Federal Court of Appeal | Cour d'appel fédérale

Date: 20141117

Docket: A-72-13

Citation: 2014 FCA 267

CORAM : **NADON J.A.**
SCOTT J.A.
BOIVIN J.A.

BETWEEN:

LYRTECH RD INC.

Appellant

and

HER MAJESTY THE QUEEN

Respondent

Heard at Québec, Quebec, on October 21, 2014.

Judgement delivered at Ottawa, Ontario, on November 17, 2014.

REASONS FOR JUDGMENT BY: SCOTT J.A.

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

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REASONS FOR JUDGMENT

SCOTT J.A.

I) Background

[1] This is an appeal from a judgment of Justice Favreau (the judge) of the Tax Court of Canada (the Court) dated January 24, 2013, dismissing the appeals filed by Lyrtech RD Inc. (the appellant) against the assessments made under the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (the Act), for taxation years 2005, 2006 and 2007. The judge concluded that the appellant was

not a Canadian-controlled private corporation as defined in paragraph 125(7)(*a*) of the Act. The appellant was therefore not entitled to the fifteen percent (15%) addition to the investment tax credit provided for in subsection 127(10.1) of the Act, nor was it entitled to an investment tax credit refund under subsection 127.1(1) of the Act, since it was not a qualifying corporation within the meaning of subsection 127.1(2) of the Act.

[2] For the reasons which follow, I am of the view that this appeal should be dismissed.

II) Facts

[3] Lyrtech Inc. (Lyrtech) is a public corporation that has had a class of shares of its capital stock listed on a designated stock exchange in Canada since October 4, 2000,

[4] Between 2000 and 2004, Lyrtech, as a public corporation, claimed against its tax payable non-refundable investment tax credits at the rate of twenty percent (20%) of its research and development (R&D) qualified expenditure pool. For the 2000 to 2004 taxation years, Lyrtech was unable to claim federal investment tax credits for its eligible R&D expenditures because it was in a loss position.

[5] In 2005, Lyrtech restructured its business and transferred its R&D activities to the appellant, a new corporation created on May 30, 2005, so that it could again benefit from investment tax credits under subsection 127.1(1) of the Act and the fifteen percent (15%) addition to the investment tax credit under subsection 127(10.1) of the Act.

[6] The appended organizational chart, part of the judge's decision, shows the corporate structure in place following the 2005 reorganization.

[7] On June 1, 2005, as part of the restructuring, Fiducie Financière Lyrtech (FFL), a discretionary trust, was created by corporation 4296621 Canada Inc., a subsidiary of Lyrtech. FFL became the owner of all the appellant's voting shares.

[8] The appellant, 4296630 Canada Inc. and 4296648 Canada Inc. became the beneficiaries of FFL's income, while 4296630 Canada Inc., 4296648 Canada Inc. and 4296621 Canada Inc. became the beneficiaries of FFL's capital.

[9] Under the trust deed, the trustees have to be directors of Lyrtech at all times because they are appointed trustees of FFL when they agree to be directors. The trust deed also stipulates that the number of trustees cannot exceed the number of directors of Lyrtech.

[10] Miguel Caron and Louis Bélanger sat on the boards of directors of Lyrtech, the appellant, and each Lyrtech subsidiary; they were also FFL trustees.

[11] In addition, it must be noted that the Lyrtech board of directors had seven (7) shareholder-elected directors. None of the shareholders owned more than ten percent (10%) of Lyrtech's capital stock, with the exception of Corriente Master Fund, which held slightly over 25,000,000 of the 243,725,724 Class A shares issued and in circulation that entailed one voting

right per share. Consequently, none of the shareholders was able to elect the majority of Lyrtech's directors.

[12] Following the restructuring, the appellant claimed investment tax credits in the amount of $384,812, $663,130 and $742,640, respectively, for taxation years 2005 to 2007. The respondent denied it these credits given Lyrtech's control of the appellant.

III) Judgment of the Tax Court of Canada

[13] The judge had to determine whether the appellant met the definition of a "Canadian-controlled private corporation" as defined in paragraph 125(7)(*a*) of the Act during taxation years 2005, 2006 and 2007 to entitle it to the addition of the investment tax credit claimed.

[14] The judge accepted the principle that one person can have *de facto* control of a corporation while another person simultaneously has *de jure* control for all provisions of the Act, without it being necessary for the Act to make specific reference thereto.

[15] In the case at bar, given that the appellant's capital stock was held by FFL, FFL exercised the appellant's *de jure* control.

[16] After analyzing the evidence, the judge found that there was an undeniable relationship between Lyrtech and the appellant meaning that Lyrtech had *de facto* control of the appellant. He arrived at this conclusion by applying the factors found in paragraph 23 of Interpretation Bulletin IT-64R4. He also applied the factors set out in the case law, specifically in *Mimetix*

Pharmaceuticals Inc. v. Canada, [2001] T.C.J. No. 749, [2002] 1 T.C.C. 2188, aff'd 2003 FCA 106, [2003] 3 C.T.C. 72, namely, the economic controlling influence Lyrtech exercised over the appellant.

[17] This led the judge to conclude that Lyrtech controlled the appellant directly or indirectly within the meaning of subsections 125(7) and 256(5.1) of the Act.

[18] Moreover, the judge rejected the respondent's alternative argument that, in addition to *de facto* control, Lyrtech had indirect *de jure* control of the appellant pursuant to subparagraph 251(5)(*b*)(i) and subsection 248(25) of the Act as applied to a discretionary trust. According to the judge, the beneficiaries of FFL's capital only had an aleatory, uncertain or indirect right to the appellant's capital stock.

IV) Issues

[19] This appeal raises the following issues:

a) *Did the judge err in deciding that the appellant did not meet the definition of a "Canadian-controlled private corporation" under subsection 125(7) of the Act during the taxation years ending on December 31, 2005, 2006 and 2007?*

b) *Did the judge err in rejecting the respondent's alternative argument and in concluding that Lyrtech did not also control the appellant under subparagraph 251(5)(b)(i) of the Act?*

[20] *Housen v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235, holds that where the issue concerns the application of legal standards to the facts, the Federal Court of Appeal may only

intervene if the judge made a palpable and overriding error. If the issue concerns the application of legal standards, it is subject to a standard of correctness.

V) Parties' submissions

A. *Appellant's submissions*

[21] The appellant essentially makes the same submissions as it did before the judge. First, it challenges the judge's conclusion that *de jure* control and *de facto* control can coexist simultaneously while being exercised by two distinct persons, for all provisions of the Act, without it being necessary for the Act to make specific reference thereto.

[22] This Court's decision in *Parthenon Investments Limited v. Canada (National Revenue)*, [1997] F.C.J. No. 800, [1997] 3 C.T.C. 152 (*Parthenon*), led Parliament to enact subsections 256(6.1) and (6.2) to adopt the concept of simultaneous *de jure* and *de facto* control.

[23] To confirm the presence of this concept in all provisions of the Act, the judge cited *Rosario Poirier Inc. v. Canada*, [2002] 4 C.T.C. 2346, [2002] T.C.J. No. 255 (*Poirier*), and *Avotus Corp. v. Canada*, 2006 TCC 505, [2006] T.C.J. No. 501 (*Avotus*). The appellant is challenging the relevancy of both cases on the grounds that there was a specific provision in the Act that allowed simultaneous control, namely subparagraph 256(1.2)(*b*)(ii) in *Poirier*, and that the facts in *Avotus* are completely different from the case at bar.

[24] Contrary to the judge's conclusion, the appellant submits therefore that subsections 256(6.1) and (6.2) concern a specific situation and that there is no similar provision for the application of paragraph (*a*) of the definition of Canadian-controlled private corporation in subsection 125(7). Consequently, it argues that we should stand by doctrine of *Parthenon*, namely, that *de jure* and *de facto* control can only be exercised by one and the same person.

[25] In short, the appellant submits that paragraph (*a*) of the definition of "Canadian-controlled private corporation" under subsection 125(7) of the Act had to contain a specific provision relating to the simultaneous existence of *de jure* and *de facto* control or a similar provision to that of subsection 256(6) of the Act, which it does not.

[26] The appellant is also challenging the judge's second conclusion, according to which Lyrtech had *de facto* control of the appellant.

[27] The appellant submits that a narrower test should be applied to determine whether there is *de facto* control. In the appellant's opinion, *de facto* control exists when a party can effect a change in the board of directors or very directly influence the shareholders that would otherwise have the ability to elect the board of directors.

[28] In this regard, the appellant points out that the judge merely referred to the factors noted in the parties' partial agreed statement of facts. He failed to apply the test set out in the case law, such as in *Silicon Graphics Ltd. v. Canada*, 2002 FCA 260, [2002] 3 C.T.C. 527 (*Silicon Graphics*), namely, the clear ability to effect a significant change in the board of directors or to

influence in a very direct way the shareholders who would otherwise have the ability to elect the board of directors.

[29] The appellant further submits that the judge, having concluded that Mr. Bélanger and Mr. Caron had *de facto* control of the appellant, could not then determine that Lyrtech had this *de facto* control since they were distinct persons. Moreover, the judge did not take into consideration the duties of these two trustees under the *Civil Code of Québec*, S.Q. 1991, c. 64 (articles 1261, 1278, 1309 and 1310).

[30] Lastly, the appellant criticizes the judge for ignoring basic information, namely, that Lyrtech was a public company and that it had seven (7) shareholder-elected directors.

B. *Respondent's submissions*

[31] In turn, the respondent submits that the judge interpreted subsection 256(5.1) of the Act correctly. The enactment of this subsection resulted in broadening the concept of control to include *de facto* control, which had not been the case previously. Lyrtech's *de facto* control of the appellant therefore excluded it from the definition of a Canadian-controlled private corporation.

[32] The respondent argues that the judge did not make a palpable and overriding error in his analysis of the facts with respect to the existence of *de facto* control on the part of Lyrtech, particularly given that the evidence establishes that the appellant was operationally and economically dependent on Lyrtech.

[33] On appeal, the respondent reiterated its alternative argument, rejected by the judge, and alleged that the judge erred in refusing to apply the legal fiction created by subparagraph 251(5)(*b*)(i) of the Act when he determined that the appellant was not deemed to be controlled by Lyrtech.

VI) Analysis

a) Did the judge err in deciding that the appellant did not meet the definition of a "Canadian-controlled private corporation" under subsection 125(7) of the Act during the taxation years ending on December 31, 2005, 2006 and 2007?

[34] First, it should be noted that under section 248 of the Act, a Canadian-controlled private corporation is defined as such under subsection 125(7) of the Act, which reads as follows:

Income Tax Act R.S.C. 1985, c.1 (5th supp.)	*Loi de l'impôt sur le revenu* L.R.C. 1985, ch. 1 (5e suppl.)
Paragraph 125 (7) (*a*)	Alinéa 125 (7) *a*)
Definitions	Définitions
(7) In this section :	(7) Les définitions qui suivent s'appliquent au présent article :
"Canadian-controlled private corporation" means a private corporation that is a Canadian corporation other than:	«société privée sous contrôle canadien». Société privée qui est une société canadienne, à l'exception des sociétés suivantes :
(*a*) a corporation controlled, directly or indirectly in any manner whatever, by one or more non-resident persons, by one or more public corporations (other than a prescribed venture capital corporation), by one or more corporations described in paragraph	*a*) la société contrôlée, directement ou indirectement, de quelque manière que ce soit, par une ou plusieurs personnes non-résidentes, par une ou plusieurs sociétés publiques (sauf une société à capital de risque visée par règlement), par une ou plusieurs sociétés visées à

(*c*), or by any combination of them;	l'alinéa *c*) ou par une combinaison de ces personnes ou sociétés;

[35] *Buckerfield's Ltd. v. Minister of National Revenue*, [1964] C.T.C. 504, 64 D.T.C. 5301 clearly decided that *de jure* control is held by the holder of the majority of the votes that elect the board of directors.

[36] The purpose of introducing subsection 256(5.1) of the Act in 1988 was to define the phrase "controlled, directly or indirectly in any manner whatever" in order to incorporate the concept of *de facto* control into the Act (*Transport M.L. Couture Inc. v. Canada*, 2004 FCA 23 at paragraph 14).

[37] Moreover, section 256 of the Act is in Chapter XVII, which deals with the interpretation of the Act. Subsection 256(5.1) of the Act begins as follows: "For the purposes of this Act". The wording used by Parliament does not contain any restrictions and does not intend to limit its scope for a particular purpose or situation.

[38] Moreover, it is my opinion that the judge did not err in following the doctrine propounded by this Court in *Poirier* at paragraphs 28 to 30, which confirms the principle that the existence of *de jure* control does not preclude the possibility of another party exercising *de facto* control at the same time.

[39] Furthermore, particularly with respect to the concept of *de facto* control, the basic principle is set out in *Silicon Graphics*, at paragraph 67. *9044 2807 Québec Inc. v. Canada*, 2004 FCA 23, [2004] F.C.J. No. 135 clarifies it at paragraph 24:

> It is not possible to list all the factors which may be useful in determining whether a corporation is subject to *de facto* control (*Duha Printers*, [1998] 1 S.C.R. 795, para. [38]). However, whatever factors are considered, they must show that a person or group of persons has the clear right and ability to change the board of directors of the corporation in question or to influence in a very direct way the shareholders who would otherwise have the ability to elect the board of directors (*Silicon Graphics*, [2002] FCA 260, para. [67]). In other words, the evidence must show that the decision-making power of the corporation in question in fact lies elsewhere than with those who have *de jure* control.

[40] Paragraph 23 of Interpretation Bulletin IT 6424, published shortly after *Silicon Graphics*, lists the general factors to be weighed to determine whether a person has *de facto* control of a corporation. The trial judge applied these factors, and they can be summarized as follows:

(a) the percentage of ownership of voting shares (when such ownership is not more than 50 per cent) in relation to the holdings of other shareholders;

(b) ownership of a large debt of a corporation which may become payable on demand (unless exempted by subsection 256(3) or (6)) or a substantial investment in retractable preferred shares;

(c) shareholder agreements that include a casting vote;

(d) commercial or contractual relationships of the corporation, e.g., economic dependence on a single supplier or customer;

(e) possession of a unique expertise that is required to operate the business; and;

(f) the influence that a family member, who is a shareholder, creditor, supplier, etc., of a corporation, may have over another family member who is a shareholder of the corporation.

. . .

[41] The judge also made an exhaustive analysis of the applicable tests. He then proceeded to an in-depth review of the factual background to conclude that Lyrtech had *de facto* control of the appellant given the relationship between Louis Bélanger, Miguel Caron and the appellant. In addition, the judge placed particular emphasis on the appellant's economic dependence on Lyrtech.

[42] What is relevant for R&D credits is whether there was an economic dependence or *de facto* control during the taxation years in issue. The fact that the appellant intended to eventually become financially autonomous is irrelevant; what is relevant is whether it was autonomous during the years at issue, failing which it was not entitled to the credits.

[43] In the matter at bar, the appellant has failed to satisfy me that the judge made a palpable and overriding error when he concluded that Lyrtech had *de facto* control of the appellant given Lyrtech's economic controlling influence and the relationships binding the appellant and Lyrtech.

b) Did the judge err in rejecting the respondent's alternative argument and in concluding that Lyrtech did not also control the appellant under subparagraph 251(5)(b)(i) of the Act?

[44] Given the conclusion on the first issue, which disposes of this appeal, and considering the circumstances of this case, there is no need to address the alternative argument raised by the respondent.

[45] For these reasons, I would dismiss the appeal with costs.

"A.F. Scott"

J.A.

"I agree.
M. Nadon, J.A."

"I agree.
Richard Boivin, J.A."

Translation

FEDERAL COURT OF APPEAL

SOLICITORS OF RECORD

DOCKET:	A-72-13
STYLE OF CAUSE:	LYRTECH RD INC. v. HER MAJESTY THE QUEEN
PLACE OF HEARING:	QUÉBEC, QUEBEC
DATE OF HEARING:	OCTOBER 21, 2014
REASONS FOR JUDGMENT BY:	SCOTT J.A.
CONCURRED IN BY:	NADON J.A. BOIVIN J.A.
DATED:	NOVEMBER 17, 2014

APPEARANCES:

René Roy	FOR THE APPELLANT LYRTECH RD INC.
Anne Poirier Dany Leduc	FOR THE RESPONDENT HER MAJESTY THE QUEEN

SOLICITORS OF RECORD:

Fasken Martineau DuMoulin Québec, Quebec	FOR THE APPELLANT LYRTECH RD INC.
William F. Pentney Deputy Attorney General of Canada Ottawa, Ontario	FOR THE RESPONDENT HER MAJESTY THE QUEEN