Loosely tossing around allegations of tax avoidance could imperil your credibility

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Taxes are a hot topic these days. Those who cheat the system cost the rest of us who pay what we owe, which undermines an income-tax system such as Canada’s that relies on honesty and transparency. Yet some would throw around the term “tax avoidance” a little too freely.

Recently the Dutch organization SOMO issued a report saying that Canadian miner Turquoise Hill Resources (THR) “avoided nearly $470-million in Canadian taxes” by using European subsidiaries. The accompanying media release says “[THR] reports that this arrangement was approved by Canadian authorities,” and quotes allied anti-mining activist Mining Watch Canada that “The public needs to know how and why this approval was granted.” The subsequent Globe and Mail story quotes the same Mining Watch spokesman as saying “CRA has deemed [THR’s arrangement] to be legal, and it’s depriving Canada of millions in revenue and it’s not at all clear why they would do that.”

While I can’t speak to the tax laws of the other countries mentioned in the report, having practised Canadian tax law for more than 25 years I can address whether Canadian taxes were “dodged.” Full disclosure: while I have advised many mining companies (including THR and Rio Tinto), I was not involved in whatever planning implemented the arrangement described in the SOMO report (assuming it to be accurate), which is common for Canadian corporations with operations outside Canada. I represent no one in expressing the following views, which are entirely my own and have not been approved by anyone else.

The SOMO report says THR raised capital to finance development of a mine in Mongolia belonging to a majority-owned Mongolian subsidiary (OTL), and used that money to fund a Luxembourg subsidiary (Movele), which then loaned the money to OTL. According to SOMO, what THR “should” have done is loan the money directly to OTL, resulting in THR earning interest income (not Movele) and incurring Canadian tax: not doing so “dodged” US$470-million of Canadian tax.
While reasonable people can differ about what someone’s “fair share” should be, Parliament (elected democratically by Canadians) decides – the Income Tax Act (ITA) sets out how much tax each person owes, no more and no less. The Canada Revenue Agency audits taxpayers and reassesses when it believes more is owing. The courts ultimately resolve any differences. Where someone has technically complied with rules but in a way that is not what the law intends, the CRA can apply a “general anti-avoidance rule” (GAAR).

First of all, structuring one’s affairs within the rules so as to minimize taxes is demonstrably fair game: The Supreme Court of Canada has stated clearly that (1) “taxpayers have the right to order their affairs to minimize tax payable” (Jean Coutu Group Inc. v. Canada, 2016); and (2) “Unless the Act provides otherwise, a taxpayer is entitled to be taxed based on what it actually did, not based on what it could have done, and certainly not based on what a less sophisticated taxpayer might have done.” (Shell Canada Ltd. v. Canada, 1999).

Right away then, the SOMO/Mining Watch tax-avoidance allegation rings hollow. Someone making an RRSP contribution is not a “tax dodger” just because they could have made the same investment outside their RRSP without the tax savings.

Why would the CRA deem this type of planning to be legal, Mining Watch asks? Because the CRA's job is to determine whether a taxpayer has computed taxes owing under the laws enacted by Parliament, not to make the value judgments that are Parliament’s alone to make.

What about the GAAR that applies when a taxpayer’s planning meets the letter of the law but not the object and spirit? Well, the ITA specifically exempts from Canadian tax repatriated earnings from active businesses (like mining) carried on by foreign subsidiaries in countries that have a tax treaty or similar agreement with Canada: This is foreign-source income that Canada doesn’t tax in the first place.

Moreover, the ITA has specific provisions that deliberately facilitate using a foreign subsidiary to make loans to foreign operating subsidiaries rather than making such loans directly, which is what thousands of Canadian corporations with foreign businesses do. That being so, the CRA could hardly have concluded otherwise than as they did, and THR or any similarly situated Canadian corporation can’t fairly be accused of “dodging” taxes that Canada has consciously chosen not to levy.
Does Canada have the right tax policy in this instance? Mining Watch is quoted in a Toronto Star article as asking, “What’s the incentive for Canada? If that’s considered a legitimate tax policy, then the policy needs to change.”

Well, Canada does have the right tax policy for several reasons (including putting Canadian companies on the same tax footing as their foreign competitors), and there are many benefits for Canada. For example, THR appears to have no mines or any other income-generating operations in Canada, just money-spending corporate offices that could be located anywhere. Whatever taxes (income and otherwise) they pay in Canada, and whatever they spend on TSX listing fees and on Canadian employees and Canadian service providers (accountants, bankers, lawyers, etc.) who themselves pay Canadian taxes, is all found money for Canada. That’s the incentive for Canada, and that’s why Australia, the United Kingdom and many other countries aggressively pursue these companies. They want to attract high-value-added economic activity and all of the indirect benefits (including tax revenues) that go with it, not because these companies are expected to structure foreign operations to maximize taxes in the head-office jurisdiction, where there are no income-producing assets. Every time one of these companies leaves Canada (or simply sets up elsewhere), the Canadian economy loses, and all of us have to pay more.

So then: A company that does exactly what the ITA provides for, in full compliance with the letter and the spirit of the law and with “in advance” transparent disclosure to all relevant tax authorities, gets smeared as a “tax avoider.” Reasonable people may differ, but in this case Parliament, the Supreme Court of Canada and the CRA are all on the same side of the issue.

SOMO, Mining Watch and other activists with their own agendas are welcome to their opinions, but spurious claims of “tax avoidance” unfairly tarnish others while eroding the attackers’ credibility the next time they cry wolf. As the saying goes, “When you throw mud, you get your hands dirty.”