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Cancellation of Interpretation Bulletin IT-233R

Interpretation Bulletin IT-233R, *Lease-Option Agreements; Sale-Leaseback Agreements*, dated February 11, 1983, is cancelled as of today's date.

The Canada Customs and Revenue Agency (CCRA) announced at the Canadian Tax Conference (CTF) last September that it was planning to withdraw IT-233R. As we said at that time, the bulletin was intended to curb abuses in leases in situations where the substance of the transactions disclosed that the parties intended to effect a sale. It was not meant to be used by taxpayers to avoid the legal consequences of their own transactions. As well, we invited comments in writing concerning this course of action and we received no opposition to our proposal.

The Supreme Court has held, in *Shell Canada Limited v. The Queen*, 99 DTC 5669, [1999] 4 CTC 313, and other decisions, that the economic realities of a situation cannot be used to recharacterize a taxpayer's bona fide legal relationships. It has held that, absent a specific provision of the *Income Tax Act* (the Act) to the contrary or a finding that there is a sham, the taxpayer's legal relationships must be respected in tax cases. Thus, generally and subject to the general anti-avoidance rule (GAAR), recharacterization is permissible only if the label attached by the taxpayer to the particular transaction does not properly reflect its actual legal effect.

Thus, it is our view that the determination of whether a contract is a lease or sale is based on the legal relationship created by the terms of the agreement, rather than on any attempt to ascertain the underlying economic reality. Therefore, in the absence of sham, it is our view that a lease is a lease and a sale is a sale. However, notwithstanding the legal relationship, GAAR may be used to assess cases in which there is an avoidance transaction that results in a misuse or an abuse of provisions of the Act.

This position equally applies to all leases including financing leases. We wish to point out that the Act recognizes the validity of financial leases since it has been amended to specifically deal with aspects of them (for example, the specified leasing rules in subsection 1100(1.1) of the *Income Tax Regulations*, section 16.1 and subsections 13(5.2) to 13(5.4) of the Act).

The issue as to whether taxpayers, who already entered into lease or financing lease agreements and determined their tax consequences on the basis of the position in the bulletin, can continue to do so will depend on the particular facts of a given situation. We encourage taxpayers to consult with their local tax services office on this matter. In examining each specific situation, the CCRA will consider its comments made at the

1988 Canadian Tax Foundation conference and in *Income Tax Technical News* No. 5. On the application of IT-233R, the CCRA stated that its position was meant to be an assessing policy and was not intended to allow taxpayers to determine their filing position by claiming that the form of their agreement does not reflect the true legal relationship, particularly where the result would be that two taxpayers owned the same property.

Finally, withdrawal of the bulletin will ensure consistency between the CCRA's position on lease characterization for the purposes of Part I of the Act and for the purposes of Part XIII, "Tax on Income from Canada of Non-Resident Persons"; Part I.3, "Tax on Large Corporations"; and the goods and services tax.