Federal Court of Appeal

Cour d'appel fédérale

Date: 20081215

Dockets: A-122-08
A-123-08
A-121-08

Citation: 2008 FCA 400

CORAM: **DÉCARY J.A.**
LÉTOURNEAU J.A.
NOËL J.A.

A-122-08

BETWEEN:

CDSL CANADA LIMITED

Appellant

and

HER MAJESTY THE QUEEN

Respondent

A-123-08

BETWEEN:

GROUPE CGI INC. / CGI GROUP INC.

Appellant

and

HER MAJESTY THE QUEEN

Respondent

A-121-08

BETWEEN:

CGI INFORMATION SYSTEMS AND MANAGEMENT CONSULTANTS INC.

Appellant

and

HER MAJESTY THE QUEEN

Respondent

Hearing held at Montréal, Quebec, on December 3, 2008.

Judgment delivered at Ottawa, Ontario, on December 15, 2008.

REASONS FOR JUDGMENT BY: NOËL J.A.

CONCURRED IN BY: DÉCARY J.A.
LÉTOURNEAU J.A.

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REASONS FOR JUDGMENT

NOËL J.A.

[1] These are three appeals from decisions of Associate Chief Justice Rip of the Tax Court of Canada (TCC), as he then was (TCC judge), confirming, following a common hearing and based on a single set of reasons, the assessments made by the Minister of National Revenue (Minister) under the *Income Tax Act*, R.S.C. 1985, c. 1, (5th Supp.) (Act) regarding the three appellants.

[2] In issue are the following: in the case of the appellant CDSL Canada Limited (CDSL), the assessment made for its 1998 taxation year; in the case of the appellant Groupe CGI Inc./CGI Group Inc. (CGI), the assessment made for its 1998 taxation year and the determination of losses for its 1999 taxation year; in the case of the appellant CGI Information Systems and Management Consultants Inc. (Systems), the assessments made for its 1998 and 1999 taxation years.

[3] The issue to be determined in each of the appeals is the same: does the Act, and more specifically subsection 10(l), authorize the appellants to compute their income in a manner that is inconsistent with Generally Accepted Accounting Principles (GAAP). The TCC judge answered this question in the negative and dismissed the three appeals with costs, which led to the three appeals before this Court.

BACKGROUND

[4] The facts are set out in an agreement that is reproduced in its entirety in the reasons for judgment of the TCC judge. I will merely make a brief summary in the following paragraphs, but before doing so, I find it would be appropriate to reproduce subsection 10(1) of the Act:

10. (1) For the purpose of computing a taxpayer's income for a taxation year from a business that is not an adventure or concern in the nature of trade, property described in an inventory shall be valued at the end of the year at the cost at which the taxpayer acquired the property or its fair market value at the end of the year, whichever is lower, or in a prescribed manner.	**10. (1)** Pour le calcul du revenu d'un contribuable pour une année d'imposition tiré d'une entreprise qui n'est pas un projet comportant un risque ou une affaire de caractère commercial, les biens figurant à l'inventaire sont évalués à la fin de l'année soit à leur coût d'acquisition pour le contribuable ou, si elle est inférieure, à leur juste valeur marchande à la fin de l'année, soit selon les modalités réglementaires.

[Emphasis added.]

[5] The appellants are companies that provide consulting services in the field of computer technology. Each carries on a business in the true meaning of the word. For accounting purposes,

the appellants accounted for their work in progress on a fiscal-year basis, which takes into account the portion of the profit for work completed but not yet billed. The method, known as the percentage-of-completion method and which accounts for the results of long-term contracts based on the progress of the work, is consistent with GAAP (agreement, paragraph e.).

[6] The parties agree that work in progress for services still being provided is inventory subject to subsection 10(1) and that, in accordance with that subsection, that work in progress must be valued at the lower of cost or fair market value (FMV). To calculate their income for tax purposes, the appellants valued their work in progress based on the cost, which was lower than the FMV (agreement, paragraph i.).

[7] No expert evidence was filed in the TCC, the parties having agreed that the issue was limited to determining whether section 9 and the GAAP that it incorporates override section 10 (A.B., page 82 (A-121-08); page 57 (A-122-08); page 95 (A-123-08)). Instead of reporting their income on the basis of earned income, as required by GAAP, they instead chose to be taxed on the basis of their billed income. The appellants concede that their method does not provide an accurate picture of their income.

[8] According to the agreement on facts, for its taxation years ending on September 30, 1998, and September 30, 1999, Systems determined that the cost of its inventoried work in progress was $7,234,328 and $11,819,377 respectively, whereas the FMV of this inventory was of $11,859,554 and $19,376,028 on the same dates (agreement, paragraphs b. and f.). Similarly, for its taxation

years ending on September 30, 1998, and September 30, 1999, CGI determined that the cost of its inventoried work in progress was $2,594,920 and $523,597 respectively, whereas the FMV of this inventory was of $4,253,967 and $858,356 on the same dates (agreement, paragraphs c. and g.). Lastly, for its taxation year ending on September 30, 1998, CDSL determined that the cost of its inventoried work in progress was $1,032,767, whereas the FMV of this inventory was of $1,693,060 on that same date (agreement, paragraphs d. and h.).

[9] The appellants' 1998 income tax returns show that, to reconcile their tax income with their book income and implement the reduction of income resulting from the application of subsection 10(1), they made a downward adjustment (which they call a "reserve") representing the difference between the FMV and the cost of the inventoried work (A.B., page 66 (A-121-08); page 42 (A-122-08); page 74 (A-123-08)). The following year, Systems and CGI reversed the reserve claimed in 1998 in order to claim a new one that takes into account the cost of work in progress at the end of 1999 (A.B., page 43 (A-121-08); page 46 (A-123-08)).

[10] The Minister was of the opinion that this method had the effect of deferring, unduly and contrary to GAAP, recognition of income earned by the appellants. In computing their income for the 1998 taxation year, the Minister added the difference between the FMV and the cost of inventoried work in progress: $4,625,226 in the case of Systems; $1,659,047 in the case of CGI; and $660,293 in the case of CDSL (agreement, paragraphs m., n., o.).

[11] In computing Systems' income for the 1999 taxation year, the Minister added $2,931,425, which is the difference between the net adjustment under the heading of work in progress for 1999 ($7,556,651) and the net adjustment for 1998 ($4,625,226) (agreement, paragraph p.). In computing CGI's income for the1999 taxation year, the Minister added the difference between the FMV and the cost of its inventoried work in progress, namely, $334,759. In that assessment, the amount owed was deemed to be nil (agreement, paragraph q.). The Minister then determined a loss for CGI for 1999, taking into account the addition of $334,759 and deducting $1,659,047 for the amount that it had added for 1998 (agreement, paragraph s.).

[12] The effect of the adjustments made by the Minister is the same in all three cases, namely, substituting the FMV for the cost in the valuation of the inventoried work in progress for the years in issue, thus eliminating the tax benefit that, according to the appellants, resulted from the application of subsection 10(1).

DECISION UNDER APPEAL

[13] At the beginning of his analysis, the TCC judge stated that the issue to be determined as it was presented to him is the following: does section 10 override subsection 9(1)? The parties had thus agreed on the definition of the matter to be argued before the TCC (A.B., page 82 (A-121-08); page 57 (A-122-08); page 95 (A-123-08)).

[14] The TCC judge refused to approach the issue in this manner. In his opinion, subsection 9(1) and section 10 are not mutually exclusive (reasons, paragraph 8). In saying this, the TCC judge relies on a passage from the decision of this Court in *Canada v. Cyprus Anvil Mining Corp.*, [1989] F.C.J. No. 1146 (QL), at paragraph 22, which states "that it [cannot] be said that subsection 10(1) is a specific provision overriding the general one, section 9". According to the TCC judge, these two provisions are complementary and can be applied harmoniously.

[15] The TCC judge recognizes that the appellants meet the criteria for the application of section 10 in this case (reasons, paragraph 10). He states that subsection 9(1) is a general provision, whereas section 10 refers more directly to the valuation of the inventory of a business (reasons, paragraph 11). The method selected by taxpayers to determine their profit must nonetheless give an "accurate picture" of their income (*Canderel Ltd. v. Canada*, [1998] 1 S.C.R. 147).

[16] In the subsection 10(1) formula, the cost of sales (in this case, the cost related to the services provided) must be deducted from the sales of the business (reasons, paragraph 15). According to the TCC judge, determining the amount of the inventory is simply a stage in the process required to establish the income of a business rather than another way of determining the income (reasons, paragraph 17).

[17] For taxation purposes, the appellants took a reserve against their profit in order to defer the inclusion of profit relating to the work in progress. The TCC judge finds that, as acknowledged by the parties in their agreement (paragraph i.):

> [18] . . . The effect of this practice is to defer by one year the inclusion of the profit related to work in progress. Instead of reporting their income on the basis of earned income, they instead chose to be taxed on the basis of their billed income. This is clearly the problem since nothing in the *Act* allows such a reserve to be deducted.

[18] According to the TCC judge, the valuation scheme in subsection 10(1) does not allow for deducting any loss arising from inventory (reasons, paragraph 20). Only when the FMV of the inventory is lower than its cost does section 10 indirectly authorize the taking of a loss before the actual disposition of the inventoried property (*idem*). The TCC judge concludes by stating the following (paragraph 22):

> Thus, the purpose of section 10 is merely to determine how to account for inventory in the calculation of income referred to in subsection 9(1) and it does not mean that profits from work in progress should be disregarded. Again, this section deals only with the manner in which to account for inventory for tax purposes. . . .

[19] The TCC judge adds that a different conclusion would make section 34 of the Act meaningless. This section offers certain professionals the choice of excluding their work in progress from their income. Subsection 10(5) states that the work in progress of a business that is a profession is inventory. Section 10 therefore applies whenever section 34 applies. If, as the appellants claim, section 10 allowed for the exclusion of the profit portion of work in progress from the calculation of income, section 34 would be meaningless (reasons, paragraph 23).

[20] In addition to subsection 10(1) of the Act (which has been reproduced at paragraph 4, above), the TCC judge cites the following provisions in his reasons:

SECTION 9:	ARTICLE 9:
(1) Subject to this Part, a taxpayer's income for a taxation year from a business or property is the taxpayer's profit from that business or property for the year.	(1) Sous réserve des autres dispositions de la présente partie, le revenu qu'un contribuable tire d'une entreprise ou d'un bien pour une année d'imposition est le bénéfice qu'il en tire pour cette année.
...	[...]
SECTION 10:	ARTICLE 10:
…	[…]
(2) Notwithstanding subsection (1), for the purpose of computing income for a taxation year from a business, the inventory at the commencement of the year shall be valued at the same amount as the amount at which it was valued at the end of the preceding taxation year for the purpose of computing income for that preceding year.	(2) Malgré le paragraphe (1), pour le calcul du revenu tiré d'une entreprise au cours d'une année d'imposition, les biens figurant à un inventaire au début de l'année sont évalués au même montant que celui auquel ils ont été évalués à la fin de l'année d'imposition précédente pour le calcul du revenu de cette année précédente.
(2.1) Where property described in an inventory of a taxpayer's business that is not an adventure or concern in 2008 CCI 106 (the nature of trade is valued at the end of a taxation year in accordance with a method permitted	(2.1) La méthode, permise par le présent article selon laquelle les biens figurant à l'inventaire d'une entreprise d'un contribuable qui n'est pas un projet comportant un risque ou une affaire de caractère commercial sont évalués à la fin d'une année

under this section, that method shall, subject to subsection (6), be used in the valuation of property described in the inventory at the end of the following taxation year for the purpose of computing the taxpayer's income from the business unless the taxpayer, with the concurrence of the Minister and on any terms and conditions that are specified by the Minister, adopts another method permitted under this section.

. . .

(5) Without restricting the generality of this section,

a) property (other than capital property) of a taxpayer that is advertising or packaging material, parts or supplies or work in progress of a business that is a profession is, for greater certainty, inventory of the taxpayer;

. . .

d'imposition doit servir, sous réserve du paragraphe (6), à évaluer les biens qui figurent à cet inventaire à la fin de l'année d'imposition subséquente pour le calcul du revenu que le contribuable tire de cette entreprise, sauf si celui-ci, avec l'accord du ministre et aux conditions précisées par ce dernier, adopte une autre méthode permise par le présent article.

[...]

(5) Sans préjudice de la portée générale du présent article:

a) il demeure entendu que les biens (autres que les immobilisations) d'un contribuable qui sont des travaux en cours d'une entreprise qui est une profession libérale, du matériel de publicité ou d'emballage, des pièces ou des fournitures doivent figurer parmi les éléments portés à son inventaire;

[...]

SECTION 34:

In computing the income of a taxpayer for a taxation year from a business that is the professional practice of an accountant, dentist, lawyer, medical doctor, veterinarian or chiropractor, the following rules apply:

a) where the taxpayer so elects in

ARTICLE 34:

Les règles suivantes s'appliquent au calcul du revenu d'un contribuable pour une année d'imposition tiré d'une entreprise qui consiste en l'exercice de la profession de comptable, de dentiste, d'avocat, de médecin, de vétérinaire ou de chiropraticien:

the taxpayer's return of income under this Part for the year, there shall not be included any amount in respect of work in progress at the end of the year; and

b) where the taxpayer has made an election under this section, paragraph (*a*) shall apply in computing the taxpayer's income from the business for all subsequent taxation years unless the taxpayer, with the concurrence of the Minister and on such terms and conditions as are specified by the Minister, revokes the election to have that paragraph apply.

a) aucun montant n'est inclus pour le travail en cours à la fin de l'année, si le contribuable en fait le choix dans sa déclaration de revenu produite en vertu de la présente partie pour l'année;

b) l'alinéa *a*) s'applique au calcul du revenu du contribuable tiré de l'entreprise pour les années d'imposition ultérieures, si celui-ci a fait le choix prévu au présent article, à moins qu'il ne le révoque en ce qui concerne l'application de cet alinéa avec l'accord du ministre et aux conditions fixées par ce dernier.

[21] The definition of “inventory” found at subsection 248(1) of the Act should also be reproduced:

"inventory" means a description of property the cost or value of which is relevant in computing a taxpayer’s income from a business for a taxation year or would have been so relevant if the income from the business had not been computed in accordance with the cash method and, with respect to a farming business, includes all of the livestock held in the course of carrying on the business;

« inventaire » Description des biens dont le prix ou la valeur entre dans le calcul du revenu qu’un contribuable tire d’une entreprise pour une année d’imposition ou serait ainsi entré si le revenu tiré de l’entreprise n’avait pas été calculé selon la méthode de comptabilité de caisse. S’il s’agit d’une entreprise agricole, le bétail détenu dans le cadre de l’exploitation de l’entreprise doit figurer dans cette description de biens.

ANALYSIS AND DECISION

[22] As a preliminary remark, I would note that each of the appellants submitted that the method used to compute its profit for tax purposes is consistent with past practice (appellants' memorandum, paragraph 15 or 17, as the case may be). Although this statement is not in the agreement on facts, it was not contested by the respondent. I will therefore consider it established.

[23] The parties make no mention of the standard of review in their respective memoranda. I would point out that decisions involving questions of law are subject to the standard of correctness, whereas those involving questions of fact or questions of mixed fact and law are subject to the standard of reasonableness (*Housen v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235).

[24] It is common ground that the determination of a business' profit under subsection 9(1) of the Act is a question of law and that the profit of a business for a given year is determined by setting against the revenues from the business for that year the expenses incurred in earning said income (*M.N.R. v. Irwin*, [1964] S.C.R. 662; *Associated Investors v. M.N.R.*, [1967] 2 Ex. C.R. 96; *Friesen v. Canada*, [1995] 3 S.C.R. 103; *Canderel*, *supra*).

[25] It is also common ground that the determination must be made in accordance with "well-accepted principles of business (or accounting) practice", which include GAAP, except where these are inconsistent with one or more specific provisions of the Act (see *Friesen*, *supra*, paragraph 41, and cases cited therein; see also *Canderel*, *supra*, paragraphs 40 and 54).

[26] In this case, it is not disputed that the appellants' method of accounting for their work in progress on a fiscal-year basis, which takes into account the portion of the profit for work completed but not yet billed, is consistent with GAAP and provides an accurate picture of their income.

[27] However, it is not disputed either that, for the years in issue, the appellants had "inventory" within the meaning of subsection 2(1) and therefore had to comply with subsection 10(1) rules for the valuation of this inventory.

[28] The first step in determining income is calculating gross profit, which, for a business involved in sale, is calculated according to the following formula (*Friesen, supra*, paragraph 42):

> Gross Profit = Proceeds of Sale - Cost of Sale

When there is inventory at the beginning or end of a year, or both, the cost of sale is determined as follows (*idem*):

> Cost of Sale = (Value of Inventory at beginning of year + Cost of Inventory acquisitions)
> - Value of Inventory at end of year

[29] According to the subsection 10(1) formula, inventory shall be valued at the lower of cost or FMV. The first consequence of this rule is that, if the FMV of the inventory declines below its cost in a given year, the resulting "loss" is recognized in that year (*Friesen, supra*, paragraph 45). The

other consequence of the subsection 10(1) valuation method is the following (*Friesen, supra*, paragraph 46):

> . . . the well-accepted principle of conservatism which underlies the valuation method in s. 10(1) represents not only an exception to the realization principle (in cases of loss) but also an exception to the principle of symmetry since gains are not recognized until they are realized. Thus the taxpayer who is entitled to rely on s. 10(1) is allowed to claim a business loss where the value of inventory falls but is not required to declare a business profit until the inventory is sold even if the value of the inventory rises.
>
> [Emphasis added.]

[30] That is where the conflict arises between the application of section 10, claimed by the appellants, and GAAP applicable under section 9, which, as set out above, require that the appellants account for their work in progress taking into account the portion of the profit for work completed but not yet billed. Since the valuation of inventory is a relevant step in the computation of income (*Friesen, supra*, paragraph 44), the two methods necessarily present different pictures of the income. In my view, the parties rightly submitted to the TCC judge that there was a conflict.

[31] In determining that subsection 10(1) does not conflict with section 9, the TCC judge relies on the decision of this Court in *Cyprus Anvil Mining Corp., supra*. However, in that case, the Court concluded that the provisions were not in conflict because subsection 9(1) applies to the computation of income "for a taxation year", and, at that time, subsection 10(1) applied to the computation of income without reference to any year in particular (*idem*, paragraph 22). However, not long after the decision was rendered, the Act was amended to specify that subsection 10(1), like section 9, applies to the computation of income for a given taxation year.

[32] Here, it seems undeniable that there is a conflict between section 9, which involves GAAP, and subsection 10(1), which requires that inventory be valued at the lower of cost or FMV. The question of whether subsection 10(1) of the Act overrides section 9 therefore had to be answered.

[33] In my view, this issue has already been resolved. The Supreme Court determined in *Friesen* that subsection 10(1) is a mandatory provision requiring taxpayers who compute income from a business with inventory to value their inventory according to the terms of that subsection (*Friesen, supra*, paragraph 12), that is, at the lower of cost or FMV. It is a mandatory provision that rules out the general application of section 9 regarding the valuation of inventory. That this method produces a result that is inconsistent with GAAP is no bar to its application (*Friesen, supra*, paragraph 41; *Canderel, supra*, paragraphs 40 and 54).

[34] The TCC judge's further conclusion that the application of subsection 10(1) renders section 34 meaningless is based on the following reasoning (reasons, paragraph 23):

> Section 34 offers certain professionals the choice of excluding amounts relating to their work in progress from the calculation of their income. Subsection 10(5) provides specifically that the work in progress of a business that is a profession is inventory. Section 10 therefore applies whenever section 34 applies. If, as the Appellants claim, section 10 allowed the exclusion of the profit portion of work in progress from the calculation of income, section 34 would be meaningless.

[35] With respect, it is incorrect to say that section 10 applies whenever section 34 applies. These two provisions operate differently. Taxpayers subject to section 10 must account for the value of

their inventoried work in progress based on cost or FMV, depending on the circumstances; however, section 34 gives taxpayers the choice of excluding their inventoried work in progress in computing their income, in which case, section 10 does not apply.

[36] Even if there was any incongruity between these two provisions, subsection 10(1) could not be clearer, and as the Supreme Court noted in *Shell Canada Limitée v. Canada*, [1999] 3 S.C.R. 622 at paragraph 45, the courts' role is to interpret and apply the Act as it was adopted by Parliament. As matters stand, there is no basis for reserving the application of section 10 solely for businesses referred to in section 34.

[37] Lastly, for the first time on appeal, counsel for the respondent raised the argument that the reserves claimed by the appellants do no reflect the amounts to which they are entitled, even assuming that they are subject to subsection 10(1). However, the only issue before the TCC was whether the appellants had to value their inventory according to the subsection 10(1) rule. Nowhere is it suggested that the amount of the adjustments was contested. In my view, it is too late at this point to change the nature of the issue.

[38] For these reasons, I would allow the three appeals, set aside the decision of the TCC and, rendering the decision that the TCC judge should have rendered, refer the assessments back to the Minister for reassessment on the basis that the appellants are entitled to the adjustments they made in their income tax returns to take into account the application of subsection 10(1) of the Act. I

would award costs to the appellants in the TCC and in this Court, calculated taking into account the common hearing that took place in each case.

"Marc Noël"

J.A.

"I agree.
Robert Décary J.A."

"I agree.
Gilles Létourneau J.A."

Certified true translation
Tu-Quynh Trinh

FEDERAL COURT OF APPEAL

SOLICITORS OF RECORD

DOCKET:	A-122-08
(APPEAL FROM A JUDGMENT OF ASSOCIATE CHIEF JUSTICE RIP OF THE TAX COURT OF CANADA DATED FEBRUARY 25, 2008, DOCKET NO. 2006-1596(IT)G)	
STYLES OF CAUSE:	CDSL CANADA LTD. v. HER MAJESTY THE QUEEN
PLACE OF HEARING:	Montréal, Quebec
DATE OF HEARING:	December 3, 2008
REASONS FOR JUDGMENT BY:	Noël J.A.
CONCURRED IN BY:	Décary J.A. Létourneau J.A.
DATED:	December 15, 2008

APPEARANCES:

Wilfrid Lefebvre Vincent Dionne	FOR THE APPELLANT
Marie-Andrée Legault	FOR THE RESPONDENT

SOLICITORS OF RECORD:

Ogilvy Renault Montréal, Quebec	FOR THE APPELLANT
John H. Sims, Q.C. Deputy Attorney General of Canada	FOR THE RESPONDENT

FEDERAL COURT OF APPEAL

SOLICITORS OF RECORD

DOCKET:	A-123-08
(APPEAL FROM A JUDGMENT OF ASSOCIATE CHIEF JUSTICE RIP OF THE TAX COURT OF CANADA DATED FEBRUARY 25, 2008, DOCKET NO. 2006-1597(IT)G)	
STYLES OF CAUSE:	GROUPE CGI INC. / CGI GROUP INC. v. HER MAJESTY THE QUEEN
PLACE OF HEARING:	Montréal, Quebec
DATE OF HEARING:	December 3, 2008
REASONS FOR JUDGMENT BY:	Noël J.A.
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FEDERAL COURT OF APPEAL

SOLICITORS OF RECORD

DOCKET:	A-121-08
(APPEAL FROM A JUDGMENT OF ASSOCIATE CHIEF JUSTICE RIP OF THE TAX COURT OF CANADA DATED FEBRUARY 25, 2008, DOCKET NO. 2006-1605(IT)G)	
STYLES OF CAUSE:	CGI INFORMATION SYSTEMS AND MANAGEMENT CONSULTANTS INC. v. HER MAJESTY THE QUEEN
PLACE OF HEARING:	Montréal, Quebec
DATE OF HEARING:	December 3, 2008
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