Federal Court of Appeal  Cour d'appel fédérale

Date: 20180112

Docket: A-53-17

Citation: 2018 FCA 9

CORAM: **STRATAS J.A.**
WOODS J.A.
LASKIN J.A.

BETWEEN:

NORTH SHORE POWER GROUP INC.

Appellant

and

HER MAJESTY THE QUEEN

Respondent

Heard at Toronto, Ontario, on October 31, 2017.

Judgment delivered at Ottawa, Ontario, on January 12, 2018.

REASONS FOR JUDGMENT BY: WOODS J.A.

CONCURRED IN BY: STRATAS J.A.
LASKIN J.A.

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REASONS FOR JUDGMENT

WOODS J.A.

[1] Section 232 of the *Excise Tax Act*, R.S.C. 1985, c. E-15 (Act) permits a supplier of goods or services, at its option, to adjust, refund or credit tax to a purchaser if tax has been overcharged or if the purchase price has been reduced. In the event of such an adjustment, consequential changes are made to each of the parties' net tax calculations. The central issue in this appeal is whether a supplier has credited tax for purposes of this provision if it issues a credit memo to the purchaser that cannot be satisfied due to the supplier's insolvency.

[2] The Minister of National Revenue issued reassessments to North Shore Power Group Inc. that added to its net tax amounts of harmonized sales tax (HST) that were determined to have been credited by a supplier under section 232. The company appealed the reassessments to the Tax Court of Canada, which concluded (*per* Justice Bocock) that the reassessments were correct and dismissed the appeal (2017 TCC 1).

[3] North Shore has now appealed to this Court. As discussed below, I respectfully disagree with the Tax Court's decision and would allow the appeal.

A. The legislation

[4] The option given to a supplier to adjust, refund or credit tax in section 232 is provided for in two subsections: subsection 232(1) in the case of tax that has been overcharged, and subsection 232(2) in the case of a reduction in the purchase price.

232 (1) Where a particular person has charged to, or collected from, another person an amount as or on account of tax under Division II in excess of the tax under that Division that was collectible by the particular person from the other person, the particular person may, within two years after the day the amount was so charged or collected,	232 (1) La personne qui exige ou perçoit d'une autre personne un montant au titre de la taxe prévue à la section II qui excède celui qu'elle pouvait percevoir peut, dans les deux ans suivant le jour où le montant a été ainsi exigé ou perçu :
(*a*) where the excess amount was charged but not collected, adjust the amount of tax charged; and	*a*) si l'excédent est exigé mais non perçu, redresser la taxe exigée;
(*b*) where the excess amount was collected, refund or credit the excess amount to that other person.	*b*) si l'excédent est perçu, le rembourser à l'autre personne ou le porter à son crédit.

(2) Where a particular person has charged to, or collected from, another person tax under Division II calculated on the consideration or a part thereof for a supply and, for any reason, the consideration or part is subsequently reduced, the particular person may, in or within four years after the end of the reporting period of the particular person in which the consideration was so reduced,	2) La personne qui exige ou perçoit d'une autre personne la taxe prévue à la section II, calculée sur tout ou partie de la contrepartie d'une fourniture, laquelle contrepartie est par la suite réduite en tout ou en partie au cours d'une de ses périodes de déclaration pour une raison quelconque peut, au cours de cette période ou dans les quatre ans suivant la fin de celle-ci :
(*a*) where tax calculated on the consideration or part was charged but not collected, adjust the amount of tax charged by subtracting the portion of the tax that was calculated on the amount by which the consideration or part was so reduced; and	*a*) si la taxe est exigée mais non perçue, la redresser en soustrayant la partie de la taxe qui a été calculée sur le montant de la réduction;
(*b*) where the tax calculated on the consideration or part was collected, refund or credit to that other person the portion of the tax that was calculated on the amount by which the consideration or part was so reduced.	*b*) si la taxe est perçue, rembourser à l'autre personne la partie de la taxe qui a été calculée sur le montant de la réduction, ou la porter à son crédit.
…	[…]

[5] If a supplier adjusts refunds or credits tax under either subsection 232(1) or (2), the requirements of subsection 232(3) are engaged. Essentially, this provision aims to make changes to the net tax of the supplier and purchaser, so that it is ultimately determined by the tax as adjusted.

[6] Essentially, net tax is a computation of the required remittances of tax by certain taxpayers. The calculation is provided for in subsection 225(1) of the Act and the remittances to the Receiver General are provided for in subsection 228(2).

[7] Paragraph 232(3)(*b*) and clause B(*b*) of subsection 225(1) permit a supplier to deduct the adjustment, refund or credit from its net tax, provided that the supplier had previously included this amount in its net tax.

[8] Paragraph 232(3)(*c*) and clause A(*b*) of subsection 225(1) require the purchaser to add the adjustment, refund or credit to net tax, provided that this amount had previously been deducted from its net tax as an input tax credit.

[9] Paragraph 232(3)(*a*) requires the supplier to issue documentation to the purchaser, which the legislation refers to as a credit note. The credit note must provide information as prescribed by regulation. Paragraph 232(3)(*a*) is reproduced below.

232 (3) Where a particular person adjusts, refunds or credits an amount in favour of, or to, another person in accordance with subsection (1) or (2), the following rules apply:	232 (3) Les règles suivantes s'appliquent dans le cas où une personne redresse un montant en faveur d'une autre personne en application des paragraphes (1) ou (2), le lui rembourse ou le porte à son crédit :
(*a*) the particular person shall, within a reasonable time, issue to the other person a credit note, containing prescribed information, for the amount of the adjustment, refund or credit, unless the other person issues a debit note, containing prescribed information, for the amount;	*a*) elle remet à l'autre personne, dans un délai raisonnable, une note de crédit, contenant les renseignements réglementaires, pour le montant remboursé ou le montant du redressement ou du crédit, à moins que cette dernière ne lui remette une note de débit, contenant les renseignements réglementaires, pour un tel montant;
…	[…]

B. Factual background

[10] North Shore is a corporation wholly-owned by the Town of Blind River, Ontario. It is involved in renewable energy projects.

[11] This appeal concerns contracts that North Shore had with Menova Energy Inc. for the sale and installation of solar panels. The contracts required North Shore to pay one-half of the purchase price, including HST, up front with the balance payable on delivery.

[12] The contracts were entered into on July 30, 2010. After a few months Menova cancelled a large contract, and a few months later it cancelled 9 additional contracts. Shortly thereafter, Menova informed North Shore that it was insolvent. In all, Menova cancelled 10 of 18 contracts that it had with North Shore.

[13] The up front amounts paid by North Shore with respect to the cancelled contracts were $2,987,785 on account of the purchase prices and $388,412 on account of HST (agreed facts at paragraph 7).

[14] Upon cancellation of each contract, Menova issued documentation to North Shore which it called a credit memo. Each memo constituted confirmation by Menova that a particular contract was cancelled and documented its obligation to refund the associated up front payment, including HST.

[15] The amounts owing under the credit memos were never refunded to North Shore. In 2012, Menova became bankrupt and North Shore ultimately recovered a relatively small portion of what was owed.

C. Tax filings and reassessments

[16] In filing its HST returns, North Shore was not consistent in how it treated the cancelled contracts. Its various filing positions, and the Minister's audit response, are detailed in the Tax Court decision. It is not necessary to repeat it all here.

[17] However, two elements of North Shore's tax filings are relevant to this appeal. First, North Shore claimed a deduction from net tax as an input tax credit for the HST paid on the up front payments. And second, upon cancellation of the contracts, North Shore's bookkeeper initially added the tax to be refunded to net tax, consistent with section 232. This position was reversed in subsequent reporting periods.

[18] In reassessing North Shore for the period that the up front payments were made, the Minister ultimately allowed input tax credits with respect to these amounts. For the periods that the contracts were cancelled, the Minister added the amount of the HST to be refunded to North Shore's net tax pursuant to paragraph 232(3)(*c*) of the Act. The effect is that the reassessments did not allow a deduction for the HST paid by North Shore that was to be refunded.

[19] I am not aware of the details of Menova's tax situation, except that the company did not remit the HST collected from North Shore on the up front payments. As for section 232, I do not

know how this provision affected Menova, if at all, or whether section 232 affected Menova's directors who may have been potentially liable for the HST that Menova collected but did not remit.

D. Decision of the Tax Court

[20] The Tax Court concluded that subsection 232(1) of the Act applied on the basis that there was an overpayment of tax which was credited to North Shore by the credit memos. Several factors were taken into account by the Court in reaching this conclusion.

[21] First, in determining the meaning of the term "credit" in subsection 232(1), the Court extrapolated from ordinary dictionary meanings of "credit note" and "credit memorandum" as used in commercial custom. Essentially, the Court concluded that "credit" means the acknowledgement of a sum owed. A representative definition referred to in the Court's decision is reproduced below from *Black's Law Dictionary* (5th ed.):

> **Credit memorandum:** A document used by a seller to inform a buyer that the buyer's account receivable is being credited (reduced) because of errors, returns, or allowances.

[22] Second, the Court determined that North Shore's actions in acknowledging the validity of the credit memos were fatal to its appeal. The Court mentioned that North Shore relied on the credit memos to recover a portion of the amount owed from Menova and it implicitly represented that the credit memos were a liability of Menova under section 232 in its initial tax filings (decision at paragraphs 38 and 39).

[23] Third, the Court rejected North Shore's public policy argument to the effect that the Minister's position could encourage "nefarious and sharp" behaviour from impecunious suppliers. North Shore submitted that Menova may have sought a deduction under section 232 to reduce its liability (or that of its directors) for the HST that it had failed to remit. In the Court's view, the fact that North Shore acted on the credit memos removed its ability to rely on this argument (decision at paragraph 40).

E. Issue and standard of review

[24] On an appeal from the Tax Court, this Court is to determine whether there is a reviewable error using the standards of review from *Housen v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235: questions of law are reviewed on a standard of correctness, and questions of fact and questions of mixed fact and law are reviewed on a deferential standard of "palpable and overriding" error.

[25] This appeal primarily raises an extricable question of law: What is the meaning of the term "credit" for purposes of section 232 of the Act? Correctness is the standard of review that applies.

[26] As a preliminary matter, I would comment about the determination of the Tax Court that the relevant provision to be considered is subsection 232(1) of the Act. The Court commented that this was in accordance with the submission of North Shore. However, according to a transcript of the Tax Court hearing, North Shore had submitted that subsection 232(2) was the

relevant provision. I agree with the position as stated in the transcript, but nothing turns on this because the same extricable question of law arises under both subsections 232(1) and (2).

F. Meaning of the term "credit"

[27] By issuing the credit memos, Menova gave formal notification to North Shore that it was cancelling some of the solar panel contracts and it was agreeing to refund the associated up front payments, including HST.

[28] The question is whether an agreement to refund tax is a "credit" within the meaning of "refund or credit" in subsection 232(2) of the Act. The language should be given a textual, contextual and purposive interpretation, which is harmonious with the scheme of the Act as a whole (*Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54 at para. 10, [2005] 2 S.C.R. 601).

[29] In my view, the Tax Court erred in concluding that the term "credit" in subsection 232(1) takes its meaning from the commercial terms "credit note" and "credit memorandum." I say this partly because these commercial terms do not appear in subsections 232(1) and (2), which are the provisions that engage section 232 by giving the supplier the option to adjust tax. The term "credit note" is used in subsection 232(3) only to describe the documentation required if section 232 has been engaged.

[30] This is sufficient to dispose of this issue, but I would also observe that the term "credit note" as used in subsection 232(3) cannot refer to its ordinary commercial meaning because the

term in the legislation is applicable not only to credits, but also to adjustments and refunds. Accordingly, the ordinary meaning of "credit note" does not assist in defining "credit" in this context.

[31] The question, therefore, is simply the meaning of the term "credit." I will first consider dictionary definitions. A canvass of English and French dictionaries suggests that the term can have either a broad meaning (acknowledgement of an amount owed) or a narrower one (putting a sum of money at the disposal of the recipient of the credit). The English and French dictionaries below reflect these two meanings.

> Credit: (1) A sum at a person's disposal in the books of a bank etc.
>
> (2) The acknowledgement of payment by entry in an account
>
> *Shorter Oxford English Dictionary*, 6th ed.
>
> Crédit: Opération par laquelle une personne met une somme d'argent à la disposition d'une autre; (operation by which someone puts a sum of money at the disposal of someone else)
>
> *Le Petit Robert (2006)*

[32] In addition to the ordinary meaning of "credit," the context and purpose of the legislation must be considered. As discussed below, I have concluded that the context and purpose suggest that the narrower meaning of "credit" was intended.

[33] First, it is relevant to consider that the term "credit" is ambiguous. The drafters could have used more precise language if a broad meaning were intended. For example, the legislation could have used words such as "refund or agree to refund."

[34] Further, language such as “refund or agree to refund” more closely mirrors the language used in other provisions of the Act. For example, the calculation of net tax in subsection 225(1) of the Act refers to tax that is “collectible.”

[35] Second, at the time section 232 of the Act was introduced into law, existing case law had ascribed to the term “credit” in an income tax context the narrow interpretation from *Le Petit Robert* reproduced above (*La Compagnie Minière Québec Cartier v. M.N.R.*, 84 D.T.C. 1348 at 1356, [1984] C.T.C. 2408). Even before this case, a narrow interpretation had been administratively accepted by the tax authorities in this context (Brian J. Arnold *et al*, *Timing and Income Taxation*, 2nd ed. (Toronto: Canadian Tax Foundation, 2015) at 381). Therefore, the interpretation suggested by North Shore is not only possible, but it is one that had been accepted in another tax context.

[36] Third, a broad interpretation of “credit” in the context of section 232 appears to open the door for tax consequences to taxpayers like North Shore that are contrary to the general scheme of the Act.

[37] What is the general scheme? It would have been useful for the parties to provide more detailed submissions on this, but I would note the following.

[38] Section 232 appears to contemplate that a credit given under this provision will actually be satisfied. It makes no sense for the supplier to be allowed a deduction from net tax and for the purchaser to be required to add an amount to its net tax if there is no transfer of funds. The HST

is a tax that is generally intended to be borne by consumers. By and large, businesses act as pass through entities and do not bear any of the tax burden. An interpretation of “credit” that advances this objective is more in harmony with the scheme of the Act as a whole.

[39] The Crown submits that a broader interpretation makes sense because it shifts the tax burden to the purchaser in circumstances where the purchaser is in a better position than the government to assess the financial position of the supplier.

[40] I do not agree. The Act generally imposes an obligation on all suppliers to collect tax on behalf of the government. The financial position of the supplier does not change this, and there is no reason to think that section 232 is intended to do so.

[41] It is also helpful to consider the legislative scheme in an analogous situation. By subsections 225(1) and 228(2) of the Act, tax collectible must be remitted by a supplier if it is collectible, even if it is never collected. However, relief is provided to the supplier in subsection 231(1) if the amount collectible becomes a bad debt. There is no such relief provided for credit in section 232 which becomes a bad debt.

[42] Further, the Crown submits that North Shore’s actions in relying on the credit memos should be fatal to its appeal. I can understand that the Tax Court relied on this argument because North Shore submitted to that Court that the credit memos were invalid. However, this was no longer argued in this Court.

[43] The essential issue in this appeal is the proper interpretation of the term “credit” in subsections 232(1) and (2) of the Act. The parties’ treatment of the credit memos in the context of recovery efforts cannot have a bearing on this issue. Further, it is not relevant that North Shore’s bookkeeper initially treated the credit memos as being subject to section 232. There is no evidence that the bookkeeper was aware of all of the relevant facts or looked into the matter in any detail.

[44] Finally, the Crown submits that a broad interpretation should be preferred because it promotes certainty and is easier to audit. This may be true but on the other hand a broad interpretation promotes tax consequences that are not in harmony with the scheme of the Act as a whole. The narrower interpretation is preferable for this reason, in my view.

[45] For all these reasons, the term “credit” in section 232 should have the meaning from *Le Petit Robert*, above: an operation by which a sum is put at the disposal of someone else. I do not suggest that money must actually be set aside, but it is not sufficient if there is no sum at the disposal of the purchaser.

G. Did North Shore receive a credit?

[46] In light of my conclusion that the Tax Court adopted an incorrect interpretation of “credit,” the question remains: Did Menova place the amounts to be refunded at the disposal of North Shore?

[47] It is open to this Court either to remit the matter back to the Tax Court for a determination of this question on the facts or to decide the matter itself. It is an efficient use of resources for this Court to decide, and I propose to do so.

[48] The question is resolved by considering Menova's likely financial situation when the credit memos were issued. No one from Menova testified in the Tax Court, and the evidence as to Menova's financial status was not detailed. However, an inference can be drawn that Menova was likely never in a position to satisfy the credit memos.

[49] North Shore was actively trying to minimize its loss once the first contract, which was very large, was cancelled. Instead of refunding the up front payment associated with this contract, Menova simply issued a credit memo. Not long after the first contract was cancelled, Menova cancelled 9 more contracts and notified North Shore that it was insolvent. Eventually, North Shore forced Menova into bankruptcy and only a small amount of the up front payments was recovered. North Shore's failure to recover anything except through recovery efforts is telling.

[50] I conclude that Menova did not put funds at the disposal of North Shore when it issued the credit memos, and therefore the tax was not credited.

H. Disposition

[51] I have concluded that section 232 does not apply to the transactions at issue as HST was not credited to North Shore. I would issue judgment in favour of North Shore in the amounts agreed to by the parties.

[52] Accordingly, I would allow the appeal, set aside the judgment of the Tax Court, and refer the matter back to the Minister for reconsideration and reassessment on the basis that:

(1) net tax for the reporting period ended April 30, 2011 should be reduced by the amount of $107,954, and

(2) net tax for the reporting period ended January 31, 2012 should be reduced by the amount of $240,089.

[53] I would award costs to North Shore in this Court and below.

"Judith M. Woods"
J.A.

"I agree
David Stratas J.A."

"I agree
J.B. Laskin J.A."

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

DOCKET:	A-53-17
APPEAL FROM A JUDGMENT OF THE HONOURABLE MR. JUSTICE BOCOCK DATED JANUARY 16, 2017, NO. 2015-1269(GST)G	
STYLE OF CAUSE:	NORTH SHORE POWER GROUP INC. v. HER MAJESTY THE QUEEN
PLACE OF HEARING:	TORONTO, ONTARIO
DATE OF HEARING:	OCTOBER 31, 2017
REASONS FOR JUDGMENT BY:	WOODS J.A.
CONCURRED IN BY:	STRATAS J.A. LASKIN J.A.
DATED:	JANUARY 12, 2018

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