Federal Court of Appeal  Cour d'appel fédérale

Date: 20180717

Docket: A-165-17

Citation: 2018 FCA 134

CORAM: **WEBB J.A.**
RENNIE J.A.
WOODS J.A.

BETWEEN:

THE ARMOUR GROUP LIMITED

Appellant

and

HER MAJESTY THE QUEEN

Respondent

Heard at Halifax, Nova Scotia, on April 24, 2018.

Judgment delivered at Ottawa, Ontario, on July 17, 2018.

REASONS FOR JUDGMENT BY: WEBB J.A.

CONCURRED IN BY: RENNIE J.A.
WOODS J.A.

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REASONS FOR JUDGMENT

WEBB J.A.

[1] This is an appeal from the judgment of Justice Paris of the Tax Court of Canada (2017 TCC 65) (TCC) who dismissed the appeal of The Armour Group Limited (AGL) from a reassessment which denied AGL's claim for a deduction for a lease cancellation fee of $2.24 million in 2003.

[2] For the reasons that follow I would dismiss this appeal.

I. Background

[3] The Province of Nova Scotia (the Province) owned certain land and buildings located in downtown Halifax. Founders Square Limited (FSL), a wholly-owned subsidiary of AGL, entered into a lease agreement with the Province on July 6, 1984 (the Ground Lease). FSL was also acting as a bare trustee for AGL throughout the relevant periods in relation to this appeal. In addition to the Ground Lease, FSL agreed to redevelop the property and construct an office building. The total rentable area of the new building and the existing buildings would be 200,600 square feet. The terms of the Ground Lease provided that the rent payable by FSL would be $100,000 per year for 10 years and a percentage of the gross revenue for the remaining 70 years of the term. The total term of the Ground Lease was 80 years. At the expiration of the term, the property would revert to the Province. The property was redeveloped and the office building was constructed.

[4] As part of the agreements between FSL and the Province, the Province agreed to rent 50,000 square feet of office space for a period of 30 years. While initially the Province leased this amount of space, by the early 1990s the Province had reduced the space that it was leasing to less than 50,000 square feet. FSL commenced an action in the Supreme Court of Nova Scotia on the basis that the Province had breached its agreement. Before the ensuing litigation was finally concluded, FSL and the Province entered into minutes of settlement dated February 21, 2003 to settle the issues between them. As part of the minutes of settlement, the Province acknowledged that it was liable to FSL for the amount of $4,456,250. The Province agreed to make a lump sum payment of $2,056,250 which left a remaining amount of $2,400,000. As part of the minutes of

settlement, the Province agreed to grant an option to FSL for FSL to purchase the property for its agreed-upon fair market value of $2.4 million. As a result, if FSL exercised the option to purchase the property, the purchase price of $2.4 million would be set-off against the amount of $2.4 million owing by the Province.

[5] An option to purchase was granted by the Province to FSL on March 20, 2003. The option reflected the terms of the settlement agreement and in particular, paragraph 7 states that if the option is exercised the consideration for the purchase of the property of $2,400,000 would be credited to and deducted from the remaining amount of $2,400,000 that the Province was liable to pay to FSL under the minutes of settlement. Paragraph 3 of this option also provides that:

> [t]he title of the Property shall be a marketable title and free and clear of all encumbrances with the exception of a Ground Lease dated July 6, 1984 between Her Majesty and Founders Square Limited, and with the exception of registration pursuant to the *Heritage Property Act* [R.S.N.S. 1989, c. 199].
>
> (appeal book, page 132)

[6] The recitals in the option state that the Ground Lease would also be assigned and "Property" is defined as the lands (which would include the buildings) and the Ground Lease. In the part of the option that specifies the terms of the agreement of purchase and sale of the Property that would arise upon the option being exercised, there is no separate reference to an assignment of the Ground Lease. The terms only refer to a sale of the Property.

[7] FSL transferred its rights under the option to Armour Developments Limited (ADL), another wholly-owned subsidiary of AGL, on June 10, 2003 (the Transfer Agreement). Under the Transfer Agreement, FSL transferred to ADL $160,000 of the $2,400,000 remaining liability

of the Province under the minutes of settlement. Also as part of the Transfer Agreement, ADL agreed that upon ADL becoming the owner of the lands it would grant a ground lease to FSL upon the same terms and conditions as the Ground Lease except that the annual rent would be reduced from $100,000 per year to $10 per year. The lease between ADL and FSL (as contemplated by the Transfer Agreement) is dated July 11, 2003 (appeal book, page 162) and the term of this lease, as provided in Article 3.01 thereof, commenced on July 11, 2003. This was before the date of the deed (September 19, 2003).

[8] Under the Transfer Agreement FSL agreed to transfer "to ADL all of its right, title and interest in the Option to purchase the Lands" (appeal book, page 135). The reference to the "Lands" is in the following recital in the transfer agreement:

> WHEREAS:
>
> …
>
> 2. By an Option to Purchase a true copy of which is attached hereto as Schedule "B" Founders [FSL] is entitled to purchase those lands as particularly described in Schedule "C" attached hereto (the "Lands").

[9] The Lands are the same lands that are described in the option. There is no dispute that the Lands include the buildings located thereon (which is consistent with paragraph 13(*d*) of the *Conveyancing Act*, R.S.N.S. 1989, c. 97). There is no reference to a surrender of the Ground Lease in the Transfer Agreement.

[10] On the same day (June 10, 2003) both FSL and ADL exercised the option to purchase the Property from the Province. The notice of the exercise of the option executed by FSL indicated

that it was electing "to purchase the Property referred to in the Option except the interest transferred to [ADL]".

[11] Also on June 10, 2003, FSL provided notice to the Province that it had assigned to ADL its rights under the option to purchase, "but not the Lease dated July 6, 1984 which is being cancelled concurrent with delivery of the deed" (appeal book, page 152). However, as noted above, there is no indication in the Transfer Agreement that the Ground Lease would be cancelled.

[12] On June 11, 2003, the solicitor for FSL stated that he was forwarding to the Province:

> 1. Exercise of Option to Purchase relating to the lands upon which Founders Square is located executed by Founders Square Limited;
>
> 2. Notice to Her Majesty the Queen executed by Founders Square Limited advising that they have assigned their right to that portion of the option relating to the lands.
>
> 3. Exercise of Option to Purchase executed by Armour Developments Limited.
>
> As set out in the enclosed documents, the deed, when delivered, pursuant to the option is to be made to Armour Developments Limited. With respect to the Ground Lease as set out in the option documents, there would be a surrender of the same between the Province and Founders Square Limited done simultaneously.
>
> (appeal book, page 153)

[13] The solicitor for the Province responded with a one line reply on June 20, 2003: "I confirm that the option has been appropriately exercised" (appeal book, page 156). There is no reference to the surrender of the Ground Lease nor is there any reference to the assignment

of the option to ADL. Since the deed executed by the Province conveyed the Lands to ADL, it is a reasonable inference that the Province consented to ADL purchasing the Lands.

[14] The only documents that contain any reference to the surrender of the Ground Lease are the letter from the solicitor for FSL referred to above, a letter from the solicitor for the Province dated July 8, 2003, the closing agenda and the surrender of lease. The letter from the solicitor for the Province dated July 8, 2003 has only the following reference to the surrender of lease:

> With respect to the consideration for the surrender of lease, I confirm that you are having that document changed so that it will reflect consideration of $10.00 and other good and valuable consideration.
>
> (appeal book, page 157)

[15] In the closing agenda prepared for the "Purchase of Freehold Title of the Lands of the Province of Nova Scotia pursuant to an Option Agreement dated March 20, 2003 on July 16, 2003" (appeal book, page 199) it is stated that "[a]ll documents and other instruments and deliveries will be tabled and held in escrow until all documents and instruments have been delivered, at which time the escrow shall be terminated and at such time the documents and instruments shall be released from escrow simultaneously and the closing shall be deemed to have been completed ". The documents listed on the closing agenda include the warranty deed and the surrender of lease.

[16] The surrender of lease is dated July 22, 2003 and provides that "in consideration of the sum of Ten Dollars ($10.00) and other good and valuable consideration … the Tenant [FSL] hereby assigns and surrenders to the Landlord [the Province] the premises referred to in the

Lease and the Tenant shall be released from all covenants and obligations under the Lease" (appeal book, page 200).

[17] Paragraph 2.02 of this surrender of lease provides that:

> [t]he parties acknowledge that this Surrender is being executed and delivered simultaneously with the execution and delivery of the Conveyance and that this Surrender and the Conveyance should be held in escrow until both the Surrender and Conveyance have been delivered at which time the escrow shall be terminated and at such time the Surrender and Conveyance shall be released from escrow simultaneously and that the delivery of this Surrender and the Conveyance shall in no way constitute a merger of the fee simple title and the leasehold title in the Lands.
>
> (appeal book, page 201)

[18] The actual date of the closing is unclear. The closing agenda refers to July 16, 2003, the surrender of lease is dated July 22, 2003 and the deed is dated September 19, 2003 (appeal book, page 206). At some point in 2003 the closing was completed. In filing its tax return, AGL claimed a deduction for a lease cancellation fee of $2.24 million.

II. Decision of the Tax Court Judge

[19] The Tax Court Judge found that AGL had not established that it had paid a lease cancellation fee to the Province of $2.24 million in 2003. In reaching this conclusion, the Tax Court Judge drew an unfavourable inference in relation to the failure of AGL to have a witness from the Province testify with respect to the arrangements and the lease cancellation fee. The Tax Court Judge also found that the leasehold interest had merged with the fee simple title.

III. Issue

[20] The issue in this case is whether AGL has established that it is entitled to claim a deduction for a lease cancellation fee of $2.24 million in 2003.

IV. Standard of review

[21] The standard of review for any question of fact or mixed fact and law (for which there is no extricable question of law) is palpable and overriding error and for any question of law is correctness (*Housen v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235).

V. Analysis

[22] Although the Tax Court Judge drew an unfavourable inference as a result of AGL failing to call anyone from the Province as a witness to confirm the arrangement and also found that the leasehold interest had merged with the fee simple title, in my view, it is not necessary to address either one of these findings in order to resolve the issue in this case. It is only necessary to review the documents that have been submitted and the arguments as presented by counsel for AGL to determine the issue.

[23] It is the position of AGL that the remaining amount of $2.4 million payable by the Province under the minutes of settlement was set-off against two amounts at the closing of the purchase of the Property:

(a) $2,240,000 paid by FSL as a lease cancellation fee to cancel the lease; and

(b) $160,000 paid by ADL to purchase the Lands.

[24] It is a reasonable inference from these submissions that ADL, FSL and AGL intended that ADL (and not FSL) would be the purchaser of the Lands (which would include the buildings) under the option. At the time of the closing the appraised value of the buildings was in excess of $14 million (transcript from the TCC hearing, page 58).

[25] Counsel for AGL repeatedly stated during the hearing that this case turned on the fact that all of the closing documents were held in escrow and the terms of the escrow provided that the transactions were completed simultaneously. This is reflected in the letter from the solicitor for FSL, the surrender of lease, and the closing agenda referred to above. In paragraph 31 of the memorandum filed by AGL, it is stated that: "[i]n the Closing Agenda the parties confirmed a process of simultaneous escrow ". The paragraph then quotes the excerpt from the closing agenda that is recited in paragraph 15 above.

[26] In paragraph 32 of its memorandum, AGL states that:

> [i]mportantly, the Lease Surrender Agreement itself confirmed this process of simultaneous escrow and expressly indicated the parties' intention against any merger of leasehold interest (held by FSL) and the fee simple title (as conveyed to ADL). Indeed, this was the only way to ensure against a merger that would have entirely defeated the purpose for the FSL's assignment to ADL in the first place.

[27] There was no indication that the parties intended any sequence of events at the closing. AGL in its memorandum of fact and law and throughout the hearing of this appeal continued to insist that the transactions were completed simultaneously. During the hearing of this appeal, this

Court posed the question of whether the Province would have been entitled to any lease cancellation payment as a result of the surrender of the Ground Lease at the exact same time that the Province conveyed title to the Lands to ADL. The parties submitted additional written submissions on this point.

[28] Despite having maintained during the hearing of this appeal that the transactions were completed simultaneously, in the supplemental submissions filed by AGL, it is stated, as part of paragraph 4, that:

> (d) In this case, the parties intended the escrow to operate in the manner that would of necessity allow for the following sequence of events within the protective realm of the escrow: (i) surrender the Ground Lease on payment of the Lease Cancellation Fee; (ii) transfer of the fee simple to ADL; and (iii) perfection of the new ground lease between ADL and FSL.
>
> (e) By then allowing for simultaneous delivery and closing of all such transactions within the escrow, FSL's right to lease the building did not lapse and the validity and integrity of FSL's sub-leases with its office tenants was never compromised.

[29] The result of this appears to be that AGL is arguing that the three transactions referred to in paragraph 4(d) quoted above occurred both simultaneously and in the sequence as set out in this paragraph 4(d). However, these two positions are irreconcilable. If the transactions occurred simultaneously, they could not also have occurred in the sequence as set out in paragraph 4(d) above. This does not mean that the transactions, in law, occurred simultaneously. It only illustrates that the two positions are irreconcilable.

[30] It is always open to a court to determine whether the transactions, in law, occurred as proposed by a particular person. Even if the parties to a transaction agreed that certain

transactions occurred simultaneously, a court could determine otherwise (*DeGasperis Muzzo Corp. v. 951865 Ontario Inc.*, 35 R.P.R. (3d) 243, [2000] O.J. No. 3218, at para. 14 (Ont. Sup. Ct.), affirmed on appeal 42 R.P.R. (3d) 63), 2001 CarswellOnt 2285 (Ont. C.A.).

[31] In this case, these two proposed scenarios will be examined to determine whether either scenario would support a finding that a lease surrender payment of $2.24 million was paid to the Province.

[32] First, assume that the Ground Lease was surrendered and the lease cancellation fee was paid immediately before the Lands were conveyed to ADL. The "protective realm of the escrow" would not alter the legal consequences that would flow from this sequence of events. Based on this scenario, ADL would be acquiring the Lands free from the encumbrance of the Ground Lease. In the Transfer Agreement, FSL transferred all of its rights under the option to ADL to purchase the Lands. Therefore, ADL was the holder of an option to purchase the Lands, subject to the encumbrance of the Ground Lease, for $2.4 million.

[33] The nature of an option was described by the Supreme Court of Canada in *Mitsui & Co. (Canada) Ltd. v. Royal Bank of Canada*, [1995] 2 S.C.R. 187 at 201, 123 D.L.R. (4th) 449 at paras. 27 & 28:

> An option contract is an antecedent contract because it precedes the contract of purchase and sale that will result if the opportunity provided by the option is "seized upon" or exercised. Once an option is exercised, the parties discharge their obligations under the option contract by entering into the contract of purchase and sale. The exercise of an option is the election to buy property on the terms specified in the option agreement, and is the equivalent of accepting the irrevocable offer made in the option. One cannot exercise the same option twice. The exercise of the option must mean the acceptance of the offer. That acceptance

must be unconditional, must only be made once, and must be made in accordance with the terms of the option.

Characterization of the Option in Clause 32

The exercise of an option must lead to a binding contract of purchase and sale. The mechanism of converting an option to purchase into a contract of purchase and sale has been described by Lord Diplock in *Sudbrook Trading Estate Ltd. v. Eggleton*, [1983] 1 A.C. 444 (H.L.), at pp. 476-77:

> The option clause cannot be classified as a mere "agreement to make an agreement." There are not any terms left to be agreed between the parties. In modern terminology, it is to be classified as a unilateral or "if" contract. Although it creates from the outset a right on the part of the lessees, which they will be entitled, but not bound, to exercise against the lessors at a future date, it does not give rise to any legal obligations on the part of either party unless and until the lessees give notice in writing to the lessors, within the stipulated period, of their desire to purchase the freehold reversion to the lease. The giving of such notice, however, converts the "if" contract into a synallagmatic or bilateral contract, which creates mutual legal rights and obligations on the part of both lessors and lessees.

(emphasis added)

[34] Therefore, upon exercising this option, ADL would have accepted the offer of the Province to sell the Property and would have been obligated to pay the purchase price of $2.4 million.

[35] The position of AGL is that the $2.4 million referred to in the option was payable for the value of the future revenue stream arising under the Ground Lease held by the Province and the present value of the Province’s reversionary interest in the property. However, in my view, this is not an accurate description of the option. The option is for the “Sale of the Property” which is

defined as the Lands and Ground Lease. If the Ground Lease is removed (as a result of the surrender of the Ground Lease) the Province then owns the Lands (including the buildings) subject only to the registration under the *Heritage Property Act*. The Lands (including the buildings) would still be owned by the Province (albeit without the encumbrance of the Ground Lease) and the option would still provide for a sale of these Lands for $2.4 million. There is nothing in the option that indicates that the purchase price for the Lands without the encumbrance of the Ground Lease would be any less than $2.4 million.

[36] There was no indication that any amendments were made to the terms and conditions of the option and, in particular, there is no document that indicates that the obligations of ADL arising from the exercise of the option were changed as a result of the surrender of the Ground Lease. Therefore, there is no document that indicates that the amount payable by ADL for the Lands (which would include the buildings with an appraised value in excess of $14 million) without the Ground Lease as an encumbrance would drop to $160,000. As a result, in this scenario, the purchase price payable by ADL for the Lands would presumably still be $2.4 million (which is the purchase price as set out in the option agreement for the Property) and this amount would be payable in addition to any amount payable by FSL (a different person) in relation to the surrender of lease.

[37] Since there was no indication in the closing agenda that any amount would be paid at the closing (other than payment as a set off against the amount payable by the Province under the minutes of settlement), if, as proposed by AGL in its supplemental submissions, the lease was surrendered immediately before the property was conveyed, this would not support a finding that

any amount was paid or payable by FSL or ADL other than the $2.4 million purchase price as contemplated by the option and, in particular, would not support a finding that a lease cancellation fee of $2.24 million was paid or payable by FSL to the Province. The more likely result is that ADL purchased the Lands for $2.4 million and that this purchase price was set-off against the $2.4 million owing by the Province to FSL under the minutes of settlement.

[38] By having the surrender of lease occur before the Lands were conveyed, there would also be a brief moment in time when there was no lease. Having even a moment in time when there was no lease in place would also be inconsistent with the clearly stated intention of FSL that the lease not lapse (paragraph 4(e) from the supplemental submissions of AGL referred to in paragraph 28 above).

[39] The other scenario proposed by AGL was that the transactions occurred simultaneously. If, however, it is assumed that the transactions occurred simultaneously, this would also not support the position of AGL that a lease cancellation fee of $2.24 million was paid or payable to the Province. If a lease surrender fee is payable at the exact same moment in time that the Province conveys title to the Lands, then it is far from clear why the Province would be entitled to that payment. Since, as set out in paragraph 23 above, it is the position of AFL that the only amount payable to the Province (other than the amount payable as a lease cancellation fee) was $160,000 payable by ADL for the purchase of the Lands, without a lease cancellation fee of $2.24 payable to the Province there would not be a sufficient amount to set off against the $2.4 million that the Province owed under the minutes of settlement.

[40] Having the transactions occur simultaneously would also not resolve the issue of why the amount payable by ADL under the agreement arising from the exercise of the option would be reduced from $2,400,000 to $160,000.

[41] As a result, neither scenario would support a finding that there was a surrender of the Ground Lease to the Province for $2.24 million at any time when the Province owned the Lands.

[42] As a result, in my view, the Tax court Judge did not err in his conclusion, as stated in paragraph 50 of his reasons “that upon the proper construction of the agreements that are before me, FSL used the $2.4 million credit under the Minutes of Settlement to pay for the transfer of the Property to ADL”.

[43] Therefore, AGL has not established that there was a lease cancellation fee paid (or payable) to the Province in 2003 in the amount of $2,240,000.

[44] I would dismiss the appeal with costs.

"Wyman W. Webb"
J.A.

“I agree
Donald J. Rennie J.A.”

“I agree
J. Woods J.A.”

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

APPEAL FROM A JUDGMENT OF THE TAX COURT OF CANADA DATED APRIL 24, 2017, DOCKET NUMBER 2013-3902(IT)G

DOCKET:	A-165-17
STYLE OF CAUSE:	THE ARMOUR GROUP LIMITED v. HER MAJESTY THE QUEEN
PLACE OF HEARING:	HALIFAX, NOVA SCOTIA
DATE OF HEARING:	APRIL 24, 2018
REASONS FOR JUDGMENT BY:	WEBB J.A.
CONCURRED IN BY:	RENNIE J.A. WOODS J.A.
DATED:	JULY 17, 2018

APPEARANCES:

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