Federal Court of Appeal  Cour d'appel fédérale

Date: 20180319

Docket: A-415-16

Citation: 2018 FCA 54

CORAM: **WEBB J.A.**
NEAR J.A.
GLEASON J.A.

BETWEEN:

ONENERGY INC.

Appellant

and

HER MAJESTY THE QUEEN

Respondent

Heard at Toronto, Ontario, on October 16, 2017.

Judgment delivered at Ottawa, Ontario, on March 19, 2018.

REASONS FOR JUDGMENT BY: WEBB J.A.

CONCURRED IN BY: NEAR J.A.
GLEASON J.A.

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REASONS FOR JUDGMENT

WEBB J.A.

[1] This is an appeal from a determination made by Justice C. Miller of the Tax Court of Canada (2016 TCC 230) under Rule 58 of the *Tax Court of Canada Rules (General Procedure)*, SOR/90-688a, of the following question:

> Whether, on the facts agreed to by the Parties and any other facts found by the Court, the Appellant is deemed to have incurred litigation costs in the course of a commercial activity pursuant to subparagraph 141.1(3)(a) of the Excise Tax Act (the "Act").

[2] The Tax Court judge's answer to the question was no. For the reasons that follow I would allow the appeal and answer the question in the affirmative.

I. Background

[3] The parties submitted an agreed statement of facts. No further evidence was presented at the Tax Court hearing.

[4] ONEnergy Inc. had been carrying on business under the name Look Communications Inc. (Look). Look carried on a telecommunications business in Ontario and Quebec. The telecommunications business was not successful and on December 1, 2008 Look announced that:

(a) it would not be able to continue operating the telecommunications business;

(b) the business would be wound up; and

(c) it would be selling its assets under a court approved plan of arrangement.

[5] On May 5, 2009 Look announced that it had reached an agreement to sell its band of 100 MHz of contiguous licence spectrum (Spectrum) and its CRTC broadcast licence (Licence) for gross proceeds of $80 million, subject to court approval. The approval for the sale was received on May 14, 2009 and the sale of these assets closed on September 11, 2009.

[6] While Look was carrying on its telecommunications business it had a share option plan and a share appreciation rights plan (SAR plan). The SAR plan provided that certain share appreciation rights (SARs) could be awarded by the board of Look to directors, employees and

consultants. When the SARs were exercised Look would make a payment to the rights holder in an amount equal to the difference between the fair market value of the shares of Look when the rights were exercised and when the rights were awarded.

[7] By 2009 certain directors, executives, shareholders and employees (and in certain cases their personal holding companies) (the Former Executives) held significant options and SARs. Between the time that the sale of the Spectrum and Licence was announced by Look and the closing of the transaction, the board of Look cancelled all options and SARs and used a valuation of $0.40 per share. The highest share price for the shares of Look noted in the Agreed Statement of Facts in 2009 was the price of $0.23 per share on May 14, 2009. The board also decided to unconditionally set aside $11 million for a severance retention and bonus pool effective May 31, 2009.

[8] The net proceeds from the Spectrum and Licence sale were $64 million. The sale of the Spectrum and Licence effectively terminated the telecommunications business of Look. The payments for the cancellation of the options and SARs and the bonuses were made to the Former Executives. Although the date of these payments is not included in the agreed statement of facts, it would appear that these payments were made before they were publicly disclosed in a Management Information Circular issued on January 19, 2010. The shareholders of Look opposed what they identified as $14,700,000 of excess payments to the Former Executives and subsequently commenced an action against the Former Executives in the Ontario Superior Court of Justice to recover this amount.

[9] The issue in this appeal relates to the GST or HST paid by Look in relation to the legal services provided with respect to the lawsuit that Look commenced against the Former Executives.

II. Decision of the Tax Court

[10] The Tax Court judge found that in applying a textual, contextual and purposive analysis to subsection 141.1(3) of the *Excise Tax Act*, R.S.C. 1985, c. E-15 (the Act), there was a difference between winding down a business and winding down a corporation. While he found that the Spectrum sale was part of the commercial activities of Look, the litigation against the Former Executives was not. His conclusion is summarized in paragraph 35 of his reasons:

> **35** In summary, I distinguish between the termination of the business and the consequences flowing from such termination. I also distinguish between the wind up of the business and the wind down of the corporation. I emphasize it is the connection that is paramount, not the timing of the activity. And the connection must be one that on a textual, contextual and purposive interpretation recognizes the commercial expectation of a business supplying goods or services. In this case that means a connection between the litigation activity and the entering into, implementation of or enforcement of the Spectrum sale. There is simply no such connection.

[11] The Tax Court judge also found that any connection between the litigation and the winding down of the corporation would not be sufficient to allow Look to claim input tax credits for the GST or HST paid in relation to the legal services provided in connection with the litigation against the Former Executives. As a result the Tax Court judge stated that the answer to the question posed under Rule 58 was no.

III. Standard of Review

[12] The standard of review for any question of law is correctness and for any finding of fact (or question of mixed fact and law without an extricable legal question) is palpable and overriding error (*Housen v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235).

IV. Analysis

[13] The question for determination focused on paragraph 141.1(3)(*a*) of the Act. Subsection 141.1(3) of the Act is as follows:

For the purposes of this Part,	Pour l'application de la présente partie :
(*a*) to the extent that a person does anything (other than make a supply) in connection with the acquisition, establishment, disposition or termination of a commercial activity of the person, the person shall be deemed to have done that thing in the course of commercial activities of the person; and	*a*) dans la mesure où elle accomplit un acte, sauf la réalisation d'une fourniture, à l'occasion de l'acquisition, de l'établissement, de l'aliénation ou de la cessation d'une de ses activités commerciales, une personne est réputée avoir accompli l'acte dans le cadre de ses activités commerciales;
(*b*) to the extent that a person does anything (other than make a supply) in connection with the acquisition, establishment, disposition or termination of an activity of the person that is not a commercial activity, the person shall be deemed to have done that thing otherwise than in the course of commercial activities.	*b*) dans la mesure où elle accomplit un acte, sauf la réalisation d'une fourniture, à l'occasion de l'acquisition, de l'établissement, de l'aliénation ou de la cessation d'une de ses activités non commerciales, une personne est réputée avoir accompli l'acte en dehors du cadre d'une activité commerciale.

[14] As noted by the Tax Court judge, when interpreting a statutory provision the court is to apply a textual, contextual and purposive analysis (*Canada Trustco Mortgage Co. v. The Queen*, 2005 SCC 54, [2005] 2 S.C.R. 601, at paragraph 10). Paragraph 141.1(3)(*a*) of the Act is broadly worded and in addressing the words "in connection with" the Tax Court judge stated:

> **21** Keep in mind, I am still just looking at this from a textual perspective, which, on its face, given jurisprudence's acceptance of a relatively broad view of the term, would appear to link, albeit tenuously, the legal services to the commercial activity of the Spectrum Sale, thus giving it the requisite commercial nature. But is it of that nature? I do not believe it is. In line with my thinking in *BJ Services [BJ Services Company Canada v. The Queen*, [2002] G.S.T.C. 124, 2003 G.T.C. 513], I conclude there is no commercial expectation that directors on winding up a corporation will abscond with funds and that the cost of such contingency is somehow worked into the cost of the supply. This is unlike the situation in *BJ Services* where I was satisfied the activity went to "the company's ability to sustain a profitable business". Not so here. The business of Look was effectively wound up before there was any activity necessitating the acquisition of legal services. What was not wound up was the corporation itself. This was not a matter of incurring legal fees to collect accounts receivables, which clearly are part of the termination of the business. This expense is as close to what I would consider a "personal expense" in a corporate context as I can imagine. The business is over. Going after greedy directors, who may have lined their own pockets, to redistribute monies recovered from them to shareholders has no connection to where those monies came from. It matters not that the directors concocted their plan when the possibility of significant proceeds from a sale became real. So what? The activity to recoup arose from the directors actually taking the funds once in Look's accounts. I conclude that even on a textual approach there is no link between the Spectrum Sale and the legal activity to go after the directors.
>
> (emphasis added)

[15] I agree that paragraph 141.1(3)(*a*) of the Act is broadly worded. In my view, the Tax Court judge made a palpable and overriding error in finding that the amounts paid for legal services were "personal" and that there was no connection between the litigation and the source of the funds used to pay the Former Executives.

[16] To determine whether the legal expenses were personal for the purposes of the Act, in my view, it is necessary to examine the basis for the litigation and what Look is seeking to recover.

[17] The disputed amounts were paid to the Former Executives for their cancelled options and SARs and as a bonus. The options and SARs would have been part of the compensation or remuneration payable to the Former Executives and the bonus would also be remuneration paid to these persons. Although the legal basis for the claim against the Former Executives may be a breach of fiduciary duty, the result of that breach (if established) would be an overpayment of remuneration. Therefore, in my view, the litigation should be characterized as a claim for overpaid remuneration.

[18] The remuneration would have been paid for services rendered as part of the commercial activities of Look or the termination of those activities and, therefore, not personal. If a claim for overpaid remuneration is not connected to the business of the employer, then any claim by an employee against his or her employer for underpaid remuneration (for example a claim for wrongful dismissal) would not be connected to the business of the employer. It does not seem to me that this is the appropriate result and therefore legal expenses related to employment matters (including litigation related to allegedly overpaid remuneration) would not be personal expenses.

[19] The Tax Court judge, as part of his finding that the legal expenses were personal, found that there was no connection between the litigation and the source of the funds. However, there was a direct connection between the litigation and the source of the funds used to pay the Former Executives. The legal services were acquired to challenge and recover remuneration that was

paid to the Former Executives (who were employees (including directors)). The corporate resolutions, which resulted in the excess payments, were adopted between the time that the sale of the Spectrum and Licence was announced and the closing of the sale. Look had previously decided to wind-down its business and sell its assets under a court approved arrangement.

[20] It seems logical for a company whose business was not successful and that was winding down its business and liquidating its assets that the only source for the payment of the amounts in excess of $14 million to the Former Executives was the proceeds from the sale of the Spectrum and Licence. The amounts paid to the Former Executives were therefore inextricably linked to the sale of the Spectrum and Licence and there was a direct connection between the source of the funds (the proceeds from the sale of the Spectrum and Licence sale) and the litigation. The legal expenses incurred to attempt to recover any overpaid remuneration were not personal.

[21] The general provision which permits a person to claim input tax credits is subsection 169(1) of the Act:

169(1) Subject to this Part, where a person acquires or imports property or a service or brings it into a participating province and, during a reporting period of the person during which the person is a registrant, tax in respect of the supply, importation or bringing in becomes payable by the person or is paid by the person without having become payable, the amount determined by the following formula is an input tax credit of the person in respect of the property or service for	**169(1)** Sous réserve des autres dispositions de la présente partie, un crédit de taxe sur les intrants d'une personne, pour sa période de déclaration au cours de laquelle elle est un inscrit, relativement à un bien ou à un service qu'elle acquiert, importe ou transfère dans une province participante, correspond au résultat du calcul suivant si, au cours de cette période, la taxe relative à la fourniture, à l'importation ou au transfert devient payable par la

the period:

A × B

where

A is the tax in respect of the supply, importation or bringing in, as the case may be, that becomes payable by the person during the reporting period or that is paid by the person during the period without having become payable; and

B is

(*a*) where the tax is deemed under subsection 202(4) to have been paid in respect of the property on the last day of a taxation year of the person, the extent (expressed as a percentage of the total use of the property in the course of commercial activities and businesses of the person during that taxation year) to which the person used the property in the course of commercial activities of the person during that taxation year,

(*b*) where the property or service is acquired, imported or brought into the province, as the case may be, by the person for use in improving capital property of the person, the extent (expressed as a percentage) to which the person was using the capital property in the course of commercial activities of the person immediately after the capital property or a portion thereof was last acquired or imported by the person, and

personne ou est payée par elle sans qu'elle soit devenue payable :

A × B

où :

A représente la taxe relative à la fourniture, à l'importation ou au transfert, selon le cas, qui, au cours de la période de déclaration, devient payable par la personne ou est payée par elle sans qu'elle soit devenue payable;

B:

a) dans le cas où la taxe est réputée, par le paragraphe 202(4), avoir été payée relativement au bien le dernier jour d'une année d'imposition de la personne, le pourcentage que représente l'utilisation que la personne faisait du bien dans le cadre de ses activités commerciales au cours de cette année par rapport à l'utilisation totale qu'elle en faisait alors dans le cadre de ses activités commerciales et de ses entreprises;

b) dans le cas où le bien ou le service est acquis, importé ou transféré dans la province, selon le cas, par la personne pour utilisation dans le cadre d'améliorations apportées à une de ses immobilisations, le pourcentage qui représente la mesure dans laquelle la personne utilisait l'immobilisation dans le cadre de ses activités commerciales immédiatement après sa dernière acquisition ou importation de tout ou partie de l'immobilisation;

(*c*) in any other case, the extent (expressed as a percentage) to which the person acquired or imported the property or service or brought it into the participating province, as the case may be, for consumption, use or supply in the course of commercial activities of the person.	*c*) dans les autres cas, le pourcentage qui représente la mesure dans laquelle la personne a acquis ou importé le bien ou le service, ou l'a transféré dans la province, selon le cas, pour consommation, utilisation ou fourniture dans le cadre de ses activités commerciales.
(emphasis added)	(soulignement ajouté)

[22] Generally input tax credits are allowed for GST or HST paid in relation to the acquisition of property or services by a person to the extent that such property or services were acquired for consumption or use in the course of commercial activities of that person. In *Her Majesty the Queen v. General Motors of Canada Ltd.*, 2009 FCA 114, [2010] 2 F.C.R. 344 (*General Motors*) the issue was whether General Motors of Canada Ltd. (GMCL) was entitled to input tax credits for the GST paid in relation to fees that it paid to investment managers who were managing funds held in the pension plans established by GMCL. One of the issues was whether the services were acquired for consumption or use in the course of the commercial activities of GMCL. The commercial activities of GMCL were the manufacture, assembly and sale of cars and trucks.

[23] In *General Motors* this Court held that there was a sufficient nexus or connection between the services provided by the investment managers and the commercial activities of GMCL. In making this connection, this Court noted that:

> **44** The Tax Court Judge gave to the words "in the course of", found in paragraph 169(1)(c), a wide meaning given by this Court in *The Queen v. Blanchard*, 95 D.T.C. 5479 (F.C.A.) and in *M.N.R. v. Yonge-Eglington Building*

Ltd., 74 D.T.C. 6180, at page 6184, where the words "in connection with", or "incidental to", or "arising from" were suggested. She held that GMCL's responsibilities to properly manage the Pension Plan assets were derived not only through the agreements but also through its duties as administrator under the OPBA and its duties to provide pension benefits to its employees (her para. 65). She noted that pension benefits, like salaries, are part of the compensation package which is an integral component to the commercial activities of the corporation. She fully explains these considerations at paragraphs 66-67. At paragraph 67 she stated:

> In addition to these contractual and statutory obligations, GMCL has agreed to provide, maintain and administer a compensation package, not only as one of the terms of employment extended to its employees, but as a vehicle for attracting and keeping the most qualified individuals within its organization. Without a profitable pension plan, GMCL's capacity to successfully compete in the market is substantially diminished. While the expenses associated with the administration of these pension assets may be viewed as being only indirectly related to the manufacture of vehicles, they are nonetheless an integral component to the overall success of GMCL's commercial activities in the market place. According to Mr. Marven's evidence, he likened the provision of a pension plan to other forms of employee compensation such as the provision of health care benefits. The only logical, common sense conclusion is that all of the functions of GMCL, in relation to these pension assets, are for the sole benefit of its employees, both the salaried and hourly employees and, consequently, they are an essential component to GMCL's business activities. Therefore, GMCL acquired the services of the Investment Managers for use in its commercial activities. As such, while GMCL does not directly utilize the services in making GST supplies in its operations, those services are part of its inputs toward its employee compensation program, which is a necessary adjunct of its infrastructure to making taxable sales. The expenses are not personal in nature. They are ancillary to the primary business activities of GMCL and meet the need of attracting and maintaining an adequate employee base to support its primary business operations. Therefore these expenses, although indirect expenses to GMCL's business, qualify as expenses paid for in the consumption or use in the course of the commercial activities of GMCL. Subsection 169(1) does not require that managing a pension plan be the sole commercial activity of a person, only that the supply be consumed or used "in the course of commercial activities". To divorce the services of the Investment Managers from the commercial activities of GMCL, in the manner that the Respondent would have me do, ignores not

> only the contractual and statutory obligations of GMCL but also the commercial realities of a competitive marketplace.
>
> (emphasis added by this Court)

[24] The amounts paid in *General Motors* were found to be for services that "are part of its inputs toward its employee compensation program, which is a necessary adjunct of its infrastructure to making taxable sales". Similarly in this case, the legal services related to the litigation were also linked to the employee compensation program of Look, albeit with a different motivation. GMCL was retaining investment fund managers to manage the investments presumably to enhance the pension plans, while Look was seeking to reduce the amounts payable to the Former Executives and recover any excess payments.

[25] As a result of the *General Motors* case, amounts that are paid to persons who are managing investments of pension plans that will be used to fund pensions for employees when they retire are paid for services that are acquired for consumption in the course of commercial activities and are not personal in nature.

[26] Neither the Tax Court nor this Court referred to subsection 141.01(2) of the Act in *General Motors*. Nor was there any reference to this subsection in the decision of this Court in *398722 Alberta Ltd. v. Canada*, [2000] G.T.C. 4091, 257 N.R. 71 (F.C.A.) which was cited in *General Motors* in relation to the question of the connection or nexus of the investment management services to the commercial activities of GMCL.

[27] Subsection 141.01(2) of the Act provides that:

(2) Where a person acquires or imports property or a service or brings it into a participating province for consumption or use in the course of an endeavour of the person, the person shall, for the purposes of this Part, be deemed to have acquired or imported the property or service or brought it into the province, as the case may be,	**(2)** La personne qui acquiert ou importe un bien ou un service, ou le transfère dans une province participante, pour consommation ou utilisation dans le cadre de son initiative est réputée, pour l'application de la présente partie, l'acquérir, l'importer ou le transférer dans la province, selon le cas, pour consommation ou utilisation :
(*a*) for consumption or use in the course of commercial activities of the person, to the extent that the property or service is acquired, imported or brought into the province by the person for the purpose of making taxable supplies for consideration in the course of that endeavour; and	*a*) dans le cadre de ses activités commerciales, dans la mesure où elle l'acquiert, l'importe ou le transfère dans la province afin d'effectuer, pour une contrepartie, une fourniture taxable dans le cadre de l'initiative;
(*b*) for consumption or use otherwise than in the course of commercial activities of the person, to the extent that the property or service is acquired, imported or brought into the province by the person	*b*) hors du cadre de ses activités commerciales, dans la mesure où elle l'acquiert, l'importe ou le transfère dans la province :
(i) for the purpose of making supplies in the course of that endeavour that are not taxable supplies made for consideration, or	(i) afin d'effectuer, dans le cadre de l'initiative, une fourniture autre qu'une fourniture taxable effectuée pour une contrepartie,
(ii) for a purpose other than the making of supplies in the course of that endeavour.	(ii) à une fin autre que celle d'effectuer une fourniture dans le cadre de l'initiative.

[28] Since this Court found in *General Motors* that the services of the investment managers were acquired for consumption or use in the commercial activities of GMCL and since GMCL

was in the business of making taxable supplies of cars and trucks, it would logically follow that the services of the investment manager were acquired for the purpose of making these taxable supplies. Without employees, GMCL could not make taxable supplies. There was also no suggestion that GMCL was making any exempt supplies.

[29] GMCL was making taxable supplies at the time that the expenditures in question were incurred. However, in this case, Look had ceased making taxable supplies before the legal expenses were incurred. In this situation, arguably there is a conflict between subsection 141.01(2) of the Act and subsection 141.1(3) of the Act as it may be difficult to argue that any expense incurred after a registrant has ceased making taxable supplies is made for the purpose of making taxable supplies even though the expenditure is made in connection with the termination of the commercial activity.

[30] This conflict, in my view, can be resolved as follows. In general, subsection 141.01(2) of the Act would provide that a property or service will be deemed to be acquired in the course of commercial activities to the extent that it is acquired for the purpose of making taxable supplies for consideration. However, if the registrant is acquiring a property or a service in connection with the acquisition, establishment, disposition or termination of a commercial activity, that person will not lose the entitlement to claim an input tax credit solely because that person is not making any taxable supplies at the time that such property or service is acquired. Because subsection 141.1(3) of the Act is the more specific provision that only applies in certain situations, it will override subsection 141.01(2) of the Act (*National Bank Life Insurance, Life Insurance Co. v. Her Majesty the Queen*, 2006 FCA 161, 381 N.R. 117, at paras. 9 and 10).

[31] The Tax Court judge noted in particular that legal services acquired to collect accounts receivable, after a registrant has stopped making taxable supplies, would qualify as services acquired as part of the termination of the commercial activity of the registrant and hence would be deemed to be acquired in the course of commercial activities pursuant to subsection 141.1(3) of the Act. Presumably those accounts receivable would have arisen from taxable supplies made by the registrant.

[32] In this case, even though Look had ceased making taxable supplies when it commenced the litigation against the Former Executives, it was pursuing these Former Executives for amounts that Look was claiming were excess compensation paid to these persons. These amounts would have been paid (rightly or wrongly) for services rendered while Look was carrying on a commercial activity or while Look was terminating its commercial activity.

[33] In both situations (litigation to establish and collect the accounts receivable and litigation to establish the appropriate amount payable for remuneration and collect any overpaid remuneration) the underlying activity which gave rise to the litigation was completed before the registrant stopped making taxable supplies. However, the dispute relating to the amount payable (either to or by the registrant) commences after the registrant has ceased making taxable supplies. In my view, since the necessary connection would be there for legal services to collect amounts owing to the registrant, it should also be there for legal services for amounts payable by the registrant.

[34] Therefore, in my view, there would be a connection between the litigation to establish (after the registrant has stopped making taxable supplies) that there was an amount of overpaid compensation (and collecting that amount) and the termination of the commercial activity of the registrant because that compensation would be related to services rendered while the registrant was making taxable supplies. Therefore, there is a connection between the termination of Look's commercial activity and the legal services acquired in relation to the litigation against the Former Executives that would be sufficient to permit Look to claim the input tax credits for the GST or HST paid in relation to those legal services.

[35] As a result, I would allow the appeal, with costs, and set aside the determination made by the Tax Court judge. Making the determination that the Tax Court judge should have made, I would answer the question in the affirmative.

"Wyman W. Webb"
J.A.

"I agree
D. G. Near J.A."

"I agree
Mary J.L. Gleason J.A."

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

APPEAL FROM A JUDGMENT OF THE TAX COURT OF CANADA DATED OCTOBER 14, 2016, NO. (2015-2233(GST)G)

DOCKET:	A-415-16
STYLE OF CAUSE:	ONENERGY INC. v. HER MAJESTY THE QUEEN
PLACE OF HEARING:	TORONTO, ONTARIO
DATE OF HEARING:	OCTOBER 16, 2017
REASONS FOR JUDGMENT BY:	WEBB J.A.
CONCURRED IN BY:	NEAR J.A. GLEASON J.A.
DATED:	MARCH 19, 2018

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