FEDERAL COURT OF APPEAL

UNCHARTED PATHS FOR ARM'S-LENGTH DEALING AND INDIRECT TRANSFERS

Canada v. Microbjo Properties Inc.
2023 FCA 157

KEYWORDS: ARM'S LENGTH ■ INDIRECT ■ FEDERAL COURT OF APPEAL ■ ARM'S-LENGTH TRANSACTIONS ■ AGGRESSIVE TAX PLANNING ■ TRANSFERS

INTRODUCTION

In *Microbjo*,[27] the Federal Court of Appeal, reversing the Tax Court's decision, held that two independent commercial actors did not "factually" act at arm's length in the context of a tax-driven transaction. The Federal Court of Appeal reached this remarkable conclusion without any reference to the well-established, decades-old framework endorsed by the Supreme Court of Canada for characterizing arm's-length transactions. Instead, the court articulated a broad, open-ended test based on "economic risk" and "tension" that cannot possibly be applied literally and will no doubt inspire the CRA to seek to characterize a much wider range of contractual relationships between independent actors as "factually" non-arm's-length.

In addition, the court adopted a novel approach to "indirect" transfers of property from a tax debtor under section 160 of the Act, holding that *each separate step* in an indirect transfer must satisfy the criteria in section 160 in order for the ultimate recipient to be liable for the tax debt. This approach potentially provides taxpayers with new grounds to avoid liability under section 160, and the court may have believed it necessary to significantly expand the notion of "non-arm's-length" to preserve section 160's historically broad reach.

However, given that, by the time the appeal was heard, Parliament had enacted subsection 160(5) to forbid the planning that gave rise to the *Microbjo* dispute[28] (coupled with an extremely broadly worded adviser penalty in subsection 160.01),[29]

27 *Canada v. Microbjo Properties Inc.*, 2023 FCA 157; rev'g the lower court decision, sub nom. *Damis Properties Inc. v. The Queen*, 2021 TCC 24.

28 Fall Economic Statement Implementation Act, 2022, SC 2022, c. 19, section 38. *Microbjo* was heard on February 9, 2023.

29 Fall Economic Statement Implementation Act, supra note 28, section 39. With respect to the "draconian" nature of the penalty, see Philip Friedlan and Adam Friedlan, "New Planning Penalty for Avoidance of Tax Debt" (2023) 23:1 *Tax for the Owner Manager* 5-6.

it is not clear what motivated the court to rewrite the law on arm's-length transfers or on the application of section 160. The decision in *Microbjo* is particularly dissatisfying given that the court could have likely reached the same result through a straightforward application of the long-established case law, rather than by making new law that has left considerable uncertainty and will no doubt prompt much further litigation. One can only hope that subsequent cases will reinterpret *Microbjo*—preferably in short order—to bring it more in line with previously settled law.

Background

Five taxpayers indirectly owned (each through a partnership) a parcel of farmland. They decided to dispose of the farmland to an arm's-length purchaser for gains totalling around $17 million, gross of expected taxes of around $5.7 million. Before closing, Wilshire Technology Corporation ("WTC")—which the court itself characterized as "an independent third party"[30]—approached the taxpayers, claiming to have a mechanism to shelter the expected taxes from the sale. To implement this mechanism, WTC proposed to acquire the taxpayers' partnership interests at a premium to their expected after-tax value, provided that the taxpayers implement a reorganization immediately prior to the sale of the farmland.

The taxpayers were pleased—as any ordinary commercial actor would be—to be offered the opportunity to receive additional money for their interests in the farmland. Accordingly, after taking legal advice to ensure that their legal and economic interests were protected, they accepted WTC's proposal and implemented the requested reorganization. Essentially, each of the five taxpayers rolled its partnership interest into a newly formed subsidiary. WTC took board and operational control of the subsidiaries two days prior to the sale and issued put rights allowing the taxpayers to sell their shares in the subsidiaries to WTC at a price that reflected the after-tax proceeds of sale ($13.5 million), plus 46 percent of the expected tax savings ($2.6 million).[31] During the period when it had operational control of the subsidiaries, WTC implemented various transactions involving software licences that it claimed would shelter the $5.7 million in taxes triggered by the sale. The taxpayers themselves had no knowledge of what these transactions would be, and they were not party to them. Rather, the taxpayers simply exercised their put rights, and WTC bought their shares at the agreed price. WTC satisfied the purchase price for the subsidiary shares immediately after the share transfer, using the subsidiaries' cash and receivables.[32] Importantly, on the day that the taxpayers sold their shares, subsection 256(9) deemed them to have relinquished control over the subsidiaries at the beginning of the day, such that when they received the agreed amounts under the put agreements, they were deemed

30 *Microbjo*, supra note 27 (FCA), at paragraph 8.

31 Prior to the sale, each subsidiary increased the stated capital of the common shares held by the taxpayers to an amount approximating the expected sale price of the shares, in order to increase the adjusted cost base of the shares by the same amount. See *Microbjo*, supra note 27 (TCC), at paragraph 9.

32 Ibid.

to no longer control the subsidiaries. WTC eventually filed the subsidiaries' returns on the basis that no tax was owing from the sale of farmland.

WTC's tax shelter strategy turned out, however, to be ineffective, and the CRA reassessed the subsidiaries for the unpaid taxes. WTC objected to these reassessments but, once the objections were confirmed, did not appeal them further. By this point, the subsidiaries had no assets. The CRA thus issued derivative assessments under section 160 against the five selling taxpayers, arguing that they indirectly received transfers from the subsidiaries without consideration and that they were not acting at arm's length from the subsidiaries.

The Tax Court vacated the section 160 assessments. The court noted that section 160 applies "[w]here a person has . . . transferred property, either directly or indirectly, by means of a trust or by any other means whatever, to . . . a person with whom the person was not dealing at arm's length."[33] Following a review of the case law on "indirect" transfers, the court held that the subsidiaries had "indirectly" transferred property to the taxpayers.[34] Observing that section 160 makes no distinction between "direct" and "indirect" transfers,[35] the Tax Court next considered whether the subsidiaries were acting at arm's length to the taxpayers at the time of the indirect transfers of property. To make this assessment, the court undertook a review of the leading case law on characterizing factual non-arm's-length transactions, including the Supreme Court of Canada's decisions in *McLarty*[36] and *Swiss Bank*,[37] and the Federal Court of Appeal's decision in *Remai*.[38] The Tax Court noted in particular the Supreme Court's endorsement, in *McClarty*, of an approach based on the following three indicia:[39]

1. Was there a common mind that directed the bargaining for both parties to a transaction?
2. Were the parties to a transaction acting in concert without separate interests?
3. Was there "de facto" control?

33 Ibid., at paragraph 112.

34 Ibid., at paragraphs 117 to 139. ("In conclusion, there is a clear connection between the reduction in the property of the subsidiaries and the increase in the property of the Appellants. Consequently, I find that the subsidiaries indirectly transferred approximately 82% of the Property to the Appellants on December 31, 2006." Ibid., at paragraph 139.)

35 Ibid., at paragraph 135.

36 *Canada v. McLarty*, 2008 SCC 26.

37 *Swiss Bank Corp. et al. v. Minister of National Revenue*, [1974] SCR 1144; aff'g [1971] CTC 427 (Ex. Ct.).

38 *Canada v. Remai*, 2009 FCA 340.

39 *McLarty*, supra note 36, at paragraph 62. This three-part test traces its origins to *Peter Cundill & Associates Ltd. v. The Queen*, [1991] 1 CTC 197 (FCTD); aff'd [1991] 2 CTC 221 (FCA). The test was subsequently incorporated into CRA *Interpretation Bulletin* IT-419R2, "Meaning of Arm's Length," before being endorsed by the Supreme Court in *McLarty*. IT-419R2 was cancelled and replaced on May 2, 2014 by *Income Tax Folio* S1-F5-C1, "Related Persons and Dealing at Arm's Length," which today reproduces, word for word, the three-part test, at paragraph 1.38.

The Tax Court concluded that none of these indicia applied to the dealings between the taxpayers *and the subsidiaries* at the moment when the subsidiaries' cash and receivables were indirectly transferred to the taxpayers by WTC in satisfaction of the purchase price for the shares. The court summarized its reasoning as follows:

> [200] The Appellants did nothing to avoid the payment of tax by the subsidiaries. The Appellants simply sold their shares in the subsidiaries to WTC. WTC took steps to avoid the payment of tax by the subsidiaries.
>
> [201] WTC did seek to profit from the arrangements by taking steps to reduce the tax liabilities in the subsidiaries. The Appellants obtained more for their shares than one might in theory expect given the tax liabilities because WTC took on the tax risk associated with owning the subsidiaries. For its own reasons, WTC valued the tax liabilities of the subsidiaries at an amount less than the actual amount of the liabilities.
>
> [202] WTC's offer to the Appellants was premised on it being able to take steps to reduce the tax liability of the subsidiaries. The commercial transactions were such that the risk relating to the tax liability of the subsidiaries clearly fell on WTC as the purchaser of the subsidiaries. The Appellants represented and warranted that the disclosure of the assets and tax liabilities of the subsidiaries in the share put agreements was accurate as of December 29, 2006, but nothing more.
>
> [203] In light of the foregoing, *I conclude that the Appellants and the subsidiaries were dealing at arm's length at the time of the transfer of the Property from the subsidiaries to the Appellants on December 31, 2006* and therefore the condition in paragraph 160(1)(c) for the application of paragraphs 160(1)(d) and (e) is not met.[40]

It bears emphasizing that the Tax Court's analysis concerned exclusively whether the taxpayers acted factually at arm's length from *the subsidiaries* at the moment when the subsidiaries' property was indirectly transferred to the taxpayers by WTC.[41] Contrary to what was subsequently suggested by the Federal Court of Appeal (as discussed below), at no time did the Tax Court evaluate whether the taxpayers acted at arm's length from *WTC*—presumably because the Tax Court considered the answer to that question to be obvious.

The Federal Court of Appeal's Decision

The Federal Court of Appeal began its analysis by criticizing the Tax Court's observation that section 160 makes no distinction between direct and indirect transfers, and instead holding that

> subsection 160(1) applies to successive transfers by treating a transferee as a transferor where it is itself a tax debtor either on its own account or as a joint and several debtor with the first transferor.[42]

40 *Microbjo*, supra note 27 (TCC), at paragraphs 200 to 203 (emphasis added).

41 Ibid., at paragraphs 140, 148, 157 to 158, 197, 203, and 347 to 351.

42 *Microbjo*, supra note 27 (FCA), at paragraph 56.

Accordingly, the court held that the taxpayers

> can only be found to be jointly and severally liable for the tax liability of the subsidiaries if the conditions for the application of subsection 160(1) *against WTC* are also met.[43]

The court then stated—incorrectly—that the Tax Court, at paragraphs 185 to 202 of its decision, evaluated whether the taxpayers "were in fact dealing at arm's length with WTC at the time of the transfer."[44] However, as can be seen in paragraph 203 of the Tax Court's decision, quoted above, the court's analysis was in fact limited to whether the taxpayers acted at arm's length from *the subsidiaries*.[45] Paragraphs 185 to 202 of the Tax Court's decision related to whether WTC and the taxpayers "acted in concert" to direct *the subsidiaries*—in which case (as discussed below) they would have been rendered non-arm's-length vis-à-vis *the subsidiaries*, not vis-à-vis *each other*.

The Federal Court of Appeal then held that the Tax Court had erred in its conclusion that the taxpayers acted at arm's length from WTC. In reaching this conclusion, however, the court did not ground its analysis in the three indicia in *McLarty*. Rather, the court sketched out a novel test that it articulated as follows:

> The purpose of the arm's length test is to verify whether the relationship between transacting parties is such that courts can have the assurance that the terms of the deal "will reflect ordinary commercial dealing[s] between parties acting in their separate interests" (*Swiss Bank* (SCC), p. 1152; *McLarty*, para. 43; *Remai*, para. 34). Such assurances *cannot be found unless parties not only seek a profit, but also transact with their own property or money with the result that what is at stake is their own patrimony or property*.[46]

The court went on to hold that the tax plan put together by WTC was not a bona fide actual tax plan, but rather

> nothing more than emptying the subsidiaries of their cash, putting its hands on its share of the payout, allowing as many years as possible to pass before the revenue authorities could become aware that the tax liability had turned into a tax debt . . . and leaving the tax collector dry.[47]

Consequently, according to the court, the purchase price agreed upon between WTC and the taxpayers—who, it bears repeating, knew nothing about the details of the tax plan and were not involved in its implementation—did not reflect "ordinary

---

43 Ibid. (emphasis added).

44 Ibid., at paragraphs 21.

45 See also *Microbjo*, supra note 27 (TCC), at paragraph 148 (emphasis added): "The issue, therefore, is whether at that point in time the Appellants *and the subsidiaries* were dealing at arm's length" (emphasis added).

46 *Microbjo*, supra note 27 (FCA), at paragraph 78 (emphasis added).

47 Ibid., at paragraph 71.

commercial dealing[s] between parties acting in their separate interests."[48] The court further reasoned as follows:

> Turning to the facts of this case, it is true that WTC and the respondents each sought to enrich themselves and that they were, in theory at least, at odds as to how to split the payout. However, because they were splitting amounts earmarked to pay a tax liability that was bound to become a tax debt rather than their own money, *the resulting split does not provide the assurance that it reflects an ordinary commercial dealing between parties acting in their separate interests*. Specifically, the tension that provides that assurance did not exist to the extent that it would had the parties been dealing with their own money. . . .
>
> *A transaction that takes place at a price far removed from the price that one would expect based on the risks assumed and the rewards sought can provide a strong indication that the parties are not dealing at arm's length*. . . .
>
> Although there are circumstances that can explain price anomalies, for instance when one party plainly outsmarts the other contracting party, nothing of the sort can explain the lopsided price in the present case. *Quite clearly, the fact that the parties were splitting money that was not theirs and believed that they could profit without putting at risk their own patrimony or property took away one of the fundamental safeguards that is inherent in an arm's length relationship*.
>
> *Further, once the respondents were swayed to buy into WTC*'s plan by the thought of turning an unexpected profit out of their crystallized tax liability through what they viewed as a risk-free exercise, they became the instruments through which *WTC*, acting as the sole mastermind, would lay its hands on the $1.3 million [that is, Microbjo's portion of the $5.7 million], *isolate it with the remaining cash in the subsidiaries and share it with the respondents in the proportion that it imposed*. Contrary to what the Tax Court asserts, no part of the contractual arrangement lessened the respondents' state of subservience. . . .
>
> *In the end, the absence of the arm's length tension caused by the fact that the parties were splitting money that did not belong to them and revealed by the respondents' disproportionate share of the payout and their absolute willingness to blindly abide by WTC's every term in order to obtain it lead me to conclude that the respondents were not in fact dealing at arm's length with WTC at the time of the transfer*.[49]

Commentary

Indirect Transfers

The court's holding that, for an indirect transfer to trigger liability under section 160, every step in the transfer must also trigger section 160 represents a novel (and, for taxpayers, potentially very welcome) limitation on the scope of subsection 160(1). The case law had previously held that section 160 *can* operate in cascade, such that if a section 160 tax debtor itself transfers property to a further non-arm's-length party, that further non-arm's-length party may face second-order derivative liability under section 160.[50] However, prior to *Microbjo*, there does not appear to have been

48 Ibid., at paragraph 81.

49 Ibid., at paragraphs 81, 84 to 86, and 90 (emphasis added).

50 See, for example, *Jurak v. Canada*, 2003 FCA 58; and *Armenti v. The Queen*, 2007 TCC 389.

any suggestion that any indirect transfer of property *must* be analyzed as a cascade application of section 160, such that each step in the cascade must trigger section 160 in order for the derivative liability to attach to the ultimate recipient of the property.

As much as taxpayers may applaud the court's novel approach to indirect transfers, this approach does not appear to be consistent with the plain wording of section 160. It has also apparently had the regrettable consequence of obliging the court to significantly expand the notion of factual non-arm's-length dealing in order to arrive at the result that it considered just.

Determining Non-Arm's-Length Transactions

The court's novel approach to characterizing arm's-length transactions diverges from decades of prior case law and raises many challenging questions that will no doubt be the subject of future litigation.

Mischaracterizing the Case Law

The court cited three cases in support of the proposition that, for an arm's-length relationship to exist, the parties must "not only seek a profit, but also transact with their own property or money with the result that what is at stake is their own patrimony or property."[51] However, an attentive reading of these cases confirms that none of them says anything of the sort. In particular:

- In *McLarty*, a taxpayer participated in a scheme involving the acquisition of seismic data at allegedly inflated values using limited-recourse notes and then claiming Canadian exploration expenses for the limited-recourse amounts. At issue, among other things, was whether the taxpayer acted at "arm's length" from the vendor of the seismic data. After endorsing the three-indicia test set out above to assess whether a relationship is "arm's length," the Supreme Court unanimously[52] agreed with the trial judge that the taxpayer's decision to acquire seismic data was its own decision and that neither the taxpayer nor the vendor had the power to impose its will on the other. It necessarily followed that they acted at arm's length. Remarkably, the court reached this conclusion even though the vendor acted as the taxpayer's agent in concluding the sale.
- In *Swiss Bank*, several banks, using subscriptions from various investors, created an investment fund. The banks held the fund's assets as trustees and, on behalf of the investors, constituted a corporation ("SIP") to manage the fund. SIP constituted an Ontario corporation to facilitate the fund's investments in Canadian property. The banks, using subscriptions from the underlying investors, lent funds to capitalize this Ontario corporation. At issue was whether the

51 *Microbjo*, supra note 27 (FCA), at paragraph 78.

52 There was a dissent in *McLarty*, although the dissenting judges indicated that they "agree[d] with the majority's holding that the transaction occurred at arm's length" (*McLarty*, supra note 36, at paragraph 79, Bastarache and Abella JJ dissenting).

Ontario corporation could be considered at arm's length from the underlying investors for the purpose of determining whether withholding tax was payable on the resulting interest payments. The Exchequer Court held that "where several parties . . . act in concert, and in the same interest, *to direct or dictate the conduct of another*, . . . the 'mind' that directs may be that of the combination as a whole acting in concert."[53] The Supreme Court concurred with the analysis and affirmed that because SIP—as agent and delegate of the investors—had sole control over the Ontario corporation on behalf of the investors, the investors acted in concert through SIP to control the Ontario corporation and thus were not at arm's length *from the corporation*.[54]

- *Remai* concerned an exchange of promissory notes by a foundation with an unrelated party for the purpose of effectively transforming "unqualifying securities" into "qualifying securities." The minister alleged that the unrelated party was not at arm's length from the foundation, apparently on the ground that the unrelated party realized no economic gain or loss from the transaction. The Federal Court of Appeal rejected this argument, holding that it was not necessary that the terms and conditions of a transaction reflect "ordinary commercial dealing" for the parties to a transaction to be considered at arm's length.

Arguably, *McLarty*, *Swiss Bank*, and *Remai* better support the conclusions of the Tax Court than those of the Federal Court of Appeal, given their holdings that

- simply cooperating to implement a scheme to obtain tax benefits does not render parties non-arm's-length (*McLarty*);
- "acting in concert" entails two or more people acting together to dictate the actions of a third party, and results in the *third party* not being at arm's length from the joint actors (*Swiss Bank*); and
- parties to a transaction do not automatically become "non-arm's-length" simply because the terms of the transaction may deviate from ordinary commercial terms (*Remai*).

Thus, while the Federal Court of Appeal portrayed its holding in *Microbjo* as a distillation of the leading case law, its decision appears rather to be based on a fundamental reinterpretation of what those cases stand for.

A Radical Reform of "Acting in Concert"

Although the court did not refer to the indicia endorsed by the Supreme Court in *McLarty*, it did on several occasions invoke the expression "acting in concert," thereby suggesting that its conclusion was inspired by the second *McLarty* indicium. However, the archetypal case of "acting in concert" is the situation where a corporation's directors and/or shareholders collude to appropriate funds from the corporation; in

53 *Swiss Bank*, supra note 37 (Ex. Ct.), at 437 (emphasis added).

54 Ibid. (SCC), at 1151-52.

this situation, the directors and/or shareholders "act in concert" to dictate the *corporation's* decision making and, accordingly, do not act at arm's length from the *corporation*.[55] As discussed above, the leading case on "acting in concert" is *Swiss Bank*, which held that an Ontario corporation was not at arm's length from its various investors who constituted a single entity to control it. There was never any suggestion in that case that the various investors were at non-arm's-length from *each other* by virtue of the fact that they "acted in concert" to control the fund.

Put another way, the fact that two parties may be "acting in concert" to dictate the decision making of a third party does not necessarily make those parties non-arm's-length *to each other*.[56] To the extent that the Federal Court of Appeal found that WTC was not acting at arm's length *from the taxpayers* because they were "acting in concert" to control the subsidiaries, such a holding represents a major and potentially far-reaching divergence from the long-established understanding of the term "acting in concert."

Perhaps aware of the fact that the "acting in concert" prong could not by itself justify a finding that WTC acted at non-arm's-length from the taxpayers, the court twice observed that the taxpayers put themselves in a "total state of subservience" to WTC by transferring operational control of the subsidiaries to WTC two days before the sale of the farmland.[57] This notion of "subservience" relates to the first and third *McLarty* indicia, and the court seems to have been inspired by the obiter dictum in *McLarty* that "[h]ad the trial judge found that *McLarty* had subordinated his entire decision making power to Compton as his agent, his dealings with Compton as vendor would not have been at arm's length."[58] However, in *Microbjo*, in exchange for transferring their control, the taxpayers received put options for their shares at a 20 percent price premium; moreover, as noted by the Tax Court, they obtained legal advice to the effect that their interests would be adequately protected, and they ensured that their transactions with WTC were structured accordingly.[59] It is very difficult to see such an arrangement as rendering the taxpayers "subservient" to WTC for the purpose of determining a non-arm's-length relationship.

---

55 See *Veilleux v. La Reine*, 2022 TCC 69, in particular at paragraphs 22 to 23 (review of case law).

56 For a fuller discussion of *Swiss Bank* and how "acting in concert" results in a "vertical" non-arm's-length relationship rather than a "horizontal" non-arm's length relationship, see S. Mah and M. Meredith, "Factual Non-Arm's-Length Relationships," in *Report of Proceedings of the Sixty-Sixth Tax Conference*, 2014 Conference Report (Toronto: Canadian Tax Foundation, 2015), 16:1-24, at 16:10-14. ("Having considered all of these cases, one might reasonably return to a consideration of *Swiss Bank* and ask why it was so different. . . . In our view, it is important to remember that the non-arm's-length finding was made only with respect to the vertical relationship. The involvement of SIP and the managers did result factually in the aggregation of the investors, but did not result in the investors being found not to deal at arm's length inter se." Ibid., at 16:14.)

57 *Microbjo*, supra note 27 (FCA), at paragraphs 86 and 87.

58 *McLarty*, supra note 36, at paragraph 72.

59 *Microbjo*, supra note 27 (TCC), at paragraphs 188 and 194.

Ambiguities in the Court's Analysis

The court's reasoning in *Microbjo* features a number of other logical gaps that leave the full import of the decision very unclear.

As mentioned above, the court articulated a "test" according to which an arm's-length transaction "cannot be found unless parties not only seek a profit, but also transact with their own property or money with the result that what is at stake is their own patrimony or property."[60] However, the court surely did not intend for this test to be taken literally. For example, the requirement that parties to a transaction must "seek a profit" appears to imply that any donation is necessarily non-arm's-length.[61] However, the requirement that a party "transact with their own property or money" appears to imply that every transaction undertaken by a trustee or administrator is necessarily non-arm's-length from the counterparty. The requirement that a party must have an amount "at stake" from its own patrimony or property appears to imply that—as has occurred in *Microbjo*—a seller is necessarily at non-arm's-length from a buyer who is simply able to top another buyer's price. Such implications are obviously absurd and presumably not what the court intended.

Moreover, nowhere does the court's "test" take into account the most important and determinant fact in its analysis, namely, the fraudulent nature of WTC's tax scheme. One is left to wonder how the court's analysis would have applied if WTC's tax scheme had had a greater degree of prima facie plausibility and had failed owing to either a good faith difference in interpretation between WTC and the CRA or a simple error in implementation on WTC's part. It has long been accepted and uncontroversial that a company's tax attributes (losses, pools, etc.) can significantly affect its value,[62] and it hardly seems right to deem a vendor of a company to be at non-arm's-length from a purchaser simply because the purchaser has a plan to make use of the company's tax attributes.

In a similar vein, perhaps the most concerning aspect of *Microbjo* is how the court apparently imputed WTC's supposed "knowledge" that its tax plan was fraudulent to the taxpayers, in spite of the uncontested facts that the taxpayers had no such knowledge.[63] Rather, as was found by the Tax Court, the taxpayers were offered a premium for their farmland by an independent party and they accepted it—as surely any ordinary commercial actor would. *Microbjo* seems to stand for the remarkable proposition that a vendor of a corporation has an affirmative obligation to validate and

60 Ibid. (FCA), at paragraph 78.

61 The trial judge made this very point, noting that "[c]ommerciality 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." *Microbjo*, supra note 27 (TCC), at paragraph 178.

62 The Act itself recognizes this in the definition of "contractual protection" in newly enacted subsection 237.3(1).

63 Indeed, the Federal Court of Appeal itself acknowledged that "WTC was the mastermind behind the plan and only it was aware of its true nature." *Microbjo*, supra note 27 (FCA), at paragraph 74.

monitor the purchaser's fiscal compliance post-acquisition, and that failure to do so can result in a factual non-arm's-length relationship between the vendor and the purchaser even following the acquisition.

Conclusion

The Federal Court of Appeal's analysis in *Microbjo* may well have been more straightforward and less confusing had the court simply drawn straightforward analogies from the archetypical "acting in concert" cases. In other words, instead of multiple *shareholders* or *directors* colluding to appropriate funds from a corporation for their own use (the archetypal case), the transactions in *Microbjo* featured current and future shareholders colluding to achieve the same effect. A key fact in such an analysis might have been that the taxpayers voluntarily ceded total operational control over the subsidiaries to WTC *prior* to the purchase of the shares, for the known purpose of implementing a plan to extract funds from the subsidiaries for their own use. The fact that the taxpayers may have been ignorant of the details of the plan arguably does not absolve them from their responsibility for setting the plan in motion and rendering them factually not at arm's length *from the subsidiaries* up to the time when the funds were transferred to them.

Unfortunately, by eschewing such an incremental approach based on longstanding precedent, and instead proposing a sweeping new test that, as discussed above, can hardly be taken literally, *Microbjo* has introduced considerable uncertainty and confusion into what it takes for parties to transact factually at arm's length. The decision will no doubt be a source of inspiration to CRA officials seeking to characterize parties as non-arm's-length simply because they enter into shareholders' agreements or other relational contracts that produce favourable tax consequences. Much further litigation may be necessary to settle the dust that *Microbjo* has kicked up.

Michael H. Lubetsky