Federal Court of Appeal  Cour d'appel fédérale

Date: 20191115

Docket: A-196-18

Citation: 2019 FCA 283

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

BETWEEN:

LAWRENCE WOLF

Appellant

and

HER MAJESTY THE QUEEN

Respondent

Heard at Ottawa, Ontario, on October 17, 2019.

Judgment delivered at Ottawa, Ontario, on November 15, 2019.

REASONS FOR JUDGMENT BY: WEBB J.A.

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

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REASONS FOR JUDGMENT

WEBB J.A.

[1] This is an appeal from the judgment rendered by the Tax Court of Canada (2018 TCC 84). The Tax Court dismissed Lawrence Wolf's appeal from the assessment issued under the *Income Tax Act*, R.S.C. 1985, c. 1, (5th Supp.), (the Act) for 2012 in relation to the income that he earned in Canada. Lawrence Wolf was assessed taxes payable under the Act on the basis that he had a permanent establishment in Canada for the purposes of the *Convention Between Canada and the United States of America with Respect to Taxes on Income and on Capital (1980)*

(enacted in law in Canada by the *Canada-United States Tax Convention Act, 1984*, S.C. 1984, c. 20) (Tax Convention).

[2] Lawrence Wolf has appealed this determination. For the reasons that follow, I would dismiss this appeal.

I. Background

[3] Lawrence Wolf is an aerospace engineer who specializes in designing fuel systems for aircraft. He was a resident of the United States in 2012. For several years, Lawrence Wolf worked as a consultant for Bombardier Inc. (and its predecessors) in Montréal (*Lawrence Wolf v. The Queen*, 2000 DTC 2595 (TCC), 2002 DTC 6853 (FCA)). During one of his periods of consulting, he invented a fuel line system for aircraft. Bombardier Inc. obtained the patent for this invention and transferred the patent to Lawrence Wolf on the condition that Bombardier Inc. would retain a licence to use it without paying any royalties.

[4] During the 2012 taxation year, Lawrence Wolf carried on business as an independent contractor for TDM Technical Services. This company arranged for Lawrence Wolf to provide consulting services to Bombardier Inc. He was present in Canada from the start of 2012 to August 10, 2012. During this period of time, he earned a total of $26,244 of income for his consulting work with Bombardier Inc.

[5] Lawrence Wolf had also entered into an arrangement with Davis Aircraft Products Company, Inc. (Davis Aircraft) in the United States. Davis Aircraft specialized in aerospace manufacture and design. As part of the arrangement, a limited liability company, Wolfbend LLC, was formed under the laws of New York. For U.S. tax purposes, Wolfbend LLC was treated as a partnership. There were five members of Wolfbend LLC: Douglas Davis (17%), Jill Davis (17%), Bruce Davis (16%), Steven Wolf (15%) and Lawrence Wolf (35%). For the year 2012, based on the amounts reported by Lawrence Wolf in his U.S. Tax Return, Wolfbend LLC would have allocated a total of US $666,277 of business income and US $131,837 of royalties to its members in proportion to their interest in Wolfbend LLC. Lawrence Wolf's share of this business income was US $233,197 and his share of the royalties was US $46,143.

[6] There is no dispute that Lawrence Wolf was present in Canada for more than 183 days during the twelve-month period ending on August 10, 2012.

II. Tax Convention

[7] Paragraph 1 of Article VII of the Tax Convention provides that the business profits of a resident of the United States may be taxable in Canada to the extent that such business profits are attributable to a permanent establishment through which the business is carried on in Canada. The rules related to whether a person has a permanent establishment are set out in Article V. Paragraph 9 of Article V of the Tax Convention provides that:

9. Subject to paragraph 3, where an enterprise of a Contracting State provides services in the other	9. Sous réserve du paragraphe 3, lorsqu'une entreprise d'un État contractant fournit des services dans

Contracting State, if that enterprise is found not to have a permanent establishment in that other State by virtue of the preceding paragraphs of this Article, that enterprise shall be deemed to provide those services through a permanent establishment in that other State if and only if:	l'autre État contractant, s'il est déterminé qu'elle n'a pas d'établissement stable dans cet autre État en vertu des paragraphes précédents du présent article, cette entreprise est réputée fournir ces services par l'intermédiaire d'un établissement stable dans cet autre État dans les seuls cas où :
(a) Those services are performed in that other State by an individual who is present in that other State for a period or periods aggregating 183 days or more in any twelve-month period, and, during that period or periods, more than 50 percent of the gross active business revenues of the enterprise consists of income derived from the services performed in that other State by that individual; or	a) Ces services sont fournis dans cet autre État par une personne physique qui y séjourne pendant une période ou des périodes totalisant 183 jours ou plus au cours d'une période quelconque de douze mois et, pendant cette période ou ces périodes, plus de 50 p. 100 des recettes brutes tirées d'une entreprise exploitée activement de l'entreprise consistent en un revenu tiré des services fournis dans cet autre État par la personne physique; ou
(b) The services are provided in that other State for an aggregate of 183 days or more in any twelve-month period with respect to the same or connected project for customers who are either residents of that other State or who maintain a permanent establishment in that other State and the services are provided in respect of that permanent establishment.	b) Les services sont fournis dans cet autre État pendant une période totale de 183 jours ou plus au cours d'une période quelconque de douze mois relativement au même projet ou à un projet connexe pour des clients qui soit sont des résidents de cet autre État, soit y maintiennent un établissement stable, et les services sont fournis relativement à cet établissement stable.

[8] The parties agree that the applicable provision in issue in this matter is subparagraph 9(a). There are two tests that must be satisfied in order for this subparagraph to apply. One test relates to the period of time during which an individual (who is a resident of the United States and who is performing services in Canada on behalf of an enterprise) is present in Canada. The other test

relates to the gross active business revenues of the particular enterprise that is providing services in Canada. As noted above, there is no dispute that Lawrence Wolf satisfied the test related to the number of days during which he was present in Canada. Therefore, the only dispute in this matter is related to the enterprise that provided services and the gross active business revenues of that enterprise.

III. Decision of the Tax Court

[9] At the Tax Court hearing, the Crown had submitted that Wolfbend LLC was a corporation and that its revenues "were generated by its own enterprise" (paragraph 33 of the reasons of the Tax Court Judge). Based on his review of the evidence that was before him related to Lawrence Wolf, Wolfbend LLC and Davis Aircraft – and, in particular, the contracts between Lawrence Wolf and Davis Aircraft – the Tax Court Judge found that Wolfbend LLC was not carrying on any business and, therefore, it did not have an enterprise:

> [35] The facts of this case do not support the second proposition of the Respondent. Wolfbend does not constitute an "enterprise" for the purposes of the Convention. The Court makes this finding of fact because the evidence is that Wolfbend does not carry on a "business" as defined in subsection 248(1) of the ITA.
>
> [36] According to Mr. Wolf's testimony and the terms of the Operating Agreement, Wolfbend was only established for the purpose of collecting and allocating profits generated through the Manufacturing & License Agreement. The Manufacturing & License Agreement stated that the method of allocation of profits would be indicated in the Operating Agreement. The transfers of the "revenues" – the term used in the agreement – between Davis Aircraft Inc. and Wolfbend were referred to as "disbursements". Neither Mr. Wolf nor the Respondent attempted to characterize these "disbursements". It is thus impossible for this Court to make a specific finding of fact on the nature of the payments made to Wolfbend. In any event, there is no evidence that Wolfbend had a business. The evidence is that the profits generated by the Manufacturing & License Agreement were clearly those of Mr. Wolf and Davis Aircraft Inc. These

> profits were to be allocated to them according to the terms of the Operating Agreement. The most convincing evidence of the existence of an enterprise is the Manufacturing & License Agreement. Davis Aircraft Inc. was required to maintain records in order to determine the profits generated by the Manufacturing & License Agreement, not Wolfbend. Mr. Wolf was a party to this agreement and Wolfbend was not. Clearly, Mr. Wolf made a "business deal" with Davis Aircraft Inc., not with Wolfbend. The Court therefore concludes that the payments received by Mr. Wolf from Wolfbend were revenues of Mr. Wolf's enterprise.
>
> (footnote references have not been included and emphasis has been added)

[10] The "Mr. Wolf" to whom the Tax Court Judge is referring is Lawrence Wolf. Having found that it was Lawrence Wolf's enterprise in the United States that generated the revenues from the Manufacturing & License Agreement, the Tax Court Judge then considered whether this was part of the same enterprise under which Lawrence Wolf was providing engineering services to Bombardier Inc. The Tax Court Judge concluded that it was all part of the same enterprise.

[11] However, with respect to the determination of the gross revenues of the U.S. portion of Lawrence Wolf's enterprise, the Tax Court Judge found that Lawrence Wolf did not provide any evidence to indicate when those revenues were generated. Therefore, he was unable to determine what percentage of the gross active business revenues of the enterprise consisted of income derived from the services performed in Canada, during the period or periods of time when Lawrence Wolf was present in Canada. The Tax Court Judge concluded that, since Lawrence Wolf failed to prove that the percentage of his revenues from the Canadian source was not more than 50% of the total gross active business revenues of his enterprise during the period or periods while he was present in Canada, his appeal failed.

IV. Issues and Standard of Review

[12] Lawrence Wolf raises the issue of whether the Tax Court Judge erred in determining that he did not establish that 50% or less of his gross active business income from his enterprise was earned in Canada during the period that he was present in Canada. The Crown raises the issue of whether the Tax Court Judge erred in determining that the enterprise that generated the profit in the United States and the royalties was Lawrence Wolf's enterprise and not Wolfbend LLC's enterprise.

[13] The standard of review for any question of fact or for any question of mixed fact and law (when there is no extricable question of law) is palpable and overriding error and the standard of review for any question of law is correctness (*Housen v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235). The interpretation of the contracts presented to the Tax Court is a question of mixed fact and law (*Sattva Capital Corp. v. Creston Moly Corp.*, 2014 SCC 53 at para. 50, [2014] 2 S.C.R. 633) and, therefore, the standard of review for the interpretation of the contracts considered by the Tax Court Judge is palpable and overriding error.

V. Analysis

[14] I will first deal with the issue raised by the Crown. The Crown submitted that the Tax Court Judge had pierced the corporate veil in finding that the enterprise that gave rise to the profits generated in the United States was Lawrence Wolf's enterprise and not Wolfbend LLC's enterprise. The Crown referred to the decision of this Court in *Meredith v. Canada (Attorney*

General), 2002 FCA 258, [2002] F.C.J. No. 1007 (QL) where this Court had held that the Tax Court Judge in that case had erred in piercing the corporate veil by looking beyond the contracts that the corporation had entered into with third parties.

[15] In this case, the relevant question is whether the enterprise that generated the profits allocated to Lawrence Wolf in the United States was the enterprise of Wolfbend LLC or Lawrence Wolf. If the enterprise that generated those profits was the enterprise of Wolfbend LLC and not Lawrence Wolf, then the gross active business revenues of that enterprise would not have been Lawrence Wolf's revenues and would not be included in determining whether the gross revenue test in subparagraph 9(a) of Article V was satisfied in this case.

[16] The Tax Court Judge, in this case, did not pierce the corporate veil and find that Lawrence Wolf should be considered to be carrying on the business that Wolfbend LLC was carrying on. Rather he examined the contracts and other evidence to determine who was carrying on the business in the United States. The Tax Court Judge noted that Wolfbend LLC was not a party to the contracts that were presented to the Tax Court. As a result of his interpretation of the contracts and the other evidence presented, he concluded that Wolfbend LLC did not carry on any business activity in the United States and that "the profits generated by the Manufacturing & License Agreement were clearly those of Lawrence Wolf and Davis Aircraft Inc." (paragraph 36 of the reasons of the Tax Court).

[17] However, if the profits generated by the Manufacturing & License Agreement (which appear to be the profits of US $666,277 for 2012) were the profits of Lawrence Wolf and Davis

Aircraft, this would appear to raise the question of whether Lawrence Wolf's share of these profits should have been one-half of this amount (or US $333,138), instead of the 35% of this amount that was allocated to him by Wolfbend LLC (which was reported in his U.S. tax return). If Wolfbend LLC was not carrying on any business activity in 2012, on what basis could it allocate income to its five members?

[18] The parties, in their Partial Agreement of Statement of Facts submitted to the Tax Court agreed that:

> 16. During the 2012 taxation year, a "Manufacturing & Licence Agreement" between Davis Aircraft Products Company Inc., a USA Company, and Wolfbend LLC was in force, as appears from a copy of the agreement attached hereto as Annexe A-6.
>
> …
>
> 18. With respect to his 2012 taxation year, the Appellant reported ordinary business income of $233,197 from his partnership in Wolfbend LLC, as appears from a copy of Form 1065 filed with the IRS attached hereto as Annexe A-9.

[19] The parties had agreed that Lawrence Wolf's share of the ordinary business income allocated by Wolfbend LLC in the United States was $233,197, and that this was the amount that he had reported in the United States. Neither party argued that Wolfbend LLC was not carrying on any business or that it was not entitled to allocate the profits to its members that it allocated in 2012. The finding made by the Tax Court Judge that Wolfbend LLC was not carrying on any business, and that "the profits generated by the Manufacturing & License Agreement were clearly those of Lawrence Wolf and Davis Aircraft Inc.", was not consistent with the submissions of either party. This finding also appears to cast doubt on whether Lawrence Wolf's share of these profits was the amount that he had reported for U.S. tax purposes.

[20] To be consistent with the information that was filed in the United States for tax purposes, it would seem logical that it was Wolfbend LLC's enterprise (and not Lawrence Wolf and Davis Aircraft's enterprise) that gave rise to the profits that it allocated to its members in 2012 for US tax purposes. Although Wolfbend LLC was treated as a partnership for U.S. tax purposes, for Canadian tax purposes it would appear that it would be treated as a corporation, based on the Technical Explanation issued by the U. S. Department of the Treasury related to the Protocol done at Chelsea on September 21, 2007 (which added paragraphs 6 of Article IV and 9 of Article V to the Tax Convention). Canada reviewed and subscribed to the contents of this Technical Explanation. Lawrence Wolf had raised an argument at the Tax Court hearing based on paragraph 6 of Article IV of the Tax Convention (which was added to address certain issues related to fiscally transparent entities) but that argument was abandoned and not pursued at the hearing of this appeal.

[21] Neither party made any submissions related to paragraph 6 of Article IV of the Tax Convention in this appeal. It is also not necessary to address this paragraph to decide this appeal. Therefore, it is not appropriate to make any findings in relation to this paragraph in this appeal.

[22] In this case, Wolfbend LLC was treated as a partnership for U.S. tax purposes. However, if, for Canadian tax purposes, any enterprise being carried on by Wolfbend LLC is considered to only be carried on by it (and, therefore, any revenue that it generates from carrying on that enterprise is treated as its revenue from that enterprise), any enterprise of Wolfbend LLC, as a separate person for Canadian tax purposes, would not be the enterprise of Lawrence Wolf. As a result, Lawrence Wolf's only enterprise would be the provision of consulting services to

Bombardier Inc. in Canada. Therefore, the gross revenue test as set out in subparagraph 9(a) of Article V of the Tax Convention would be satisfied. This could have been an alternate basis on which this appeal could have been addressed if either party would have raised this issue.

[23] However, in this appeal, Lawrence Wolf did not argue that the Tax Court Judge made any error in his finding that Wolfbend LLC did not carry on any business. Likewise, the Crown did not point to any palpable and overriding error that the Tax Court Judge had made in his interpretation of the contracts or the evidence. The only argument raised by the Crown was that the Tax Court Judge had pierced the corporate veil. As noted above, I do not agree that the Tax Court Judge pierced the corporate veil. In my view, he made a finding of mixed fact and law that the U.S. enterprise was being carried on by Lawrence Wolf and Davis Aircraft.

[24] Also in this appeal, neither party made any submissions (other than the Crown's submissions in relation to piercing the corporate veil) that the Tax Court Judge made any error in finding that the enterprise that gave rise to the profits generated in the U.S. was part of the same enterprise that generated the income in Canada. The only issue addressed by the parties in relation to the single enterprise finding (other than as noted with respect to piercing the corporate veil) was with respect to the finding that Lawrence Wolf had failed to establish that the income derived from the services performed in Canada was not more than 50% of the total gross active business revenues of his enterprise.

[25] As a result, based on the arguments raised by the parties in this appeal, the issue is whether the Tax Court Judge made a palpable and overriding error in relation to the

determination of the gross active business revenues of Lawrence Wolf from his enterprise during the relevant period or periods of time. The Tax Court Judge found that Lawrence Wolf had failed to establish that 50% or less of the gross active business revenues of his enterprise (including the profits allocated to him by Wolfbend LLC) during this period or periods were derived from the services rendered in Canada.

[26] Lawrence Wolf agrees that the relevant period of time for the determination of the gross active business revenues of the enterprise for the purposes of subparagraph 9(a) of Article V is the period or periods of time during which he was present in Canada. However, while Lawrence Wolf referred to certain provisions of the agreements that had been submitted to the Tax Court, he did not adduce any evidence with respect to the actual timing of the earning of the revenue in the United States.

[27] The timing of the earning of the revenue is relevant and is a matter that Lawrence Wolf ought to have addressed through his evidence. Lawrence Wolf would know what period or periods he was present in Canada and, although the records were kept by Davis Aircraft, there is nothing to indicate why Lawrence Wolf could not have obtained the financial information from Davis Aircraft with respect to the timing of the earning of the revenue in the United States. Lawrence Wolf did not point to anything in the record that would support any finding of when the revenue was earned in the United States.

[28] As a result, Lawrence Wolf failed to establish that the Tax Court Judge made any palpable and overriding error in finding that there was insufficient evidence for him to conclude that 50% or less of the gross active business income from Lawrence Wolf's enterprise was earned in Canada during the period that he was present in Canada.

[29] As a result, I would dismiss the appeal with costs.

"Wyman W. Webb"
J.A.

"I agree
Richard Boivin J.A."

"I agree
Donald J. Rennie J.A."

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

APPEAL FROM A JUDGMENT OF THE TAX COURT OF CANADA DATED MAY 31, 2018, CITATION NO. 2018 TCC 84 (DOCKET NO. 2015-1745 (IT)G)

DOCKET:	A-196-18
STYLE OF CAUSE:	LAWRENCE WOLF v. HER MAJESTY THE QUEEN
PLACE OF HEARING:	OTTAWA, ONTARIO
DATE OF HEARING:	OCTOBER 17, 2019
REASONS FOR JUDGMENT BY:	WEBB J.A.
CONCURRED IN BY:	BOIVIN J.A. RENNIE J.A.
DATED:	NOVEMBER 15, 2019

APPEARANCES:

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