria for conducting business are "primarily directed at measuring sources of income, income earning activities, and the assets, etc., used in each business (i.e. the revenue side of corporate operations)" (*Foreign Affiliates — Investment Business*, Ruling No. 9509775, July 14, 1995). The CRA further stated that "the fact that a foreign affiliate receives funding to carry on its income earning activity by way of debt or equity from a related party would have little if any relevance in the determination of whether its business is carried on with persons with whom it does not deal at arm's length" (emphasis added). Similarly, in 2000, the CRA reiterated its position, stating that the relevant criteria are "directed at measuring sources of income, employee time and effort and assets used in each business and no indication is given whether or how the amount of the debt or equity or the amount of time that is spent by employees administering debt or equity associated with a business would be relevant" (Ruling No. 2000-0006565 (emphasis added)). It further noted that the aforementioned set of criteria is "in most cases, a

complete set of relevant criteria in the determination of whether a business is conducted principally with persons with whom the affiliate does not deal at arm's length and the source of a corporation's debt and equity financing would generally not be material to that determination" (emphasis added).

[62] Before moving on to consider corporate oversight, I pause here to note that even if I accepted the Crown's argument that capitalization could be said to be part of the conduct of a business, a further problem would remain. FAPI is calculated on an annual basis. In this case, capital injections into Glenhuron predate the taxation years under review. Even if capitalization were part of conducting business, it would be untenable to say that a foreign affiliate is conducting business with a lender or investor decades after receiving money from them.

(3) Corporate Oversight by a Parent

[63] The Tax Court judge found that corporate oversight of Glenhuron by its parent transformed Glenhuron's interactions with third parties into activities conducted with persons not at arm's length. In particular, he found that the Loblaw Group exercised close oversight of Glenhuron's investment activities via derivative policies, regular reporting requirements, and regular attendance at Glenhuron's board meetings. In his view, "Loblaw influence pervades the conduct of business" (para. 247).

[64] I cannot find any basis in the text, context or purpose of the arm's length requirement to support the Tax Court judge's consideration of corporate oversight as

part of conducting business. Fundamentally, a corporation is separate from its shareholders. Its business may be conducted using money provided by shareholders or in accordance with policies adopted by the board of directors on behalf of the shareholders, but this does not change the fact that the corporation remains the party conducting business. Treating oversight by a parent corporation as shifting the responsibility for conducting business is also incompatible with the rest of the FAPI regime. As discussed above, the regime applies only where there is a *controlled* foreign affiliate. If there is a CFA, there is necessarily corporate oversight by its parent. Considering whether corporate oversight has been exercised at arm's length with a CFA is asking a question to which one already knows the answer. Parliament does not speak in vain; it would not have added an arm's length requirement if it could never be met. The intervener the Canadian Bankers' Association aptly encapsulates this situation:

It is incongruous to posit that Parliament has consistently provided a safe harbour for Canada's largest multinational financial enterprises since 1995, yet intended to undermine that safe harbour if the oversight, cooperation, and coordination that is to be expected in such a group is present.

(I.F., at para. 37)

C. *Application*

[65] Since the Tax Court judge erred in his interpretation of the arm's length requirement, this Court can apply afresh the correct interpretation of this requirement to the detailed findings of fact made by the courts below, findings that the parties do

not challenge (see *R. v. Cole*, 2012 SCC 53, [2012] 3 S.C.R. 34, at para. 82; *R. v. Vu*, 2013 SCC 60, [2013] 3 S.C.R. 657, at para. 67; *R. v. Friesen*, 2020 SCC 9, at para. 27).

[66] This Court must determine whether Glenhuron’s investment business activities were conducted *principally* with arm’s length persons or with non-arm’s length persons. In 1995, the Minister of Finance suggested that the analysis should be done on a “business by business basis” in order “[t]o accommodate multiple foreign affiliate activities” (Department of Finance, *Special Report — Revised Draft Legislation and Technical Notes: Foreign Affiliates* (1995), at p. vi). However, both parties treat the relevant business as Glenhuron’s investment business taken as a *whole* rather than segmenting the analysis into the different lines of investment business conducted by Glenhuron (e.g., swaps, intercorporate loans, equity forwards). The parties also agree that this determination requires balancing all activities on both sides — arm’s length and non-arm’s length — to assess which side is more prevalent. Therefore, although a different approach could perhaps also be warranted, I will leave this question for another day when the Court has the benefit of competing arguments. My application of the arm’s length requirement will thus be based on the approach proposed by the parties.

[67] Once corporate oversight and the capital investments received by Glenhuron are excluded, only Glenhuron’s investment activities remain part of the business that is relevant for the application of the arm’s length requirement. The vast majority of these activities were conducted with arm’s length persons. Therefore, I

conclude that this requirement was met during the years in issue and that Loblaw Financial was thus entitled to rely on the financial institution exception. The appeal should be dismissed.

[68] On the arm's length side, Glenhuron invested in short-term debt securities, cross-currency swaps, and interest swaps. These were by far the most lucrative activities undertaken by Glenhuron, amounting to at least 86 percent of its income during the years in issue. The breakdown year by year is as follows:

Taxation Year	Short-term debt securities	Cross-currency and interest swaps	Total
2001	72%	21%	93%
2002	32%	54%	86%
2003	15%	73%	88%
2004	16%	70%	86%
2005	38%	55%	93%
2008	27%	66%	93%
2010	3%	92%	95%

(C.A. reasons, at Appendix A)

[69] Moreover, these activities mobilized the vast majority of Glenhuron's assets. Investments in short-term debt securities ranged from \$653 million to \$977 million and investments in swaps from \$200 million to \$1.3 billion.

[70] Glenhuron also made loans to individual truck drivers. The Federal Court of Appeal found that this part of its business was substantially conducted with both arm's length and non-arm's length parties (paras. 75-76). The loans were more of a

side business than Glenhuron's primary business. In 2001, Glenhuron acquired approximately 1,875 loans for \$86 million. These loans had been made to individual drivers to finance the purchase of rights to distribute food produced by a related U.S. corporation, Best Foods Baking Co. Glenhuron subsequently made 700 to 800 new loans per year with an average value ranging between \$40,000 and \$50,000. Another related corporation was guaranteeing about a third of the value of the loans and collecting payments on Glenhuron's behalf. The expected return of 8.5 percent on these loans was greater than what Glenhuron was making on its other activities. But given the small value of these loans, the return did not exceed \$8 million per year, whereas Glenhuron's yearly income ranged from \$44.6 million to \$88.6 million. In 2005, Glenhuron sold its loan portfolio to a related Irish company for \$106 million, but it continued to manage the portfolio on behalf of that related company until 2009. Throughout that time, only two employees were managing the portfolio; they were laid off when management was terminated in 2009.

[71] On the non-arm's length side, the Tax Court judge found that Glenhuron was involved in activities pertaining to equity forwards to purchase Loblaw shares and intercorporate loans. Combined, these activities are, however, insignificant in comparison to those involving short-term debt securities and swaps. I fail to see how they could reverse the tide and reach the "principally" threshold.

[72] Glenhuron's intercorporate loans were, like the loans to the truck drivers, a side business. In 2002, Glenhuron loaned \$325 million for 38 days to a related

corporation. It earned \$3.2 million from that loan, but this represented only 5.7 percent of its income that year. In 2008, Glenhuron loaned another related corporation \$300 million, which was repaid the same year, earning \$1.2 million. This is also insignificant compared to Glenhuron's income of \$72.7 million in 2008.

[73] Glenhuron entered into a series of equity forward contracts with a bank at arm's length, CitiBank. These contracts were, however, pegged to the shares of Loblaw Companies Ltd., a related corporation, so the Tax Court judge found these dealings not to be at arm's length. Assuming without deciding that these equity forwards are correctly classified as business conducted with persons not at arm's length, they were not significant enough to tilt the balance. Between 2003 and 2009, Glenhuron lost \$108 million in total on those contracts because the stock price of the shares peaked in 2005 and then declined. The breakdown of the losses year by year was not discussed by the courts below. During the 7 years in issue (2001, 2002, 2003, 2004, 2005, 2008, and 2010), Glenhuron earned \$415.1 million of gross operating income. Overall, this loss of \$108 million represents 20 percent of its combined losses and gains. Contrary to the intercorporate loans and the loans to the drivers, this sum is not insignificant. Nonetheless, even when combined, the equity forwards, the intercorporate loans, and the loans to the drivers do not reach the "principally" threshold.

[74] In brief, the arm's length requirement was met during the years in issue.

VI. Conclusion

[75] For the foregoing reasons, I would dismiss the appeal with costs.

Appendix

Income Tax Act, R.S.C. 1985, c. 1 (5th supp.)³

95 (1) In this subdivision,

...

investment business of a foreign affiliate of a taxpayer means a business carried on by the affiliate in a taxation year (other than a business deemed by subsection 95(2) to be a business other than an active business carried on by the affiliate) the principal purpose of which is to derive income from property (including interest, dividends, rents, royalties or any similar returns or substitutes therefor), income from the insurance or reinsurance of risks, income from the factoring of trade accounts receivable, or profits from the disposition of investment property, unless it is established by the taxpayer or the affiliate that, throughout the period in the year during which the business was carried on by the affiliate,

(a) the business (other than any business conducted principally with persons with whom the affiliate does not deal at arm's length) is

(i) a business carried on by it as a foreign bank, a trust company, a credit union, an insurance corporation or a trader or dealer in securities or commodities, the activities of which are regulated under the laws

(A) of each country in which the business is carried on through a permanent establishment (as defined by regulation) in that country and of the country under whose laws the affiliate is governed and any of exists, was (unless the affiliate was continued in any jurisdiction) formed or organized, or was last continued,

(B) of the country in which the business is principally carried on, or

(C) if the affiliate is related to a non-resident corporation, of the country under whose laws that non-resident corporation is governed and any of exists, was (unless that non-resident corporation was continued in any jurisdiction) formed or organized, or was last continued, if those regulating laws are

³ As the provisions stood at all relevant times (version in force from 2000 to 2008).

recognized under the laws of the country in which the business is principally carried on and all of those countries are members of the European Union, or

...

(b) either

(i) the affiliate (otherwise than as a member of a partnership) carries on the business (the affiliate being, in respect of those times, in that period of the year, that it so carries on the business, referred to in paragraph (c) as the *operator*), or

(ii) the affiliate carries on the business as a qualifying member of a partnership (the partnership being, in respect of those times, in that period of the year, that the affiliate so carries on the business, referred to in paragraph (c) as the *operator*), and

(c) the operator employs

(i) more than five employees full time in the active conduct of the business, or

(ii) the equivalent of more than five employees full time in the active conduct of the business taking into consideration only

(A) the services provided by employees of the operator, and

(B) the services provided outside Canada to the operator by any one or more persons each of whom is, during the time at which the services were performed by the person, an employee of

(I) a corporation related to the affiliate (otherwise than because of a right referred to in paragraph 251(5)(b)),

(II) in the case where the operator is the affiliate,

1. a corporation (referred to in this subparagraph as a *providing shareholder*) that is a qualifying shareholder of the affiliate,

2. a designated corporation in respect of the affiliate, or

3. a designated partnership in respect of the affiliate, and

(III) in the case where the operator is the partnership described in subparagraph (b)(ii),

1. any person (referred to in this subparagraph as a *providing member*) who is a qualifying member of that partnership,
2. a designated corporation in respect of the affiliate, or
3. a designated partnership in respect of the affiliate,

if the corporations referred to in subclause (B)(I) and the designated corporations, designated partnerships, providing shareholders or providing members referred to in subclauses (B)(II) and (III) receive compensation from the operator for the services provided to the operator by those employees the value of which is not less than the cost to those corporations, partnerships, shareholders or members of the compensation paid or accruing to the benefit of those employees that performed the services during the time at which the services were performed by those employees;

(2) For the purposes of this subdivision,

...

(b) the provision, by a foreign affiliate of a taxpayer, of services or of an undertaking to provide services

(i) is deemed to be a separate business, other than an active business, carried on by the affiliate, and any income from that business or that pertains to or is incident to that business is deemed to be income from a business other than an active business, to the extent that the amounts paid or payable in consideration for those services or for the undertaking to provide services

...

(B) are deductible, or can reasonably be considered to relate to an amount that is deductible, in computing the foreign accrual property income of a foreign affiliate of

(I) any taxpayer of whom the affiliate is a foreign affiliate, or

(II) another taxpayer who does not deal at arm's length with

1. the affiliate, or

2. any taxpayer of whom the affiliate is a foreign affiliate . . .

...

(I) in computing the income from property for a taxation year of a foreign affiliate of a taxpayer there shall be included the income of the affiliate for the year from a business (other than an investment business of the affiliate) the principal purpose of which is to derive income from trading or dealing in indebtedness (which for the purpose of this paragraph includes the earning of interest on indebtedness) other than

(i) indebtedness owing by persons with whom the affiliate deals at arm's length who are resident in the country in which the affiliate was formed or continued and exists and is governed and in which the business is principally carried on, or

(ii) trade accounts receivable owing by persons with whom the affiliate deals at arm's length,

unless

(iii) the business is carried on by the affiliate as a foreign bank, a trust company, a credit union, an insurance corporation or a trader or dealer in securities or commodities, the activities of which are regulated under the laws

(A) of each country in which the business is carried on through a permanent establishment (as defined by regulation) in that country and of the country under whose laws the affiliate is governed and any of exists, was (unless the affiliate was continued in any jurisdiction) formed or organized, or was last continued,

(B) of the country in which the business is principally carried on, or

(C) if the affiliate is related to a non-resident corporation, of the country under whose laws that non-resident corporation is governed and any of exists, was (unless that non-resident corporation was continued in any jurisdiction) formed or organized, or was last continued, if those regulating laws are recognized under the laws of the country in which the business is principally carried on and all of those countries are members of the European Union, and

(iv) the taxpayer is

(A) a bank, a trust company, a credit union, an insurance corporation or a trader or dealer in securities or commodities resident in Canada, the business activities of which are subject by law to the supervision of a regulating authority such as the Superintendent of Financial Institutions or a similar authority of a province,

(B) a subsidiary wholly-owned corporation of a corporation described in clause 95(2)(1)(iv)(A), or

(C) a corporation of which a corporation described in clause 95(2)(1)(iv)(A) is a subsidiary wholly-owned corporation;

[Emphasis added.]

Appeal dismissed with costs.

Solicitor for the appellant: Attorney General of Canada, Toronto.

Solicitors for the respondent: Osler, Hoskin & Harcourt, Toronto.

*Solicitor for the intervener the Attorney General of Ontario: Attorney
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