Citation: 2015 TCC 171
Date: 20150703
Docket: 2012-481(GST)G

BETWEEN:

SUN LIFE ASSURANCE COMPANY OF CANADA,

Applicant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS RESPECTING SUBMISSIONS ON COSTS

Owen J.

[1] Subsequent to the pronouncement of my judgment in *Sun Life Assurance Company of Canada v. The Queen*, 2015 TCC 37, the Appellant in that matter filed a motion for costs on the basis that it had made an offer of settlement to the Respondent and had obtained a judgment more favourable than the terms of the offer. The Applicant submits that it is entitled to substantial indemnity costs under subsection 147(3.1) of the *Tax Court of Canada Rules* (*General Procedure*) (the "Rules") and Tax Court of Canada Practice Notes Nos. 17 and 18. The Applicant seeks a lump sum award of costs in the amount of $200,000, which approximates 80% of counsel fees of $157,430.20 based on certain hourly billing rates, plus taxes of $20,465.93 and disbursements of $21,356.28.

[2] The Applicant says that the actual fees and disbursements incurred by it in respect of the appeal were as follows:

(a) Fees for the professional services of KPMG Law LLP in the amount of $319,795.12 plus HST of $41,573.37 for a total of $361,368.49. The fee for professional services is equal to one-quarter of the tax recovered of $1,279,180.49.

(b) The court fee for filing the Notice of Appeal in the amount of $550.00.

(c) Disbursements in the amount of $18,068.43, including HST, in respect of administrative expenses, including long distance telephone calls, photocopies, fax charges, printing and postage.

(d) Airfare in the amount of $801.58, including HST, for the attendance of two counsel at the settlement conference.

(e) Hotel expenses in the amount of $1,521.92, including HST, for the attendance of two counsel at the settlement conference.

(f) Taxi expenses in the amount of $307, including HST, for the attendance of two counsel at the settlement conference.

(g) A legal gown rental expense of $107.35, including HST.

[3] The claim for substantial indemnity costs is based on fees for professional services of $196,787.75 calculated as follows:

Justin Kutyan, partner: 108.2 hours at $1,130 per hour = $122,266

Vern Vipul, associate: 56.6 hours at $955 per hour = $54,053

Thang Trieu, associate: 18.75 hours at $785 per hour = $14,718.75

Wajiha Khan, law clerk: 23 hours at $250 per hour = $5,750

[4] The Applicant made a settlement offer to the Respondent by letter dated April 24, 2013. The letter stated:

> Further to our recent discussions, Sun Life Assurance Company of Canada ("Sun Life") would be glad to submit a settlement offer for the above mentioned file for an amount of $997,171, plus applicable interest.
>
> We have provided a summary of our relevant calculations at Schedule "A" hereto.
>
> **Basis for Calculations**
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> In considering the settlement amount, please note the following:
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> • Input Tax Credits ("ITCs") should be allowed on the Taxable Office Space actually licensed to the Advisors (the "Licensed Office Space"). On a square footage basis, $177,706.58 should be allowed with respect to the Licensed Office Space.
>
> • ITCs should be allowed with respect to the Common Space to the extent that the Common Space is attributable to the Licensed Office Space. Applying this allocation on a square footage basis, $477,383.96 of ITCs should be allowed with respect to the Common Space attributable to the Licensed Office Space.

> • Sun Life is willing to prepare a settlement offer with respect to the Vacant Space by allowing ITCs based on the percentage of the Licensed Office Space to the total of the Licensed Office Space plus the Exempt Office Space (i.e., approximately 59% during the Reportable Periods). [3] Applying this allocation, $342,080.47 of ITCs should be allowed with respect to the Vacant Space (and including the related Common Space).
>
> [Footnote 3:] This is determined by obtained by [*sic*] dividing the total square footage of the Licensed Office Space by the total of the square footage of the Licensed Office Space plus the Exempt Office Space.

[5] Schedule "A" to the above letter included detailed calculations for each financial centre based on floor space, as well as colour-coded floor plans for eleven financial centres.

[6] The Applicant says that substantially all of KPMG Law's professionals' time spent on the appeal was spent on it after the April 24, 2013 settlement offer. However, actual numbers were not provided. The hearing was held for one day in Toronto in September 2014.

[7] Subsections 147(3.1) to 147(3.8) were added to the Rules effective February 7, 2014. Prior to that, the practice of the Tax Court of Canada was conformed to the proposed text of the new rules by Practice Note No. 17, effective January 18, 2010, and Practice Note No. 18, effective January 31, 2011. The subsections of the Rules relevant in this motion state:

> (3.1) Unless otherwise ordered by the Court, if an appellant makes an offer of settlement and obtains a judgment as favourable as or more favourable than the terms of the offer of settlement, the appellant is entitled to party and party costs to the date of service of the offer and substantial indemnity costs after that date, as determined by the Court, plus reasonable disbursements and applicable taxes.
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> . . .
>
> (3.3) Subsections (3.1) and (3.2) do not apply unless the offer of settlement
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> (*a*) is in writing;
>
> (*b*) is served no earlier than 30 days after the close of pleadings and at least 90 days before the commencement of the hearing;
>
> (*c*) is not withdrawn; and
>
> (*d*) does not expire earlier than 30 days before the commencement of the hearing.

> (3.4) A party who is relying on subsection (3.1) or (3.2) has the burden of proving that
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> > (*a*) there is a relationship between the terms of the offer of settlement and the judgment; and
> >
> > (*b*) the judgment is as favourable as or more favourable than the terms of the offer of settlement, or as favourable or less favourable, as the case may be.
>
> (3.5) For the purposes of this section, "substantial indemnity costs" means 80% of solicitor and client costs.

[8] On a plain reading of the wording of the above provisions, if the conditions imposed by the new rules are met, the Applicant is entitled to substantial indemnity costs, as determined by the Court, after the date of the settlement offer unless the Court orders otherwise. In my view, subsection 147(3.1) is a default rule that applies where a qualifying settlement offer has been made but rejected and the Applicant has obtained a judgment that is related to the terms of the offer and that is at least as favourable as the offer. The purpose of the rule is to encourage parties to settle wherever possible[1] by providing a default entitlement to substantial indemnity costs incurred after the date of the offer. The default rule removes the usual impediment to the award of enhanced costs.[2] Of particular note is the fact that the rule awards 80% of solicitor and client costs without the need to satisfy the conditions typically imposed on the granting of solicitor and client costs.[3]

[9] Under the new rule, the Court has the discretion to determine what the substantial indemnity costs are in each case and the discretion to override the

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[1] The Regulatory Impact Analysis Statement accompanying the introduction of the new rules in SOR/2014-26 states: "The general objectives of the Rules amending the *Tax Court of Canada Rules (General Procedure)* are . . . (4) to encourage parties to settle their dispute early in the litigation process". Under the heading "Description and rationale" it goes on to state: "The provisions of the Rules addressing offers to settle are designed to encourage parties to settle their dispute early in the litigation process. An early settlement has the added advantage of reducing the costs borne by the parties and conserving judicial resources. Parties are entitled to make and accept offers of settlement at any time before there is a judgment and any written offer to settle will be considered by the Court in assessing costs under section 147. In addition to this general rule, there is a need to encourage parties to reach an early settlement, ideally before the beginning of the trial or hearing. This is the specific objective of adding subsections 147(3.1) to (3.8)." The desirability of settlement wherever possible is a longstanding position of the Court as reflected in the concluding words of Practice Note No. 10, effective July 23, 1997, which states: "It is emphasized, however, that while early settlements are favoured last minute settlements are regarded as much preferable to no settlement where settlement is possible."

[2] An example of the impediment to awarding such costs on the basis of a settlement offer alone can be seen in the decision in *Lyons v. The Queen*, 96 DTC 2004 (TCC).

[3] For examples of the conditions imposed on the award of solicitor and client costs, see *Young v. Young*, [1993] 4 S.C.R. 3, *Baker v. Canada (Minister of Citizenship and Immigration)*, [1999] 2 S.C.R. 817, *Hamilton v. Open Window Bakery Ltd.*, [2004] 1 S.C.R. 303 and *Minister of National Health and Welfare v. Apotex* (2000), 194 D.L.R. (4th) 483 (FCA).

default rule if the Court is of the view that the circumstances warrant such an approach. The discretionary aspects of the rule are consistent with the general proposition that costs awards are "quintessentially discretionary".[4]

[10] As is the case with the discretion associated with the award of costs generally, the discretion to determine what the substantial indemnity costs are in each case and the discretion to override the default rule should be exercised only on a principled basis: *The Queen v. Martine Landry*, 2010 FCA 135 at paragraph 22. This requirement is implicit in the observation of the Supreme Court of Canada in *Sun Indalex Finance, LLC v. United Steelworkers*, 2013 SCC 6, [2013] 1 S.C.R. 271 at paragraph 247:

> . . .
>
> Discretionary costs decisions should only be set aside on appeal if the court below "has made an error in principle or if the costs award is plainly wrong": *Hamilton v. Open Window Bakery Ltd.*, 2004 SCC 9, [2004] 1 S.C.R. 303, at para. 27.

[11] In the case of subsection 147(3.1) of the Rules, the need for a principled basis to override the default rule is reinforced by the fact that the rule states that "the appellant is entitled" to substantial indemnity costs after the date of the offer. The entitlement created by the new rule should not be taken away lightly.

[12] The Federal Court of Appeal commented on the new settlement costs rules, in *obiter dicta*, at paragraphs 30 and 31 of *Transalta Corporation v. The Queen*, 2013 FCA 285:

> 30 For the aforementioned reasons and on the basis of the prior jurisprudence of this Court, I cannot conclude that the Judge made a reviewable error in concluding that the Minister was justified in rejecting the settlement offer as it was put forward by the Appellant.
>
> 31 Further, since Practice Note 18 is not yet in force, it cannot affect the discretion of the Court to allow further costs when it is justified or to deny them when it is not. Even if the Practice Notes were in force, proposed Rule 147(3.1) recognizes that judges of the Tax Court retain discretion to not award enhanced costs. Were this not the case, the proposed rule would interfere with the ability of Tax Court judges to fashion just and appropriate cost awards, suitable to the particular circumstances of individual cases.

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[4] *Nolan v. Kerry (Canada) Inc.*, 2009 SCC 39, [2009] 2 S.C.R. 678 at paragraph 126. This discretion can be traced back to the merger of the courts of common law and equity in the 19th century.

[13] The Court observed that even if subsection 147(3.1) of the Rules was in force the Tax Court of Canada still retained discretion not to award costs in accordance with the new rule. This would allow judges of the Tax Court to fashion just and appropriate costs awards suitable to the particular circumstances of individual cases. This is not an invitation to override the default entitlement conferred by the new rule but an acknowledgement of the discretion to do so. As indicated by the Federal Court of Appeal in *Catherine Leuthold v. Canadian Broadcasting Corporation et al.*, 2014 FCA 174, the Court must be guided by the express wording of the rules applicable to costs:

> [10] Ms. Leuthold argues that the law is clear that costs are not to be used to penalize a party, nor are they to be punitive or crippling in nature. She argues that an award of costs of some $80,000 is punitive and a penalty for a person whose gross annual income is approximately $20,000 per year.
>
> [11] I agree with Ms. Leuthold's statements of principle but those principles have to be applied in light of the objective sought to be achieved through Rule 420, which is to deter parties from incurring costs and inflicting them on others by creating a financial incentive to compromise their claims. The incentive, in the case of the double costs rule, is the avoidance of a penalty. I do not think it is contentious to say that doubling the costs a party would otherwise have to pay, or imposing costs on a modestly successful party, is a penalty. As a result, it does not assist Ms. Leuthold to say that costs should not operate as a penalty. Costs should not operate as a penalty unless the Rules specifically intend them to do so.
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> [Emphasis added.]

[14] The Respondent does not dispute the fact that an offer was made by the Applicant that satisfied the conditions in subsection 147(3.3) of the Rules, nor does the Respondent dispute that there is a relationship between the terms of the offer and the judgment and that the Applicant obtained a result more favourable than the offer. The Respondent submits that she could not legally accept the offer because of the "all-or-nothing" nature of the appeal.

[15] I do not quarrel with the principle that the Respondent cannot accept an offer of settlement that is not supportable on the facts and the law. The Federal Court of Appeal described this principle in *CIBC World Markets Inc. v. The Queen*, 2012 FCA 3 as follows:

> 24 CIBC World Markets cites *1390758 Ontario Corporation v. The Queen*, 2010 TCC 572 at paragraph 36 and *Smerchanski v. Minister of National Revenue*, [1977] 2 S.C.R. 23 for the proposition that courts have enforced settlements that apply tax law to agreed facts. That is true. But the Minister's power to agree to facts is limited by the *Galway* principle — the Minister cannot agree to an

> assessment that is indefensible on the facts and the law. Nothing in *1390758 Ontario* and *Smerchanski* undercuts the *Galway* principle.

[16] I do not agree, however, that this principle applied to the settlement offer made by the Applicant to the Respondent on April 24, 2013. The legal issue before me in the appeal was whether the methodology adopted by the Applicant to determine its input tax credits was fair and reasonable in the circumstances given the dual purpose of the leased office space. In allowing the appeal, I made the following observations at paragraphs 35 and 40 of the reasons for judgment:

> Subsection 141.01(5) presupposes that a particular acquisition has more than one purpose and in such a case requires the person acquiring the property or service to determine the extent to which the property or service is acquired for the purpose of making taxable supplies for consideration or for other purposes. The method used to make this determination must be fair and reasonable and must be used consistently throughout the year. Subsection 141.01(5) thus requires that the method chosen by Sun Life to determine the extent to which a dual-purpose property or service is acquired by it for the purpose of making taxable supplies for consideration or for other purposes be fair and reasonable.
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> . . .
>
> I can see no reason why the general approach to determining reasonableness in these cases would not also apply to determining whether a particular method is "fair and reasonable". That is to say, what is "fair and reasonable" is a question of fact and requires the application of a measure of judgment and common sense. The determination is not based on the subjective view of either the Appellant or the Respondent but is based on the view of an objective observer with knowledge of all the pertinent facts. It is also important to recognize that the tax authorities cannot simply substitute their approach for that of Sun Life and that there may be more than one method that is fair and reasonable in the circumstances (see *Ville de Magog v. The Queen, supra*).

[17] The question of whether the particular method used by the Applicant to determine its ITCs was fair and reasonable may have required a yes or no answer. However, that does not mean that only one method for determining those ITCs could be considered fair and reasonable in the circumstances. As recognized by the Federal Court of Appeal in *Ville de Magog v. The Queen*, 2001 FCA 210, the nature of the test is such that there may be more than one method for determining ITCs that is fair and reasonable in the circumstances.

[18] The Applicant made a settlement offer that reduced the amount of ITCs claimed in its appeal from $1,279,180.49 to $997,171: a reduction of $282,009.49 or 22%. The Applicant provided a rationale for the amount offered and detailed

calculations based on that rationale. I do not see any legal impediment to the Respondent concluding that the method adopted by the Applicant in the settlement offer was fair and reasonable in the circumstances. In his written representations, counsel for the Respondent did not provide any reasons why the method adopted by the Applicant in the settlement offer could not be considered fair and reasonable for the purposes of subsection 141.01(5) of the *Excise Tax Act*.

[19] The Respondent also says that her conduct was irreproachable, that her position had a reasonable degree of sustainability, and that there were no unusual circumstances that would justify an increased award of costs against the Respondent. While I do not quarrel with these contentions, the objective of subsection 147(3.1) of the Rules is to provide a default entitlement to substantial indemnity costs with respect to qualifying settlements. None of the factors identified by the Respondent suggest to me that the default rule should not apply. To conclude otherwise would, without justification, materially water down the "entitlement" otherwise created by the plain words of the rule – an entitlement that is consistent with the purpose of the rule and the context in which it is found. If anything there would need to be unusual (in the sense of exceptional or extraordinary) circumstances that lead me to conclude that I should exercise my discretion to override the default rule on the basis of a principled analysis. As stated by counsel for the Respondent in his written representations, there are no unusual circumstances in this case. Consequently, the default rule in subsection 147(3.1) should be applied in accordance with its terms.

[20] This leaves me with the question of whether the Applicant's request for a lump sum award of $200,000 is in accordance with subsection 147(3.1) of the Rules. The rule provides for party and party costs up to the time of the settlement offer and 80% of solicitor and client costs after the date of the offer, plus reasonable disbursements and applicable taxes. The Applicant has not broken down its request so as to address the pre-settlement and post-settlement periods other than to state in an affidavit that substantially all of KPMG Law's professionals' time spent on the appeal was spent on it after April 24, 2013. It behooves counsel to be precise about the time spent and the activities undertaken before and after the settlement offer in issue so that the Court can make an accurate determination of costs under subsection 147(3.1) of the Rules. The phrase "substantially all" is not a precise term.

[21] With respect to the determination of solicitor and client costs on which substantial indemnity costs are based, the basic rule is that such costs are intended to provide a full indemnity for all costs reasonably incurred. This principle was

stated by Cattanach J. in *Scott Paper Co. v. Minnesota Mining and Manufacturing Co.*, [1982] F.C.J. No. 917(QL) as follows:

> The underlying purpose of an award of costs on the basis of those between solicitor and client is to provide complete indemnification for all costs, including fees and disbursements, reasonably incurred in the course of defending or prosecuting the action but excluding the costs for extra services not reasonably necessary.[5]

[22] The costs awarded under subsection 147(3.1) of the Rules are 80% of solicitor and client costs. Given the automatic 20% discount built into the rule, it is appropriate to adopt as the starting point all costs reasonably incurred.

[23] The task falls on the court to assess whether the costs claimed were reasonably incurred and each case must be addressed on its own facts. However, a couple of points are worth noting. First, an assessment of the time spent on an appeal should be made on the basis of the circumstances in existence at the relevant time. It is not the role of the court to use hindsight to second-guess the judgment of counsel regarding the amount of time spent on an appeal. Second, the best evidence of the appropriate rate for the legal services provided by counsel will generally be the rate charged by counsel for those services. In other words, it is generally reasonable to assume that the rates that were in fact charged were the product of the market in which they were charged and reflected the reasonable cost of the services provided to the client in that market.

[24] There are, however, two caveats to this second point. First, it must be clear that the client agreed to pay the rates being charged for the services provided. Hypothetical rates do not meet that criterion. Second, special arrangements, such as a contingency fee arrangement with an embedded risk premium, are unlikely to reflect market rates.[6] In the words of the Supreme Court of Canada in *Walker v. Ritchie*, 2006 SCC 45, [2006] 2 S.C.R. 428 at paragraph 28:

> . . .
>
> Unsuccessful defendants should expect to pay similar amounts by way of costs across similar pieces of litigation involving similar conduct and counsel, regardless of what arrangements the particular plaintiff may have concluded with counsel.

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[5] For similar descriptions by provincial superior courts, see *Holloway v. Holloway*, 2001 NFCA 17 at paragraphs 91 and 92 and *Apotex Inc. v. Egis Pharmaceuticals*, [1991] O.J. No. 1232 (QL) at paragraph 13.

[6] For the general principles underlying this second caveat, see *Walker v. Ritchie*, 2006 SCC 45.

[25] In this case, the Applicant seeks 80% of solicitor and client costs that are based on the total time spent on the file and the following hourly rates: Justin Kutyan, partner, $1,130 per hour; Vern Vipul, associate, $955 per hour; Thang Trieu, associate, $785 per hour, and Wajiha Khan, law clerk, $250 per hour. Mr. Kutyan was called to the bar in 2007, Mr. Vipul in 2004 and Mr. Trieu in 2008.

[26] The issue I have with this claim is that there is no evidence that the client agreed to pay these rates as the fee actually charged was a percentage of the amount recovered. In my view, a contingency fee such as this does not reflect market rates for the services provided but is a special arrangement negotiated by the parties. The Respondent cannot be expected to reimburse the Applicant for the costs incurred under such a special fee arrangement, and hypothetical rates are not an appropriate proxy for the rates that would have been charged under a more conventional fee arrangement.

[27] In a circumstance such as this, the role of the Court in applying subsection 147(3.1) of the Rules is to determine the solicitor and client costs appropriate to the particular circumstances, having regard to the general experience of the Court.

[28] The three lawyers identified by the Applicant are members of a national law firm and are based in downtown Toronto. The relevant market is therefore downtown Toronto. The hearing addressed the interpretation of provisions in the *Excise Tax Act* that to my mind cannot be viewed as simple or straightforward. The amount in issue was almost $1.3 million.

[29] In the circumstances, one could reasonably expect that the legal fees incurred by the Applicant for the appeal would be at the top end of the range identified by general experience. In other words, litigation involving similar conduct and counsel would likely involve hourly rates at the high end of the range.

[30] In *Stetson Oil & Gas Ltd. v. Stifel Nicolaus Canada Inc.*, 2013 ONSC 5213, the Court identified the rates claimed by the senior Toronto lawyers involved as being $880 for the plaintiff's lawyer and $700 to $800 for the defendant's lawyer. The Court noted that the $880 rate had to be adjusted downward as it was unlikely that a constant rate was in place for the duration of the file.

[31] An annual survey of lawyers' hourly rates conducted by *Canadian Lawyer* magazine indicated that in 2014 the average hourly rates among law firms with more than 25 lawyers were $280 for a one-year call, $318 for a five-year call, $488

for a ten-year call, $505 for a twenty-year call and $605 for lawyers of more than 20 years' standing.

[32] Taking all this into account, I have concluded that the following hourly rates are reasonable in these particular circumstances for determining solicitor and client costs: Justin Kutyan, partner, $800 per hour; Vern Vipul, associate, $550 per hour; Thang Trieu, associate, $400 per hour; and Wajiha Khan, law clerk, $100 per hour. I have no reason to question the number of hours accumulated on the file by each of these individuals.

[33] I have already commented on the lack of precision in attributing time to the periods before and after the settlement offer. In light of this, I will assume that "substantially all" means 90%, which is a common benchmark in the tax area that has been adopted by the Canada Revenue Agency in interpreting the phrase. Hence, 90% of the time should be compensated at the above rates in determining solicitor and client costs. This yields the following amounts (rounded to the nearest dollar):

> Justin Kutyan, partner: 108.2 hours times .9 times $800 per hour = $77,904
>
> Vern Vipul, associate: 56.6 hours times .9 times $550 per hour = $28,017
>
> Thang Trieu, associate: 18.75 hours times .9 times $400 per hour = $6,750
>
> Wajiha Khan, law clerk: 23 hours times .9 times $100 per hour = $2,070

[34] The total of these amounts is $114,741. The substantial indemnity costs are 80% of the solicitor and client costs, which is $91,792. I set the party and party costs at $1,050 taking into account the amount allowed for a Class C action involving two counsel under paragraph 1(*a*) of Tariff B. The total is therefore $92,842.

[35] In addition, the Applicant claimed disbursements of $21,356.28 (including HST, where applicable) and HST of 13% on the professional fees. The Respondent did not challenge the disbursements, which I will allow in full net of any of the HST applicable to the disbursements that is recovered by the Applicant through input tax credits. The Applicant will also be allowed costs equal to the 13% HST applicable to professional fees of $92,842, but again only to the extent that the HST on such professional fees is not recovered by the Applicant through input tax credits.

[36] The recovery of input tax credits in respect of the professional fees is to be determined by reference to an appropriate proportion of the actual HST paid by the Applicant on the professional fees of KPMG Law LLP charged for this appeal.

[37] If the parties cannot agree on the amount of tax that should be paid by the Respondent to the Applicant as costs then the parties may apply to the Court to have that matter determined.

Signed at Ottawa, Canada, this 3rd day of July 2015.

"J.R. Owen"

Owen J.

CITATION:	2015 TCC 171
COURT FILE NO.:	2012-481(GST)G
STYLE OF CAUSE:	SUN LIFE ASSURANCE COMPANY OF CANADA v. HER MAJESTY THE QUEEN
PLACE OF HEARING:	Toronto, Ontario
DATE OF HEARING:	September 22, 2014
REASONS RESPECTING SUBMISSIONS ON COSTS:	The Honourable Justice John R. Owen
DATE OF JUDGMENT:	February 16, 2015
DATE OF REASONS RESPECTING SUBMISSIONS ON COSTS:	July 3, 2015

SUBMISSIONS:

Counsel for the Applicant:	Justin Kutyan Stephanie Dewey
Counsel for the Respondent:	Khashayar Haghgouyan

COUNSEL OF RECORD:

For the Applicant:

Name:	Justin Kutyan Stephanie Dewey
Firm:	KPMG Law LLP Toronto, Ontario

For the Respondent:	William F. Pentney Deputy Attorney General of Canada Ottawa, Canada