International Tax

Report No.: 118

Date: June, 2021

A Discordant Jurisprudence: What Does it Mean to be "Acting in Concert"?

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Under the *Income Tax Act* (Canada) (the "**Act**"), taxpayers are deemed to not deal at arm's length if they are "related".[1] In all other circumstances, taxpayers will be dealing at non-arm's length ("**NAL**") where they are *factually* NAL.[2] In determining whether persons who are not related are dealing at arm's length, courts have generally held — and the Canada Revenue Agency ("**CRA**") agrees — that persons do not deal at arm's length in three circumstances:

(i) there is a common mind directing the bargain for both parties;

(ii) one party *de facto* controls the other; or

(iii) the parties are acting in concert without separate interests.[3]

Below we will briefly discuss both the directing mind test and the *de facto* control test, before examining the acting in concert test more closely. In particular, we are of the view that, while the courts and CRA may accept the acting in concert test as a separate branch of the NAL determination, the case which is commonly understood to have first pronounced this test, *Swiss Bank*, did not in fact create this test, nor was it accepted as a determinative ground by the Supreme Court of Canada ("**SCC**").[4]

Moreover, although the three tests are generally referred to as distinct, they are often combined in their application by the courts and the CRA. In *Gestion Yvan Drouin*, Justice Archambault observed that all three tests essentially lead to the same question: "[I]s there control of one party by the other? What the three tests are intended to determine is the existence of a relationship between persons who are parties to a given transaction where one of the parties exercises over the other an influence such that this other party is no longer free to participate in the transaction in an independent manner.[emphasis added]"[5]

(i) Directing Mind Test

The directing mind test was developed by the SCC in *Sheldon's Engineering.*[6] To determine whether the vendor and purchaser of depreciable property were dealing at arm's length, the Court looked to whether a single taxpayer controlled both the vendor and purchaser and was therefore the common mind dictating the terms of the bargain. This test has been subsequently relied on in numerous cases including in *Merritt Estate*, where the "common mind" principle was described as follows [emphasis added]:[7]

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1 Paragraph 251(1)(*a*). All statutory references herein are to the Act unless otherwise indicated.

2 Paragraph 251(1)(*c*).

3 *Peter Cundill & Associates Ltd v. R.* (1991), 91 D.T.C. 5085; see also *Canada v Remai*, 2009 FCA 340, *McLarty v The Queen*, 2008 SCC 26, *Alberta Printed Circuits Limited v. R.*, 2011 TCC 232 ("***Alberta Printed Circuits***") and CRA Income Tax Folio S1-F5-C1 at para 1.38.

4 *Swiss Bank Corporation et al. v. Minister of National Revenue*, [1971] CTC 427 (Ex. Ct.), aff'd. 72 DTC 6470 (SCC) ("***Swiss Bank***").

5 *Gestion Yvan Drouin Inc. v. R.,* 2001 DTC 72 (TCC) . See also *Keybrand Foods,* 2020 FCA 201 ("***Keybrand Foods***"), and *Robson Leather Company Ltd. v. MNR*, 77 DTC 5106 (FCA). ("***Robson Leather***").

6 *MNR v. Sheldon's Engineering*, 55 DTC 1110 (SCC).

7 *MNR v. Estate of T.R. Merritt*, 69 DTC 5159 (Ex. Ct.) at para 60 ("***Merritt Estate***").

> In my view, the basic premise on which this analysis is based is that, where the "mind" by which the bargaining is directed on behalf of one party to a contract is the same "mind" that directs the bargaining on behalf of the other party, it cannot be said that the parties are dealing at arm's length. In other words, where the evidence reveals that the same person was "dictating" the "terms of the bargain" on behalf of both parties, it cannot be said that the parties were dealing at arm's length.

(ii) *De Facto* Control Test

The courts have held, in certain circumstances, that excessive or constant advantage, authority, or influence can constitute *de facto* control (as opposed to *de jure*, or voting control), which may result in a determination that the parties to a transaction are not factually dealing at arm's length.[8] The issue of *de facto* control also arises under subsection 256(5.1) and the CRA has stated that it considers the criteria for the determination of whether a person is controlled within the meaning of subsection 256(5.1) to also be relevant for the interpretation of paragraph 251(1)(*c*).[9]

(iii) Acting in Concert Without Separate Interests Test

The concept of "acting in concert" has a somewhat dubious lineage when it comes to interpretation by the courts. In some instances, it has been accepted as an extension of the "common mind" test, where two or more persons act together to direct the bargaining on behalf of themselves *and* a third party. On the other hand, courts have also looked at the relationship between the two (or more) parties to determine if they are acting in concert with an element of common interest.[10] In the first case, the question of whether the parties are acting in concert is directed toward determining if they are NAL with the third party; in the second case, the question is directed toward determining if they are NAL with one another. The CRA, in a statement that is often cited

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8 See for example *Robson Leather*, *Pender Enterprises Ltd. v. MNR*, 65 DTC 5202 (Ex. Ct.), *Special Risks Holdings Inc v. R.* (1986), 86 D.T.C. 6035 (FCA), and *Lenester Sales Ltd. v. R.*, 2003 DTC 997 (TCC), aff'd. 2004 DTC 6451 (FCA).

9 See CRA Document No. 2004-0092871E5, dated December 20, 2004. See also *Alberta Printed Circuits* paras. 84-96 where the Tax Court of Canada states that the *de facto* control test (in subsection 256(5.1)) may be applied in the context of an arm's length analysis.

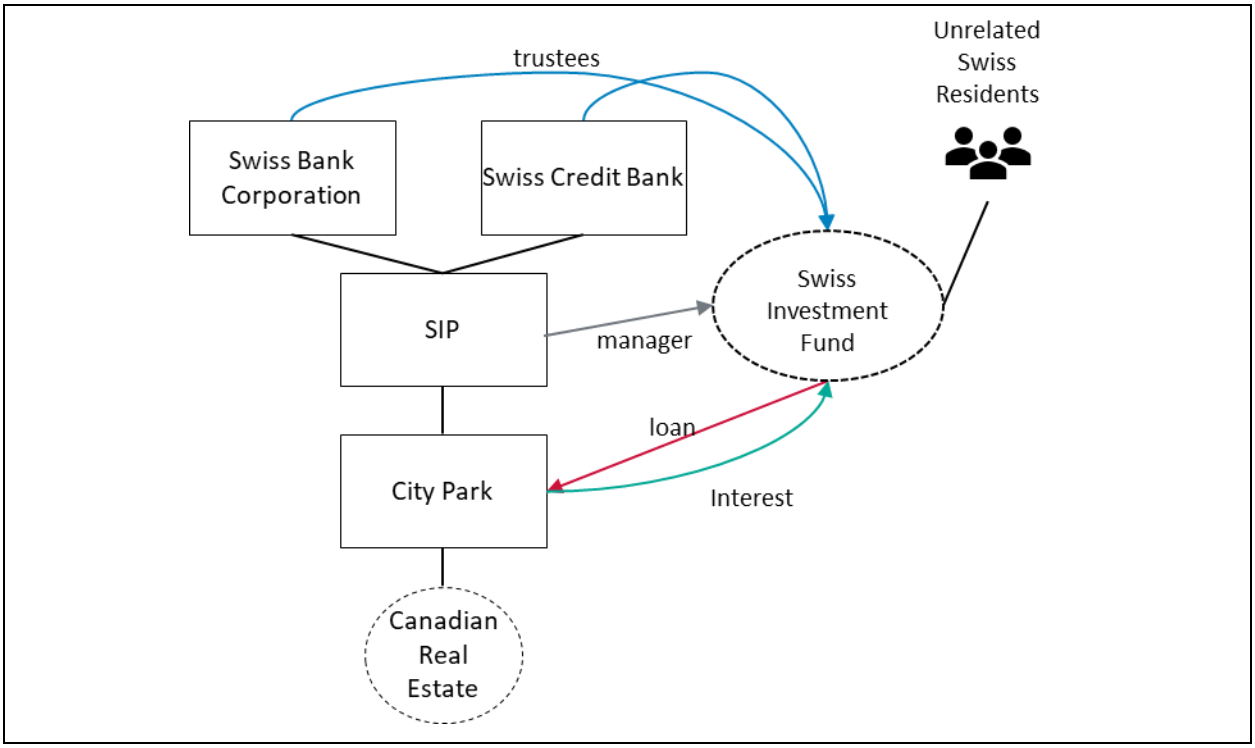
These factors, in the context of a corporation, include: (a) the percentage of ownership of voting shares (when such ownership is not more than 50 per cent) in relation to the holdings of other shareholders; (b) ownership of a large debt of a corporation which may become payable on demand (unless exempted by subsection 256(3) or (6)) or a substantial investment in retractable preferred shares; (c) shareholder agreements including the holding of a casting vote; (d) commercial or contractual relationships of the corporation (e.g., economic dependence on a single supplier or customer); (e) possession of a unique expertise that is required to operate the business; and (f) the influence that a family member, who is a shareholder, creditor, supplier, etc., of a corporation, may have over another family member who is a shareholder of the corporation. See Interpretation Bulletin IT-64R4, *Corporations, Association and Control*, dated October 13, 2004.

However, as noted in *Keybrand Foods* while there is significant overlap between situations in which a person has control in fact of a corporation (subsection 256(5.1)) and in which a person is not dealing at arm's length with that corporation, they are not the same and it would not necessarily follow that a person who is found to not be dealing at arm's length with a corporation would also be found to have control in fact of that corporation as contemplated by subsection 256(5.1).

10 This duality has been historically well noted, for example by Justice John R. Owen of the Tax Court of Canada who explains this distinction in his paper "Acting in Concert: Fact or Fiction?", *Canadian Tax Journal* (1992), Vol. 40, No. 4. See also Interpretation Bulletin IT-419, paragraph 12.

by courts, seems to adopt the second approach,[11] but it is not clear that this is a correct application of the acting in concert concept as originally formulated.

Swiss Bank is understood to be the foundational case for the "acting in concert" test.[12] In that case, two Swiss banks (Swiss Bank Corporation and Swiss Credit Bank) each owned 40% of a company (SIP) involved in the management of investment funds.[13] The two Swiss banks and SIP established a fund to invest in real estate in Canada, with SIP as manager of the fund. The fund, which was not a trust or separate legal entity but rather a form of co-ownership arrangement, issued certificates to numerous Swiss investors to raise funds, and these funds were loaned to City Park, a Canadian corporation wholly owned by SIP. City Park used the borrowed funds to construct apartment buildings.



Under clause 106(1)(*b*)(iii)(A) of the 1952 Act,[14] interest paid or credited by a Canadian resident to a non-resident was not subject to withholding tax in general where the interest was payable in a currency other than Canadian currency (interest on the loan to City Park was in Swiss francs) to a person with whom the payor was *dealing at arm's length*. At issue was whether the debtor and the creditor dealt with each other at arm's length.

Justice Thurlow of the Exchequer Court found that the recipients of the interest paid by City Park were the banks and SIP. He concluded that these parties acted in concert to establish City Park by raising the corporation's capital, and by virtue of holding, in the aggregate, the

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11 See Income Tax Folio S1-F5-C1, *Related Persons and Dealing at Arm's Length*, para. 1.38, citing as one of the criteria that have generally been used by the courts in determining whether parties to a transaction are not dealing at arm's length, "whether the parties…act in concert without separate interests".

12 *Swiss Bank*.

13 The remaining 20% of the shares of SIP were owned by a third Swiss bank that was not involved in the establishment of the investment fund.

14 R.S.C. 1952, c. 148.

required voting power, could dictate City Park's conduct. Following a review of the directing mind test as set out in *Merritt Estate,* Justice Thurlow provides the following [emphasis added]:[15]

> To this I would add that where several parties - whether natural persons or corporations or a combination of the two - act in concert, and in the same interests, to direct or dictate the conduct of another, in my opinion the "mind" that directs may be that of the combination as a whole acting in concert or that of any one of them in carrying out particular parts or functions of what the common object involves. Moreover as I see it no distinction is to be made for this purpose between persons who act for themselves in exercising control over another and those who, however numerous, act through a representative. On the other hand if one of several parties involved in a transaction acts in or represents a different interest from the others the fact that the common purpose may be to so direct the acts of another as to achieve a particular result will not by itself serve to disqualify the transaction as one between parties dealing at arm's length.
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> [I]t does not appear to me that City Park, in dealings with SIP or the appellants, either singly or as a group, could be regarded as free of the influence which the three together or separately were in a position to exert or that City Park could be regarded as dealing with any of them either together or separately at arm's length. Indeed, as a practical matter, it appears to me that the payment of the interest by City Park did amount to nothing more than the moving of money from one of the fund's pockets to another.

There are two main considerations which emerge from Justice Thurlow's analysis. First, his opening remarks ("to this I would add") indicate that he viewed his comments as an extension of the directing mind test, not a new test to determine if two parties are "acting in concert"; in short, instead of asking whether X is the directing mind of Y (so that the two are NAL), Justice Thurlow contemplates a scenario where A and B act in concert and in the same interests to direct or dictate the conduct or C (so that A and/or B are NAL with C) — in other words, this was an expansion of the directing mind concept to that of a shared directing mind, so to speak. Second, there are two components to the directing mind/acting in concert test: the persons must (i) act in concert, and (ii) *act in the same interest*, to direct or dictate another's conduct; both of these criteria must be satisfied to determine that those persons are not dealing at arm's length with the third party.

The SCC affirmed the Exchequer Court decision in *Swiss Bank,* though for different reasons. Justice Laskin found that it was the certificate holders of the investment fund that were the interest payees, and that the imposition of SIP as agent did not impact this result [emphasis added]: [16]

> In my opinion, the interposition of the managing agent and the two depositaries between City Park and the certificate holders does not, despite the regulations, create an arm's length situation between them, within the exception in clause 106(1)(*b*)(iii)(A). City Park owes its very existence to the funds provided by the certificate holders, is without support from any other source and those funds are committed to provide a return only to the certificate holders. In short, City Park is

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15 *Swiss Bank* (ExCt) at para 15.

16 *Swiss Bank* (SCC).

> completely a captive to the interests of the certificate holders, acting through professional managers and fiduciaries.

Accordingly, although it did not expressly reject the Exchequer Court decision, the SCC did not refer to the "acting in concert without separate interests" test and arguably established a completely different test to determine non-arm's length dealings, which effectively blends the directing mind test and the *de facto* control test and looks to the degree of dependence between the two parties. The concept of a "captive" party will be discussed in more detail below. Nonetheless, the "acting in concert without separate interests" test described by the Exchequer Court has been adopted and applied in numerous subsequent decisions considering factual non-arm's length relationships.

The cases that have subsequently cited *Swiss Bank*, both the Exchequer Court and the SCC, have been inconsistent in their endorsement of its principles. As such, we will discuss a few of the more interesting applications of the acting in concert test post-*Swiss Bank.*

(a) Acting in concert without separate interests

Damis Properties[17] is the most recent case which cites both the Exchequer Court and the SCC *Swiss Bank* decisions and is likely one of the most accurate applications of the Exchequer Court's "acting in concert" analysis. This comes as no surprise given that Justice Owen, who previously authored a paper on the acting in concert test also wrote the decision in *Damis Properties*.

In *Damis Properties*, each of the five appellants held a 99.99% general partnership interest in one of five partnerships that held farmland. The transactions undertaken by each appellant, all of which took place in 2006, isolated the proceeds and income from the sale of the farmland in a newly incorporated subsidiary of each appellant. Each appellant then sold its subsidiary to Wilshire Technology Corporation, a corporation incorporated by an unrelated person to acquire the shares in all the subsidiaries. The Minister assessed the appellants under s. 160(1) and alternatively under the general anti-avoidance rule. The Court concluded that the appellants were dealing at arm's length with their newly incorporated subsidiary so the condition in paragraph 160(1)(*c*) was not met. In coming to this conclusion, Justice Owen provided a comprehensive review of the factual NAL tests.

Of particular interest is that Justice Owen draws out the distinction seen in *Swiss Bank* and subsequent caselaw between "acting in concert" and its qualifier that the parties be of "the same interest".[18] Justice Owen states that "[i]t can be seen from the foregoing decisions that the thread that holds the arm's length tests together is the *concept of independent interests.* This is a valid focus whether the transactions are commercial or not."[19] He further states [emphasis added]: [20]

> The indicia sanctioned in *McLarty* are circumstances that are indicative of an absence of independent interests. If a person directs both sides of any arrangement, that implies that the other person has not exercised his, hers or its independent interests. If a person is under the de facto control of another, that implies that the person has not exercised, or is not able to exercise, his, her or its

[17] *Damis Properties Inc. v The Queen*, 2021 TCC 24.

[18] *Ibid*, at paras 169 -175.

[19] *Ibid*, at para 176.

[20] *Ibid*, at paras 177-178.

> independent interests. And, as stated by the Exchequer Court and the Supreme Court of Canada in *Swiss Bank*, the acting in concert test is concerned with whether persons are acting in their own interests.
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> With respect to those who may hold a contrary view, the notion of an "ordinary commercial transaction" is not helpful. Commerciality is not a necessary hallmark of a transaction carried out at arm's length. For example, a gift to a charity is not in and of itself evidence that the donor and charity do not deal at arm's length.

Justice Owen, like the court in *Gestion Yvan Drouin*, recognizes that the factual NAL tests are not as distinct as some jurisprudence would suggest, each leading to the question of whether the persons being tested for arm's length status have independent interests; and moreover, he treats the acting in concert "test" as an extension of the directing mind test, following the formulation of acting in concert by Justice Thurlow in *Swiss Bank*.

(b) Acting at arm's length vs. an arm's length relationship

The wording of the factual NAL test in the Act is not whether two persons *are* arm's length with one another, but rather whether they *deal* at arm's length with one another. This raises the question of whether there is any daylight between the concepts of "dealing" at arm's length and having an arm's length relationship. While not the ratio of the case, the SCC in *Swiss Bank* added that if separate interests do not exist, the fact that the transaction itself reflects an arm's length dealing is not relevant to the analysis of whether the parties are factually NAL [emphasis added]: [21]

> Although the circumstances here do not present the common type of non-arm's length dealing referred to by this Court in MNR v Sheldon's Engineering Ltd, …, they bring this case within the principle that underlies the disqualification expressed in clause 106(1)(*b*)(iii)(A), namely, that the payer and payee must not be persons who, effectively, are dealing exclusively with each other through a fund provided by the payee for the benefit of the payee. A sound reason for this that the enactment itself suggests is the assurance that the interest rate will reflect ordinary commercial dealing between parties acting in their separate interests. A lender-borrower relationship which does not offer this assurance because there are, in effect, no separate interests must be held to be outside of the exception that exempts a non-resident from taxation on Canadian interest payments. The fact that the interest actually authorized or paid is consistent with arm's length dealing is not enough in itself to avoid this conclusion.

On the other hand, despite not focusing specifically on the term "deal/dealing" the courts have in some cases analyzed the arm's length status of a relationship in terms of the manner in which the parties dealt — in the sense of transacted or traded — with one another. In *Petro-Canada*, contrasting the statements made above by Justice Owen, the Federal Court of Appeal found that two joint exploration corporations factually did not deal at arm's length with vendors of seismic data for purposes of paragraph 69(1)(*a*) of the Act based on the evidence of how the parties negotiated and transacted with one another [emphasis added]: [22]

> The terms of the transactions did not reflect ordinary commercial dealings between vendors and purchasers acting in their own interests. The joint exploration corporations, for example, did not attempt to negotiate a volume discount, as the evidence indicated would be normal for such large acquisitions

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21 *Swiss Bank* (SCC).

22 *Petro-Canada v. R.*, 2004 D.T.C. 6329 (F.B.I..) at para. 55.

> of seismic data. Neither joint exploration corporation acted independently and in its own interest in entering into the transactions.

In other words, the court focused less on the degree to which one party could control the other than whether each of the two parties, in dealing with the other and especially in negotiating the terms of the transaction, acted in its own interests.

A similar approach was adopted in *Remai Estate*.[23] In this case, Mr. Frank Remai ("**Frank**") donated securities to a charitable foundation, which subsequently transferred the securities to Sweet Developments Ltd. ("**Sweet**"), a corporation owned by Frank's nephew. At issue was whether Sweet was factually dealing at arm's length with Frank. The Federal Court of Appeal analyzed the factual arm's length status of the relationship in terms that focused to a large extent on the manner in which the parties dealt with one another [emphasis added]: [24]

> [T]he fact that it may seem that a transaction has been entered into largely as a favour by one party to the other does not necessarily mean that it cannot also be at arm's length. It all depends on the particular facts. On basis of those before him, it was not … wrong for the Judge to characterize Sweet's purchase of the FRM notes from the Foundation as an arm's length transaction.

Note that the Court made these statements even though it was only being asked whether the two parties dealt arm's length, not whether their transaction was at arm's length.

In *Campbell*, the Court clearly examined the distinction between arm's length dealings and arm's length relationships. In this case, the appellant owned 25% of the outstanding shares of the company, her husband owned another 25%, and an entirely unrelated corporation owned the remaining 50%. The appellant and the company were not related within the meaning of paragraph 251(1)(*a*) of the Act and thus they were not deemed to be not dealing with each other at arm's length, leaving the issue to be decided in the appeal as whether or not they were in fact dealing with each other at arm's length. Justice Porter was of the firm view that there was daylight between having an arm's length relationship and *dealing* at arm's length [emphasis added]: [25]

> However, simply because these leading cases involved such factual situations, does not mean that people who might ordinarily be in a non arm's length relationship cannot in fact "deal with each other at a particular time in an 'arm's length' manner", any more than it means that people who are ordinarily at arm's length might not from time to time deal with each other in a non arm's length manner. These cases are quite simply examples of what is not an arm's length relationship rather than amounting to a definition in positive terms as to what is an arm's length transaction. Thus at the end of the day all of the facts must be considered and all of the relevant criteria or tests enunciated in the case law must be applied.

Justice Porter goes on to provides the example of two individuals negotiating with each other in the marketplace, explaining that it is not their relationship necessarily that gives rise to a

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[23] *Remai Estate v. R.* (2009), 2009 FCA 340.

[24] *Ibid*, at para 48.

[25] *Campbell v Minister of National Revenue*, [1998] T.C.J. No. 571 ("***Campbell***").

finding of arm's length, but rather the way in which they deal with each other (an analysis which also requires the examination of their relationship) [emphasis added]: [26]

> If the relationship itself (and here it must again be remembered that the Act does not say "where they are in a non arm's length relationship" it says "where they are not dealing with each other at arm's length") is such that one party is in a substantial position of control, influence or power with respect to the other or they are in a relationship whereby they live or they conduct their business very closely, for instance if they were friends, relatives or business associates, without clear evidence to the contrary, the Court might well draw the inference that they were not dealing with each other at arm's length. That is not to say, however, that the parties may not rebut that inference. One must however, in my view, distinguish between the relationship and the dealing. Those who are in what might be termed a "non arm's length relationship" can surely deal with each other at arm's length in the appropriate circumstances just as those who are strangers, may in certain circumstances, collude the one with the other and thus not deal with each other at arm's length.

In essence, Justice Porter is of the view that while a NAL *relationship* may give rise to the presumption that parties are *dealing* NAL, the presumption can be refuted. The totality of the facts must be reviewed both where there is and *is not* a NAL relationship. The upshot of the above jurisprudence is that there appears to be an avenue still open to argue that while the relationship between the parties may not be an arm's length one, it is possible that they could *deal* at arm's length. However, the gap between these two concepts may often not be substantial in actual practice, leading to what appears to be a primary focus by the courts on the relationship, not dealings, of the parties.

(c) Captive parties

Finally, an interesting facet of the "acting in concert" test is the concept of "captive parties" which was formulated by the SCC in *Swiss Bank* and can be seen most clearly post-*Swiss Bank* in *Keybrand Foods*, where the Court upheld the Minister's denial of an allowable business investment loss, because it found that Keybrand was not dealing at arms length with Videbode when it obtained shares of that company. As in *Gestion*, the Court makes it clear that there is significant overlap between the branches of the NAL tests [emphasis added]: [27]

> In my view, there is no practical difference between the concepts of de facto control and directing mind, in relation to the determination of whether two persons are dealing with each other at arm's length. If a person is the directing mind for a particular transaction, that person would also have de facto control of the terms and implementation of that transaction and vice versa.

In deciding whether the parties were dealing at arm's length the Court instead looked at the degree of dependence of Vidabode on Keybrand, effectively concluding that it was captive to Keybrand [emphasis added]: [28]

> Given the degree of financial dependence of Vidabode on BWS and Keybrand and the lack of any negotiation with respect to the terms and conditions (including the price) related to the share subscription, it is more likely than not that Keybrand

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[26] *Ibid,* paras 22-24, 26.

[27] *Keybrand Foods,* para 53.

[28] *Keybrand Foods,* paras 58-60.

> controlled both sides of the transaction related to the issue of shares by Vidabode to Keybrand.
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> That a degree of dependence could support a finding that parties are not dealing with each other at arm's length is also found in Swiss Bank Corp. v. Minister of National Revenue (1972), [1974] S.C.R. 1144, 31 D.L.R. (3d) 1 (S.C.C.) (Swiss Bank) […]
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> In this case, Vidabode was also completely captive to the interests of Keybrand and BWS. If Keybrand would not have provided the necessary funds for Vidabode to pay GE Capital in December 2010 (or otherwise paid or arranged for the payment of this debt), Vidabode could not have continued to operate.

The concept of being "captive" to another party with which one is dealing is similar to the premise of Justice Owen's findings in *Damis Properties,* that the real question for the NAL tests is the c*oncept of independent interests*. Where one party is "captive" to another, it would be impossible to say that they deal at arm's length as understood under any of the three branches of the test.

In closing, we are of the view that the interpretation of *Swiss Bank* by later jurisprudence has given different meaning to the determination of whether parties are dealing at arm's length than what was intended by the Exchequer Court, or even the Supreme Court. Justice Thurlow looked to see whether A and B acted in concert without separate interests to test whether they were NAL with C, not with each other, but the CRA and most courts seem only interested in applying the acting in concert test bilaterally. The SCC decision in *Swiss Bank* is predominantly cited for the test it rejected, and almost never for the test it put forward (i.e., captive interest). This has been coupled with a deemphasis of the word "dealing" in the arm's length determination, with a resolute focus on what the relationship is between the parties. However, once a refrain is repeated often enough it tends to take on a life of its own, meaning that even with tenuous origins, the "acting in concert" test as it currently stands is likely here to stay.