Federal Court of Appeal | Cour d'appel fédérale

Date: 20200423

Docket: A-321-18

Citation: 2020 FCA 79

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

BETWEEN:

LOBLAW FINANCIAL HOLDINGS INC.

Appellant

and

HER MAJESTY THE QUEEN

Respondent

Heard at Toronto, Ontario, on October 15, 2019.

Judgment delivered at Ottawa, Ontario, on April 23, 2020.

REASONS FOR JUDGMENT BY: WOODS J.A.

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

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REASONS FOR JUDGMENT

WOODS J.A.

[1] This appeal concerns whether the foreign accrual property income (FAPI) provisions in the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (ITA) apply to Loblaw Financial Holdings Inc. in relation to its Barbados subsidiary, Glenhuron Bank Limited.

[2] The Minister of National Revenue issued reassessments to Loblaw Financial which required it to pay tax on Glenhuron's income on the basis that it was FAPI. In doing so, the Minister took the view that Glenhuron's income did not qualify for an exclusion provided to foreign banks. Loblaw Financial appealed from the reassessments to the Tax Court.

[3] In a decision reported as 2018 TCC 182, the Tax Court agreed with the Minister that the foreign bank exclusion did not apply. The basis for the Court's conclusion was that Glenhuron conducted business principally with affiliated corporations and therefore it did not conduct business principally with arm's length persons, as required by the applicable legislation.

[4] Loblaw Financial has appealed further to this Court. The appeal relates to Loblaw Financial's taxation years from 2001 to 2005, 2008 and 2010.

Factual background

[5] The background facts are helpfully set out in detail in the Tax Court's reasons. It is sufficient for purposes of this appeal to provide a brief overview.

[6] Loblaw Financial is a Canadian corporation and an indirect wholly-owned subsidiary of Loblaw Companies Limited (Loblaw). Loblaw is a Canadian public corporation which is controlled by George Weston Limited (Weston). Accordingly, Loblaw and Weston, as well as their subsidiaries, deal with one another on a non-arm's length basis.

[7] In the early 1990s, Loblaw Financial became concerned about proposed tax changes that could negatively impact its financing subsidiary in the Netherlands. It decided to incorporate a new subsidiary in Barbados.

[8] In 1993, Loblaw Financial approached the Central Bank of Barbados about licensing its Barbados subsidiary as an offshore bank under Barbados banking legislation. The Central Bank agreed to issue the licence and did so late in 1993 pursuant to the *Off-shore Banking Act*, Cap. 325 (OSBA). In 2002, the OSBA was replaced by the *International Financial Services Act*, Cap. 325 (IFSA) and the subsidiary became subject to the IFSA at that time.

[9] When the subsidiary became licensed, it was permitted to use the term "bank" in its name and the name was changed to Glenhuron Bank Limited.

[10] In accordance with Barbados legislation, Glenhuron was a bank and subject to Barbados banking regulations if the Central Bank of Barbados issued it a licence under the OSBA or the IFSA. Accordingly, once the licence was issued the Central Bank began to regulate Glenhuron's activities.

[11] Over time, capital was invested in Glenhuron by the Loblaw group, including by Loblaw Financial's Netherlands subsidiary. For the most part, these funds were invested prior to the taxation years at issue.

[12] Under the IFSA (and similarly under the OSBA), Glenhuron's activities were limited to activities described in the definition of "international banking business". It is reproduced below:

> IFSA subsection 4(2)
>
> For the purposes of subsection (1), "international banking business" means
>
> *(a)* the business of receiving foreign funds through
>
> (i) the acceptance of foreign money deposits payable upon demand or after a fixed period or after notice;
>
> (ii) the sale or placement of foreign bonds, foreign certificates, foreign notes or other foreign debt obligations or other foreign securities; or
>
> (iii) any other similar activity involving foreign money or foreign securities;
>
> *(b)* the business of using the foreign funds so acquired, either in whole or in part, for
>
> (i) loans, advances and investments;
>
> (ii) the activities of the licensee for the account of or at the risk of the licensee;
>
> (iii) the purchase or placement of foreign bonds, foreign certificates, notes or other foreign debt obligations or other foreign securities; or
>
> (iv) any other similar activity involving foreign money or foreign securities; or
>
> (*c*) the business of accepting in trust from persons resident outside Barbados or from prescribed persons
>
> (i) amounts of money in foreign currencies or in foreign securities or both;
>
> (ii) foreign personal property or foreign movable property; or
>
> (iii) foreign real property or foreign immovable property.

[13] According to expert evidence of Barbados law introduced by Loblaw Financial, the Barbados legislation required Glenhuron to satisfy both the receipt and use requirements as set out above. The expert also opined that Glenhuron satisfied these requirements. I note that the assumptions provided by Loblaw Financial on which the expert based her opinion did not include an assumption that Glenhuron's receipts were part of its business. Accordingly, this finding was part of the expert's opinion.

[14] Glenhuron remained in existence until 2013 when it was liquidated to provide Loblaw with funds for a major acquisition.

Glenhuron's activities

[15] The activities undertaken by Glenhuron are central to this appeal, and the Tax Court's reasons describe these activities in detail. In light of this, it is necessary to provide only a brief summary.

[16] During the years at issue, Glenhuron engaged in several types of financial activities:

- it purchased low risk US denominated short-term debt securities;

- it entered into interest rate swaps which were generally intended to provide Glenhuron with a rate of return equivalent to a fixed rate on a long-term borrowing;

- it entered into cross-currency swaps so that Glenhuron was not exposed to fluctuations in currency relative to the Canadian dollar;

- it entered into an arrangement with the Weston group to purchase a portfolio of loans that had been extended by arm's length banks to independent drivers of Weston bakery products in the United States. Glenhuron subsequently made additional loans to the drivers. A few years later, Glenhuron sold the loan portfolio to another corporation in the Loblaw or Weston group and Glenhuron managed the portfolio on its behalf;

- it managed investments on behalf of other corporations in the Loblaw and Weston groups for a fee. It also managed funds on behalf of one arm's length corporation. The investment strategy employed on behalf of these corporations was very similar to Glenhuron's own investment strategy;

- it made two short-term loans to non-arm's length corporations; and

- it entered into equity forward contracts to purchase Loblaw shares. Loblaw's consolidated financial statements stated that the purpose of these transactions was to "manage its exposure to fluctuations in its stock-based compensation cost as a result of changes in the market price of its common shares."

[17] In this Court, Loblaw Financial provided a summary of the asset value and income from Glenhuron's activities. The summary, which is reproduced in an appendix to these reasons, was largely based on financial statements in the record. The summary was prepared for purposes of this appeal.

[18] The source of funds for these activities is also relevant in this appeal. There were two main sources of funds. Prior to the taxation years at issue, Glenhuron's major source of funding was capital invested by corporations in the Loblaw group (either as share capital or interest-free debt). During the taxation years at issue, Glenhuron's funding increased mainly through its own retained earnings, which were substantial.

Applicable legislation

[19] The FAPI scheme is intended to prevent Canadians from avoiding tax on passive income by earning such income in foreign corporations located in low-tax jurisdictions. The scheme aims to achieve this result by requiring the foreign corporation's passive income to be included in the Canadian shareholder's income as it is earned.

[20] Below I reproduce the introductory FAPI provision which requires the FAPI to be included in the shareholder's income. The brevity of this provision is not representative of the FAPI legislation as a whole which is notoriously complex.

91 (1) In computing the income for a taxation year of a taxpayer resident in	**91 (1)** Dans le calcul du revenu pour une année d'imposition d'un

Canada, there shall be included, in respect of each share owned by the taxpayer of the capital stock of a controlled foreign affiliate of the taxpayer, as income from the share, the percentage of the foreign accrual property income of any controlled foreign affiliate of the taxpayer, for each taxation year of the affiliate ending in the taxation year of the taxpayer, equal to that share's participating percentage in respect of the affiliate, determined at the end of each such taxation year of the affiliate.	contribuable résidant au Canada, il doit être inclus, relativement à chaque action qui lui appartient dans le capital-actions d'une société étrangère affiliée contrôlée du contribuable, à titre de revenu tiré de l'action, le pourcentage du revenu étranger accumulé, tiré de biens, de toute société étrangère affiliée contrôlée du contribuable, pour chaque année d'imposition de la société affiliée qui se termine au cours de l'année d'imposition du contribuable, égal au pourcentage de participation de cette action, afférent à la société affiliée et déterminé à la fin de chaque telle année d'imposition de cette dernière.

[21] At a very basic level, the FAPI scheme operates by distinguishing between active business income, which is not FAPI, and passive income, which is. As described in the Tax Court's reasons, after the FAPI legislation had been in force for several years the government was concerned that the legislation did not have sufficient teeth to achieve its purpose. The problem was perceived to be that there were no legislative definitions of "active business income" or "passive income". Accordingly, in 1995 the legislation was overhauled to provide detailed definitions, including a definition of "investment business" which in general terms represents passive income.

[22] The definition of "investment business" in subsection 95(1) of the ITA is central to this appeal. It is sufficient for present purposes to look at the current version of the definition and it is reproduced in an appendix. This appeal focusses on the part of the definition that sets out specific exclusions for particular types of businesses, such as financial businesses which earn interest income in the context of an active business (paragraphs (*a*), (*b*) and (*c*)).

[23] One of the conditions that must be satisfied in order to qualify for one of the exclusions is an arm's length requirement set out in paragraph (*a*) of the definition of "investment business". This requirement is drafted as an exclusion to the exclusions: "other than any business conducted principally with persons with whom the affiliate does not deal at arm's length."

[24] Loblaw Financial submits that Glenhuron satisfies the requirements for an exclusion as a foreign bank. The term "foreign bank" is also defined in subsection 95(1).

The Tax Court decision

[25] There were many issues before the Tax Court, and the Court's key findings were helpfully summarized in the formal judgment. There are three findings with respect to FAPI:

- Glenhuron was a regulated foreign bank with the equivalent of greater than five full-time employees in the taxation years at issue. However, it was principally conducting business with non-arm's length persons, and consequently, Glenhuron's income was from an investment business and was required to be included in Loblaw Financial's income as FAPI;

- pursuant to paragraph 95(2)(*b*) of the ITA, Glenhuron's fee income from managing investments for non-arm's length persons was FAPI as the income was deemed to be income from a separate business other than an active business. Certain fees paid by Weston subsidiaries were also FAPI even if they were not

subject to paragraph 95(2)(*b*), as this activity would otherwise be part of Glenhuron's "investment business"; and

- in the calculation of FAPI, foreign exchange gains and losses in respect of Glenhuron's investment in short-term debt securities was on income account.

[26] As a result of these findings, the Tax Court ordered that the relevant taxation years be reassessed only with respect to foreign exchange. In other respects, the Minister's determination that Glenhuron's income was FAPI was upheld.

[27] In concluding that Glenhuron did not conduct business principally with arm's length persons, which is the only issue in this appeal, the Court rejected both of the parties' submissions. As for submissions by the Crown, the Court disagreed with the Crown that the arm's length test required that Glenhuron compete for business. As for submissions by Loblaw Financial, the Court disagreed with its contention that the arm's length test applies only to persons with whom Glenhuron had entered into income-earning arrangements.

[28] Instead, the Court concluded that competition is not a requirement of the arm's length test, but it is relevant to the analysis. The Court also concluded that all persons with whom Glenhuron conducted business should be taken into account.

[29] The Court's conclusions regarding the arm's length test also included the following:

- the arm's length test as applied to foreign banks requires an examination of a bank's receipts and uses of funds;

- the term "principally" means greater than 50 percent, and this is to be determined based on all relevant circumstances. However, in the context of the foreign bank exclusion there should be a greater relative weighting to the receipt side of the business because this is where competition would be expected;

- with respect to the receipt side, "it all came from non-arm's length parties" (paragraph 239); and

- on the use side, the Court used the awkward wording from the arm's length test and stated: "[t]he Appellant has not satisfied me that even the use of funds … was not principally conducting business with non-arm's length persons" (paragraph 248).

[30] In a separate decision reported as 2018 TCC 263, the Tax Court ordered that each party bear its own costs.

Position of Loblaw Financial

[31] In this section, I provide an overview of the submissions of Loblaw Financial concerning the arm's length requirement, which is the only issue in the appeal.

[32] I have not provided a summary of the submissions of the Crown here because the Crown generally endorses the reasons of the Tax Court. More will be said about the Crown's submissions later in the reasons.

[33] Loblaw Financial submits that the Tax Court made four errors of law:

- it read in an unlegislated competition requirement;
- it focussed on capitalization rather than sources of income;
- it characterized the conduct of business as including capital receipts; and
- it failed to treat Glenhuron as separate and distinct from Loblaw.

[34] Loblaw Financial submits that a proper interpretation of the arm's length test frames the issue as whether the foreign bank generated income by investing in, or with, arm's length persons. This follows, it is suggested, by the definition of "investment business" which focusses on income from investments.

[35] The key factors one should consider in determining who Glenhuron conducted business with, Loblaw Financial suggests, are (1) the value of Glenhuron's income-generating assets, (2) the amount of income derived from those assets, and (3) the time, attention and effort devoted to its income-generating activities.

[36] Applying these principles, Loblaw Financial suggests that Glenhuron's business is conducted principally with the arm's length persons involved in its three core activities: (1) persons from whom Glenhuron purchased short-term debt securities, (2) counterparties to Glenhuron's swaps, and (3) banks from whom Glenhuron acquired a portfolio of loans issued to independent drivers of Weston bakery products in the United States, and the drivers to whom Glenhuron issued new loans.

[37] The only non-arm's length dealings that Glenhuron had with respect to these core activities, it is suggested, are dealings with the Weston bakery group relating to the loans to drivers. Reference was made to the Tax Court's reasons at paragraphs 56, 60 and 243.

Analysis

Introduction

[38] The question to be determined is whether the Tax Court erred in concluding that Glenhuron did not conduct business principally with arm's length persons for purposes of the definition of "investment business" in subsection 95(1) of the ITA. For the reasons that follow, I conclude that the Tax Court did make reviewable errors, which are errors of law, and that the Tax Court's decision should be set aside. Accordingly, it is also necessary to consider the appropriate remedy.

[39] The analysis below is organized into the following parts:

- What is the applicable standard of review?

- What is the proper interpretation of the legislation?

- Did the Tax Court err?

- What is the appropriate remedy?

- Did Glenhuron conduct business principally with arm's length persons?

- What is an appropriate award of costs?

What is the applicable standard of review?

[40] In an appeal from the Tax Court, this Court is to apply the standards of review set out in *Housen v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235. Questions of law are to be reviewed on a standard of correctness. Questions of fact and questions of mixed fact and law (other than extricable questions of law) are to be reviewed on a standard of palpable and overriding error.

What is the proper interpretation of the legislation?

[41] The well-established approach to interpreting statutes in Canada, including the ITA, is to consider the text, context and purpose of the legislation in a manner that is harmonious with the

statute as a whole (*Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54 at para. 11, [2005] 2 S.C.R. 601).

[42] The term "investment business" requires that, to be eligible for the exclusions described in paragraphs (*a*), (*b*) and (*c*), the business must be "other than any business conducted principally with persons with whom the affiliate does not deal at arm's length."

[43] The particular question to be determined in the appeal is: Who did Glenhuron principally conduct business with? The key phrase here is "business conducted … with".

[44] The plain meaning of the phrase "business conducted … with" suggests that it applies to every person with whom Glenhuron has a business relationship. It is not limited to persons with whom Glenhuron had entered into income-earning transactions. On the other hand, the plain meaning does not extend to persons with whom Glenhuron interacted if the interaction was not in the nature of "Glenhuron doing business". This is implied by the word "with".

[45] After determining with whom Glenhuron conducted business, the business relationships must be weighed to determine with whom the corporation principally conducted business. The use of the general term "principally" suggests that the weighting will be a fact based determination that is appropriate in the particular circumstances.

[46] As for context, at a high level the FAPI scheme differentiates between passive income and active business income. As described in detail by the Tax Court, legislative changes were

made to the scheme in 1995 in response to concerns that the existing legislation did not have sufficient teeth to properly capture passive income. One way in which this objective was addressed was to add a definition of "investment business".

[47] The definition of "investment business" differentiates between active business income and passive income in a very rough way. It does this by encompassing a wide range of businesses and providing for a limited number of specific exclusions.

[48] Turning to the purpose of the provision at issue, the arm's length test is one of several requirements to qualify for one of the exclusions. The exclusions generally further the fundamental purpose of the FAPI scheme, which is to apply only to passive income. The requirements for the exclusion for foreign banks address this objective in several ways, including the arm's length requirement:

- the business has to be subject to foreign banking laws and be regulated;
- the corporation has to operate the business;
- the business must have the equivalent of more than five full-time employees; and
- the business must not be conducted principally with non-arm's length persons.

[49] It is convenient to mention here that the above conditions demonstrate that the foreign bank exclusion generally depends on whether the corporation is licensed and regulated, and not directly on whether it carries on particular types of activities.

Did the Tax Court err?

[50] The Tax Court was faced with a daunting task of having to grapple with a myriad of issues in a lengthy trial. Only one of these issues has been appealed to this Court.

[51] In my respectful view, the Tax Court's conclusion on the arm's length issue is built on an interpretation of the applicable legislation which significantly overreaches and contains errors of law. Such legal errors are to be reviewed on the non-deferential standard of correctness. As will be evident below, in large measure I agree with the submissions of Loblaw Financial on this issue, but my analysis differs somewhat.

[52] One error concerns how the arm's length test is to be interpreted in the specific context of foreign banks.

[53] The Tax Court determined that a proper interpretation of the arm's length test in a banking context requires one to examine the bank's activities from the perspective of both the receipt and use of funds (paragraph 209). This was based on the Court's view that a bank's business necessarily involves two sides - receipts and uses. The Court appeared to rely entirely

for this conclusion on the definition of an “international banking business” in the Barbados legislation.

[54] This conclusion was a legal error. Simply because Barbados legislation defines international banking in a particular manner does not mean that receipts and uses are always a necessary requirement to carry on a banking business – in Barbados or elsewhere.

[55] Canadian courts find it difficult to define the term “banking”. The Supreme Court discussed this difficulty in the context of a constitutional matter in *Canadian Pioneer Management Ltd. v. Labour Relations Board of Saskatchewan* (1979), [1980] 1 S.C.R. 433, 107 D.L.R. (3d) 1. In that case, the decision of the majority concluded that “banking” is an elusive concept, difficult to define, and its meaning should be based on a formal, institutional approach rather than a substantive approach, in the sense of the functions of banking. It follows that the use of the term “bank” in the name of the entity, and whether it is regulated, are factors to be considered, rather than the actual activities that are conducted.

[56] The Tax Court’s approach is at odds with *Canadian Pioneer*, which details that a formal, institutional approach should be taken to define a banking business. Using this approach, there is no reasonable basis to conclude that the arm’s length test requires both business receipts and uses.

[57] The Tax Court’s error that business receipts and uses are necessary to comply with the arm’s length test spawned two incorrect conclusions: (1) that the receipt side of the business

implies an element of competition (paragraph 210), and (2) that the necessity for business receipts means that the exclusion does not apply if a business simply manages its own funds (paragraph 325). Since the term "banking" depends on formal factors rather than functions, it is a legal error for the Tax Court to make these inferences.

[58] In addition, the Tax Court's focus on competition, which was dealt with at length in the Court's reasons, is an example of a court inferring a purposive interpretation from unexpressed legislative intent. This is also a legal error. As stated by the Supreme Court of Canada: "This Court has consistently held that courts must therefore be cautious before finding within the clear provisions of the [ITA] an unexpressed legislative intention … Finding unexpressed legislative intentions under the guise of purposive interpretation runs the risk of upsetting the balance Parliament has attempted to strike in the [ITA]" (*Shell Canada Ltd. v. Canada*, [1999] 3 S.C.R. 622 at para. 43, 178 D.L.R. (4th) 26). The emphasis in the Tax Court's reasons on an unexpressed intention of competition is not appropriate in this case which involves a FAPI scheme that is drafted with mind-numbing detail.

[59] The Tax Court also erred by conflating the rationale of the legislation for purposes of a GAAR analysis with the purpose of the legislation in a statutory interpretation analysis. These are distinctly different exercises (*Canada v. Oxford Properties Group Inc.*, 2018 FCA 30 at paras. 40–42, [2018] 6 C.T.C. 1, citing *Copthorne Holdings Ltd. v. R.*, 2011 SCC 63 at paras. 66, 70, [2011] 3 S.C.R. 721). It appears that the Tax Court brushed over this distinction, referring to it as "something of a fine, legalistic point" (paragraph 218).

[60] As discussed in the Tax Court reasons, competition is recognized as a policy rationale for limiting FAPI to passive income and as such it would be relevant in a GAAR analysis. However, Parliament has not explicitly required competition as an element of the foreign bank exclusion at issue. This may be contrasted with other FAPI provisions where a competition requirement is explicit (see, for example, subsection 95(2.4) of the ITA).

[61] The Court also erred in not respecting the fundamental principle that a corporation and its shareholders are separate and distinct entities (see *Chevron Corp. v. Yaiguaje*, 2015 SCC 42 at para. 95, [2015] 3 S.C.R. 69).

[62] This error is manifested in the Court's determination that Glenhuron's activities involving the purchase of short-term debt securities and its swap transactions were conducted with Loblaw. In each case, the Court stated that Glenhuron was acting on behalf of Loblaw whose money it was investing (paragraphs 242, 247). Except with respect to investment management services which are not relevant in this part of the analysis, Glenhuron was not managing Loblaw's money but its own. It was an error of law for the Court to consider that Glenhuron's money belonged to Loblaw.

What is the appropriate remedy?

[63] The errors made in the Court below were the foundation for its conclusion that Glenhuron's income was FAPI. Accordingly, the Tax Court's decision should be set aside, except for its finding with respect to investment management services which was not appealed.

[64] In light of these errors, this Court may either refer the matter back to the Tax Court for redetermination, or it may make the decision that the Tax Court should have given.

[65] In this particular case, the record was extensive, and included a 36-volume appeal book. I was initially doubtful that it would be feasible to make the necessary findings of fact in this appeal to give the judgment that the Tax Court should have given.

[66] Ultimately, I have concluded that it is possible to make the necessary findings of fact. This conclusion is assisted by three factors: (1) the reasons of the Tax Court are very detailed, (2) Loblaw Financial provided summaries of information from financial statements that could be verified from the record, and (3) the Crown does not take issue with the Tax Court's factual findings as to the activities conducted by Glenhuron.

[67] I turn now to consider what decision the Tax Court should have given.

Did Glenhuron conduct business principally with arm's length persons?

[68] In this section, I consider who Glenhuron conducted business with. For the reasons that follow, I conclude that Glenhuron principally conducted business with arm's length persons. This conclusion does not depend on whether or not the investment management business is considered a separate business.

[69] The term “investment business” explicitly requires that either Loblaw Financial or Glenhuron establish that the arm’s length requirement has been satisfied. In my view Loblaw Financial has done so. For the reasons below, I conclude that Glenhuron principally conducted business with persons with whom it entered into contracts with respect to short-term debt securities and swap transactions. Glenhuron dealt with all such persons on an arm’s length basis.

[70] The essence of Glenhuron’s business activity was to decide what areas of business to pursue and what specific income-earning contracts to enter into, and then to implement those transactions. These activities generally involved interactions between Glenhuron and the persons with whom Glenhuron entered into income-earning transactions. They also involved interactions between Glenhuron and Loblaw Financial in which the parent corporation provided direction, support and oversight.

[71] In applying the arm’s length test to these interactions, one must consider how the interaction with Loblaw Financial affects the analysis, determine the predominant income-earning transactions, and determine whether those transactions were conducted with persons with whom Glenhuron dealt at arm’s length.

[72] With respect to the interaction between Glenhuron and Loblaw Financial, the extent and nature of this interaction was not as clearly set out in the evidence as it could have been. Loblaw Financial submits that these interactions were “commercially normal and legally required”. This suggests a mere oversight role which would not amount to conducting business with Glenhuron. In my view, the evidence was not sufficiently detailed to establish that the role was limited in

this way. The role may well have involved Loblaw Financial providing support services to Glenhuron which resulted in Glenhuron conducting business with its parent corporation.

[73] However, in my view this does not affect the ultimate issue which is whether Glenhuron principally conducted business with arm's length persons. The FAPI regime as a whole, and the foreign bank exclusion in particular, is intended to encourage Canadians to carry on active businesses outside Canada. Parliament could not have intended that the foreign bank exclusion should be denied as a result of support and oversight provided by a parent corporation. The legislative intent would be frustrated if these interactions with Loblaw Financial were to be given significant weight.

[74] As for weighing Glenhuron's interactions in its income-earning transactions, a predominate weighting should be given to persons with whom Glenhuron dealt in the context of acquiring short-term debt securities and swaps. As clearly set out in the appended charts, the vast majority of Glenhuron's assets were invested in US denominated short-term debt securities, cross-currency swaps, and interest rate swaps. These activities also generated by far the most income. Except for Loblaw's supporting role discussed above, this business activity was conducted entirely with arm's length persons.

[75] Loblaw Financial submitted that there was another aspect of Glenhuron's core business, loans to drivers of Weston bakery products. Although the loans were held by arm's length drivers, the arrangement had the significant involvement of the Weston bakery group and was

subject to a formal agreement with that group. I conclude that this part of the business was substantially conducted with Weston as well as with the arm's length drivers.

[76] However, it is not necessary to take the drivers' loans into account to satisfy the arm's length test. As described in the charts, the drivers' loans employed a relatively small amount of Glenhuron's funds and they earned a relatively small amount of income. My general impression is that this activity involved more employee time than other businesses, relative to its returns, but that the number of employees engaged in this activity was still small compared to the main business activity which involved the active participation of an investment team to purchase short-term debt securities and enter into swap transactions.

[77] I would mention that the charts provided by Loblaw Financial do not contain financial information about the equity forwards. Loblaw Financial justified the exclusion on the basis that the Minister's reassessments did not include the unrealized gains or losses from this activity which were reported in the financial statements. I am not satisfied that this is a sufficient reason to exclude information about the equity forwards from the charts. However, these contracts lost money on a cumulative basis and the Crown did not submit that it was a significant business activity. On balance, I have concluded that this activity was not significant compared to Glenhuron's main activities.

[78] I turn now to consider some of the Crown's submissions.

[79] First, the Crown submits that the arm's length test requires the court to consider both Glenhuron's use of funds and receipt of funds. The Crown says that Loblaw Financial itself admitted throughout that both receipts and uses were elements of Glenhuron's business by acknowledging that Glenhuron carried on an "international banking business."

[80] This Court was not provided with Loblaw Financial's submissions in the Tax Court. However, based on the information before this Court the Crown's submission misrepresents Loblaw Financial's position. Loblaw Financial did not represent that receipts were part of Glenhuron's business as the term "business" is understood for purposes of the definition of "investment business" in the ITA. Instead, Loblaw Financial represented that receipts were part of its international banking business for purposes of Barbados banking legislation. The two concepts are very different.

[81] The question presented by the Crown's submission is whether funds received by Glenhuron for use in its business were part of the conduct of Glenhuron's business for purposes of the definition of "investment business" in the ITA. For this purpose, the term "business" should be determined in accordance with Canadian law – not the law of Barbados.

[82] For purposes of the ITA, the term "business" generally means "something occupying the time and attention and labour of a man for the purpose of profit" (see *Smith v. Anderson* (1880), 15 Ch. D. 247 at 258 (C.A.) and the definition of "business" in subsection 248(1) of the ITA).

[83] The relevance of this issue is whether capital invested by the Loblaw group was part of the conduct of Glenhuron's business. In light of the general meaning of "business", this is a factual determination. In my view, the capital investments by the Loblaw group were not part of Glenhuron's conduct of business.

[84] Applying the meaning of "business," there is no reason to conclude that the capital invested by the Loblaw group would have occupied the time and attention of Glenhuron in any meaningful way. Instead, the investments were part of Loblaw's global strategy to transfer funds from other affiliates to Glenhuron to the extent that the funds were surplus to Loblaw's business needs. It was a shareholder decision – and there is no reason to conclude that it involved business conducted by Glenhuron.

[85] I would also add that this approach is consistent with long-standing jurisprudence which draws a distinction between "capital to enable [people] to conduct their enterprises" and "the activities by which they earn their income" (*Bennett & White Construction Co. v. Minister of National Revenue*, [1949] S.C.R. 287, [1948] 4 D.L.R. 817 at 823, citing *Montreal Coke & Mfg. Co. v. Minister of National Revenue*, [1944] 3 D.L.R. 545, [1944] A.C. 126).

[86] Finally, the Crown submits that if Loblaw Financial's position is accepted, the very target of the FAPI legislation, which is an investment portfolio held offshore, would be exempt. The concern is a valid one, but it does not enable a court to give the legislation a broader interpretation than it can reasonably bear. A gap in the legislation is for Parliament to address. It

appears that Parliament may have now done so with the addition of subsection 95(2.11) of the ITA, but this is not relevant for purposes of this appeal.

[87] For these reasons, I conclude that Glenhuron's FAPI is limited to its income in relation to investment management services provided to non-arm's length persons. I would refer the reassessments back to the Minister for reassessment on this basis.

What is an appropriate award of costs?

[88] It is necessary to consider costs in this Court and the Tax Court.

[89] With respect to the appeal in this Court, costs will be awarded to Loblaw Financial based on the tariff.

[90] With respect to the Tax Court proceeding, I would make the costs order that the Tax Court should have given. The question is whether Loblaw Financial should be granted costs in excess of the tariff, and if so how much.

[91] The trial was lengthy, complex, and raised an important issue. It is clear that costs significantly above the tariff should be awarded. The Crown agreed in their submissions that this would be appropriate if Loblaw Financial were the successful party.

[92] The parties differ, however, as to amount that should be awarded. Loblaw Financial submits that an appropriate award for legal fees would be $3.1 million which represents 50 percent of its claimed legal fees up to the date of its first settlement offer and 80 percent thereafter, for an aggregate 60 percent of total fees. The Crown submits that the award for legal fees should not be fixed, but should be a percentage of reasonable billed and paid fees. It suggests a percentage of 35 percent.

[93] The award of costs is not an exact science and in this case it is appropriate for this Court to fix the amount. In my view, an award of $1.8 million plus reasonable disbursements is appropriate. This result is closer the Crown's position (35 percent) than Loblaw Financial's (60 percent).

[94] In reaching this conclusion, I have rejected Loblaw Financial's submission that the award should be significantly increased due to settlement offers it made and in light of certain conduct by the Crown.

[95] There were two settlement offers. Loblaw Financial's earlier offer was not a reasonable compromise and it does not justify an increased award. The later offer was based on a compromise but the offer was made quite late in the process. It also would not justify a significant increase in costs.

[96] With respect to the conduct of the Crown, to the extent that the Crown's conduct resulted in a lengthier and more difficult trial, the costs award reflects this to some extent. However, I am

not of the view that the award should be substantially increased. There is no reason for me to believe that the Crown took positions that were not justified in the circumstances. The Tax Court did come to a different view on this, but the judge had the benefit of observing the trial as it unfolded and the Court's comments were in the context of the Crown being the successful party.

Conclusion

[97] I would allow the appeal, and set aside the decision of the Tax Court. In giving the decision that the Tax Court should have given, I would allow the appeal in the Tax Court, and refer the reassessments back to the Minister for reconsideration and reassessment on the basis that Glenhuron's FAPI consists only of income from investment management services provided to non-arm's length parties.

[98] I would order costs to Loblaw Financial with respect to this appeal. With respect to costs in the Tax Court, I would set aside the award of costs by the Tax Court. In making the decision that the Tax Court should have given, I would award costs to Loblaw Financial in a fixed amount of $1.8 million, plus reasonable disbursements.

"Judith Woods"
J.A.

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

"I agree
Anne L. Mactavish J.A."

APPENDIX A

Glenhuron's Assets

	Short-Term Debt Securities	Cross-Currency Swaps (Notional)[4]		Interest Rate Swaps (Notional)		Loans	Appeal Book Reference
Year	US$ million	No.	US$ million	No.	CAD$ million	US$ million	
2000	709	53	661	31	833	-	Tab 16.A, p. 399, 404; Tab 81.A, p. 4528; Tab 81.L, p. 4541
2001	653	56	726	42	1,353	91	Tab 16.B, p. 411, 416-417; Tab 81.B, p. 4529; Tab 81.M, p. 4542
2002	707	59	787	41	1,347	91	Tab 16.C, p. 423, 428-430; Tab 81.C, p. 4530-4531; Tab 81.N, p. 4543
2003	765	63	861	32	1,160	96	Tab 16.D, p. 435, 440-442; Tab 81.D, p. 4532-4533; Tab 81.O, p. 4544
2004	681	57	796	21	988	106	Tab 16.E, p. 447, 452-454; Tab 81.E, p. 4534; Tab 81.P, p. 4545-4546
2005	724	54	746	13	723	-	Tab 16.F, p. 459, 465-466; Tab 81.F, p. 4535; Tab 81.Q, p. 4547-4548
2007	823	53	847	10	630	-	Tab 16.H, p. 483, 490; Tab 81.H, p. 4537; Tab 81.S, p. 4550-4551
2008	913	53	950	6	390	-	Tab 16.I, p. 496, 503; Tab 81.I, p. 4538; Tab 81.T, p. 4552
2010	977	55	1,028	3	200	-	Tab 16.K, p. 535, 543; Tab 81.K, p. 4540; Tab 81.V p. 4554

Core Business Activities: Gross Operating Income
In US$ millions

Year	GBL Total	Swaps		Short-Term Debt Securities		Loan Interest		Appeal Book Reference
2000	49.4	14.3	*29%*	34.1	*69%*	-	-	Tab 16.A, p. 400
2001	44.6	9.3	*21%*	32.2	*72%*	2.6	*6%*	Tab 16.B, p. 412
2002	55.8	30.3	*54%*	18	*32%*	7.7	*14%*	Tab 16.C, p. 424
2003	65.1	47.6	*73%*	9.5	*15%*	7.8	*12%*	Tab 16.D, p. 436
2004	59.5	41.4	*70%*	9.7	*16%*	8.1	*14%*	Tab 16.E, p. 448
2005	56.9	31.6	*55%*	21.9	*38%*	3.2	*6%*	Tab 16.F, p. 460
2007	88.6	47.6	*54%*	38.2	*43%*	-	-	Tab 16.H, p. 484
2008	72.7	48.2	*66%*	19.7	*27%*	-	-	Tab 16.I, p. 497
2010	60.5	55.5	*92%*	1.9	*3%*	-	-	Tab 16.K, p. 536

Non-Core Business Activities: Gross Operating Income
In US$ millions

Year	GBL Total	Investment Management Fees		Related Party Loans		Loan Mgmt Fees		Appeal Book Reference
2000	49.4	0.7	*1.4%*	-	-	-	-	Tab 16.A, p. 400
2001	44.6	0.4	*0.9%*	-	-	-	-	Tab 16.B, p. 412
2002	55.8	0.5	*0.9%*	3.2	*5.7%*	-	-	Tab 16.C, p. 424; Tab 83.A, p. 4676-4679
2003	65.1	0.6	*0.9%*	-	-	-	-	Tab 16.D, p. 436
2004	59.5	0.6	*1.0%*	-	-	-	-	Tab 16.E, p. 448
2005	56.9	0.9	*1.6%*	-	-	0.3	*0.5%*	Tab 16.F, p. 460
2007	88.6	1.2	*1.4%*	1.0	*1.1%*	0.6	*0.7%*	Tab 16.H, p. 484
2008	72.7	1.4	*1.9%*	2.9	*4.0%*	0.6	*0.8%*	Tab 16.I, p. 497
2010	60.5	1.7	*2.8%*	1.5	*2.5%*		-	Tab 16.K, p. 536

APPENDIX B

95 (1) In this subdivision

…

investment business of a foreign affiliate of a taxpayer means a business carried on by the foreign affiliate in a taxation year (other than a business deemed by subsection (2) to be a business other than an active business carried on by the foreign affiliate and other than a non-qualifying business of the foreign affiliate) the principal purpose of which is to derive income from property (including interest, dividends, rents, royalties or any similar returns or substitutes for such interest, dividends, rents, royalties or returns), income from the insurance or reinsurance of risks, income from the factoring of trade accounts receivable, or profits from the disposition of investment property, unless it is established by the taxpayer or the foreign affiliate that, throughout the period in the taxation year during which the business was carried on by the foreign affiliate,

(***a***) the business (other than any business conducted principally with persons with whom the affiliate does not deal at arm's length) is

(**i**) a business carried on by it as a foreign bank, a trust company, a credit union, an insurance corporation or a trader or dealer

95 (1) Les définitions qui suivent s'appliquent à la présente sous-section.

[…]

entreprise de placement Entreprise exploitée par une société étrangère affiliée d'un contribuable au cours d'une année d'imposition (à l'exception d'une entreprise qui est réputée par le paragraphe (2) être une entreprise autre qu'une entreprise exploitée activement de la société affiliée et autre qu'une entreprise non admissible de cette société) dont le principal objet consiste à tirer un revenu de biens (y compris des intérêts, dividendes, loyers, redevances et rendements semblables et tous montants de remplacement de tels intérêts, dividendes, loyers, redevances ou rendements), un revenu de l'assurance ou de la réassurance de risques, un revenu provenant de l'affacturage de comptes clients ou des bénéfices provenant de la disposition de biens de placement, sauf si le contribuable ou la société affiliée établissent que les conditions ci-après étaient réunies tout au long de la période de l'année pendant laquelle la société affiliée a exploité l'entreprise :

a) l'entreprise, sauf celle menée principalement avec des personnes avec lesquelles la société affiliée a un lien de dépendance, présente l'une des caractéristiques suivantes :

(**i**) il s'agit d'une entreprise que la société affiliée exploite à titre de banque étrangère, de société de fiducie, de caisse de crédit,

in securities or commodities, the activities of which are regulated under the laws

de compagnie d'assurance ou de négociateur ou courtier en valeurs mobilières ou en marchandises et dont les activités sont réglementées par les lois des pays suivants, selon le cas :

(**A**) of each country in which the business is carried on through a permanent establishment in that country and of the country under whose laws the affiliate is governed and any of exists, was (unless the affiliate was continued in any jurisdiction) formed or organized, or was last continued,

(**A**) chaque pays où l'entreprise est exploitée par l'intermédiaire d'un établissement stable situé dans ce pays, et le pays sous le régime des lois duquel la société affiliée est régie et, selon le cas, existe, a été constituée ou organisée (sauf si elle a été prorogée dans un territoire quelconque) ou a été prorogée la dernière fois,

(**B**) of the country in which the business is principally carried on, or

(**B**) le pays où l'entreprise est principalement exploitée,

(**C**) if the affiliate is related to a non-resident corporation, of the country under whose laws that non-resident corporation is governed and any of exists, was (unless that non-resident corporation was continued in any jurisdiction) formed or organized, or was last continued, if those regulating laws are recognized under the laws of the country in which the business is principally carried on and all of those countries are members of the European Union, or

(**C**) si la société affiliée est liée à une société non-résidente, le pays sous le régime des lois duquel cette dernière est régie et, selon le cas, existe, a été constituée ou organisée (sauf si elle a été prorogée dans un territoire quelconque) ou a été prorogée la dernière fois, si ces lois sont reconnues par les lois du pays où l'entreprise est principalement exploitée et si ces pays sont tous membres de l'Union européenne,

(**ii**) the development of real property or immovables for sale, the lending of money, the leasing or licensing of property

(**ii**) elle consiste à mettre en valeur des immeubles ou des biens réels en vue de leur vente, à prêter de l'argent, à louer des

or the insurance or reinsurance of risks,

biens, à concéder des licences sur des biens ou à assurer ou à réassurer des risques;

(***b***) either

b) selon le cas :

(**i**) the affiliate (otherwise than as a member of a partnership) carries on the business (the affiliate being, in respect of those times, in that period of the year, that it so carries on the business, referred to in paragraph (c) as the "operator"), or

(**i**) la société affiliée exploite l'entreprise autrement qu'à titre d'associé d'une société de personnes (la société affiliée étant appelée « exploitant » à l'alinéa c) pour ce qui est des moments, compris dans la période en cause, où elle exploite ainsi l'entreprise),

(**ii**) the affiliate carries on the business as a qualifying member of a partnership (the partnership being, in respect of those times, in that period of the year, that the affiliate so carries on the business, referred to in paragraph (c) as the "operator"), and

(**ii**) la société affiliée exploite l'entreprise à titre d'associé admissible d'une société de personnes (cette dernière étant appelée « exploitant » à l'alinéa c) pour ce qui est des moments, compris dans la période en cause, où la société affiliée exploite ainsi l'entreprise;

(*c*) the operator employs

c) l'exploitant emploie, selon le cas :

(**i**) more than five employees full time in the active conduct of the business, or

(**i**) plus de cinq personnes à plein temps pour assurer la conduite active de l'entreprise,

(**ii**) the equivalent of more than five employees full time in the active conduct of the business taking into consideration only

(**ii**) l'équivalent de plus de cinq personnes à plein temps pour assurer la conduite active de l'entreprise, compte tenu uniquement des services suivants :

(**A**) the services provided by employees of the operator, and

(**A**) les services fournis par ses employés,

(**B**) the services provided outside Canada to the operator by any one or more persons each of whom is,

(**B**) les services que lui fournissent à l'étranger une ou plusieurs personnes dont chacune est, pendant la

during the time at which the services were performed by the person, an employee of

(**I**) a corporation related to the affiliate (otherwise than because of a right referred to in paragraph 251(5)(*b*)),

(**II**) in the case where the operator is the affiliate,

1 a corporation (referred to in this subparagraph as a "providing shareholder") that is a qualifying shareholder of the affiliate,

2 a designated corporation in respect of the affiliate, or

3 a designated partnership in respect of the affiliate, and

(III) in the case where the operator is the partnership described in subparagraph (*b*)(ii),

1 any person (referred to in this subparagraph as a "providing member") who is a qualifying member of that partnership,

2 a designated corporation in respect of the affiliate, or

période où elle a exécuté les services, l'employé d'une des entités suivantes :

(**I**) une société liée à la société affiliée autrement qu'à cause d'un droit visé à l'alinéa 251(5)b),

(**II**) dans le cas où l'exploitant est la société affiliée :

1 une société (appelée « actionnaire fournisseur » au présent sous-alinéa) qui est un actionnaire admissible de la société affiliée,

2 une société désignée relativement à la société affiliée,

3 une société de personnes désignée relativement à la société affiliée,

(**III**) dans le cas où l'exploitant est la société de personnes visée au sous-alinéa b)(ii) :

1 une personne (appelée « associé fournisseur » au présent sous-alinéa) qui est un associé admissible de la société de personnes,

2 une société désignée relativement à la société affiliée,

3 a designated partnership in respect of the affiliate,	**3** une société de personnes désignée relativement à la société affiliée,
if the corporations referred to in subclause (B)(I) and the designated corporations, designated partnerships, providing shareholders or providing members referred to in subclauses (B)(II) and (III) receive compensation from the operator for the services provided to the operator by those employees the value of which is not less than the cost to those corporations, partnerships, shareholders or members of the compensation paid or accruing to the benefit of those employees that performed the services during the time at which the services were performed by those employees;	à condition que les sociétés visées à la subdivision (B)(I) et les sociétés désignées, sociétés de personnes désignées, actionnaires fournisseurs ou associés fournisseurs visés aux subdivisions (B)(II) et (III) reçoivent de l'exploitant, en règlement des services qui lui sont fournis par ces employés, une rétribution d'une valeur au moins égale au coût, pour ces sociétés, sociétés de personnes, actionnaires ou associés, de la rétribution payée aux employés ayant exécuté les services, ou constituée pour leur compte, pendant l'exécution de ces services.

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

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