

Docket: 2002-3517(GST)G

BETWEEN:

VILLE DE GATINEAU  
(COMMUNAUTÉ URBAINE DE L'OUTAOUAIS),

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

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Appeal heard on September 23, 2004, at Ottawa, Ontario.

Before: The Honourable Judge Lucie Lamarre

Appearances:

Counsel for the Appellant: Michael Kaylor

Counsel for the Respondent: Benoît Denis

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### JUDGMENT

The appeal from the assessment made under section 169 of Part IX of the *Excise Tax Act*, the notice of which is dated November 30, 2001, and bears the number H2001096, for the period from January 1, 1998, to June 30, 2000, is dismissed, with costs, and the assessment is confirmed.

Signed at Ottawa, Canada, this 20th day of May 2005.

"Lucie Lamarre"

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Lamarre J.

Translation certified true  
on this 10th day of January 2006.

Garth M<sup>c</sup>Leod, Translator

Citation: 2005TCC358  
Date: 20050520  
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### **REASONS FOR JUDGMENT**

Lamarre J.

[1] This is an appeal from an assessment in which the Minister of National Revenue ("Minister") disallowed the Appellant input tax credits ("ITC") totalling \$304,594.97, claimed during the period from January 1, 1998, to June 30, 2000, under section 169 of the *Excise Tax Act* ("*ETA*"), in addition to assessing penalties and interest under section 280 of the *ETA*.

[2] The Appellant initially claimed ITCs of \$312,994.07 in order to recover the surplus of the goods and services tax ("GST") paid by it on the acquisition of goods and services used in the operation of its waste water treatment plant, on the amount of GST refunded under section 259 of the *ETA* (which entitles the Appellant to a rebate of the tax payable in accordance with the percentage prescribed by regulation; that rate was 57.14 percent of the non-creditable tax during the period in issue). Of the \$312,994.07 of ITCs claimed, the Minister allowed only \$8,399.10, the balance being disallowed on the ground that, under paragraph 28(c), Part VI, of Schedule V of the *ETA*, that amount related to an exempt supply.

Statutory and Regulatory Provisions Related to the *ETA*

[3] The statutory and regulatory provisions applicable during the period in issue read as follows:

**EXCISE TAX ACT (GST)  
R.S., 1985, c. E-15, as amended**

**PART IX - GOODS AND SERVICES TAX**

**DIVISION I – INTERPRETATION**

**123. (1) Definitions** – In section 121, this Part and Schedules V to X,

[...]

**"commercial activity"** of a person means

(a) a business carried on by the person [...] except to the extent to which the business involves the making of exempt supplies by the person,

[...]

**"exempt supply"** means a supply included in Schedule V;

[...]

**"municipality"** means

(a) an incorporated city, [...] or other incorporated municipal body however designated,

[...]

**"public service body"** means a non-profit organization, a charity, a municipality, a school authority, a hospital authority, a public college or a university;

[...]

**"recipient"** of a supply of property or a service means

(a) where consideration for the supply is payable under an agreement for the supply, the person who is liable under the agreement to pay that consideration,

(b) where paragraph (a) does not apply and consideration is payable for the supply, the person who is liable to pay that consideration, and

(c) where no consideration is payable for the supply,

(i) in the case of a supply of property by way of sale, the person to whom the property is delivered or made available,

(ii) in the case of a supply of property otherwise than by way of sale, the person to whom possession or use of the property is given or made available, and

(iii) in the case of a supply of service, the person to whom the service is rendered,

and any reference to a person to whom a supply is made shall be read as a reference to the recipient of the supply;

[...]

"**service**" means anything other than

(a) property,

(b) money, and

(c) anything that is supplied to an employer by a person who is or agrees to become an employee of the employer in the course of or in relation to the office or employment of that person;

[...]

"**supply**" means, subject to sections 133 and 134, the provision of property or a service in any manner, including sale, transfer, barter, exchange, licence, rental, lease, gift or disposition;

[...]

## **Subdivision b**

### **Input tax credits**

**169. (1) General rule for credits** – Subject to this Part, where a person acquires or imports property or a service or brings it into a participating province and,

during a reporting period of the person during which the person is a registrant, tax in respect of the supply, importation or bringing in becomes payable by the person or is paid by the person without having become payable, the amount determined by the following formula is an input tax credit of the person in respect of the property or service for the period:

$$A \times B$$

where

A is the tax in respect of the supply, importation or bringing in, as the case may be, that becomes payable by the person during the reporting period or that is paid by the person during the period without having become payable; and

B [...]

(c) in any other case, the extent (expressed as a percentage) to which the person acquired or imported the property or service or brought it into the participating province, as the case may be, for consumption, use or supply in the course of commercial activities of the person.

[...]

**259. (1) Definitions** – In this section,

"**municipality**" includes a person designated by the Minister, for the purposes of this section, to be a municipality, but only in respect of activities, specified in the designation, that involve the making of supplies (other than taxable supplies) by the person of municipal services;

[...]

"**selected public service body**" means

[...]

(e) a municipality;

[...]

**(3) Rebate for persons other than designated municipalities** - If a person [...] is, on the last day of a claim period of the person or of the person's fiscal year that includes that claim period, a selected public service body, charity or qualifying non-profit organization, the Minister shall [...] pay a rebate to the person equal to the specified percentage of the non-creditable tax charged in

respect of property or a service (other than a prescribed property or service) for the claim period.

[...]

## **SCHEDULE V – EXEMPT SUPPLIES**

Subsection 123(1)

### **Part VI – Public Sector Bodies**

**1. [Definitions]** – In this Part,

[...]

**"local municipality"** of a regional municipality means a municipality that has jurisdiction over an area that is within the area over which the regional municipality has jurisdiction;

[...]

**28. [Supplies between various entities]** – A supply between

[...]

(c) a regional municipality and any of its local municipalities or any para-municipal organization of any of those local municipalities,

### **PUBLIC SERVICE BODY REBATE (GST/HST) REGULATIONS**

[...]

**1. Short title** – These Regulations may be cited as the *Public Service Body Rebate (GST/HST) Regulations*.

[...]

### **REBATE PERCENTAGES**

5. For the purpose of determining a rebate payable to a person under section 259 of the Act, the prescribed percentage is

[...]

(e) where the person is a municipality, 57.14%.

### Preliminary Remark

[4] The Communauté urbaine de l'Outaouais ("CUO") was established as a legal person in the public interest, consisting of five municipalities (Aylmer, Hull, Gatineau, Buckingham and Masson-Angers) and of the inhabitants and taxpayers of the territories of those municipalities, under the *Act respecting the Communauté urbaine de l'Outaouais* (the "ACUO"), R.S.Q., chapter C-37.1. The ACUO was repealed on January 1, 2002, by passage of the *Loi portant réforme de l'organisation territoriale municipale des régions métropolitaines de Montréal, de Québec et de l'Outaouais* (2000, c. 56). By that act, the new City of Gatineau was established as a legal person and took on the rights, obligations and responsibilities of the CUO, as well as those of the cities of Aylmer, Buckingham, Gatineau, Hull and Masson-Angers, as they existed on December 31, 2001. The new City of Gatineau became, without continuance of suit, party to every proceeding, in place of the CUO or, as the case may be, of each of the municipalities which it succeeded. As a result, the instant case, which concerns the years 1998 to 2000, involves the CUO as it existed at the time, but the new City of Gatineau has become a party to this proceeding as a result of the abrogation of the CUO. The City of Gatineau has thus become the Appellant, for and on behalf of the CUO.

### Point at Issue

[5] The only point for determination is whether the CUO was entitled to the total amount of ITCs claimed, that is \$312,994.07, or whether the Respondent is correct in claiming that it is entitled to an amount of only \$8,399.10. To summarize the facts briefly, during the period in issue, the CUO received at its waste treatment plant the waste water of three of its constituent municipalities, the cities of Gatineau, Aylmer and Hull, as they existed at that time. To dispose of that waste water, the three municipalities paid the CUO a lump-sum amount of approximately \$9 million a year, in accordance with the share established for each of them by the CUO each year. The CUO proceeded with purification of the water and, once that water was filtered, buried the solid wastes (which are also called sludge) or converted a portion of that waste (varying between approximately 70 and 85 percent) to make granules that were then resold on the market, to be spread on farmland in particular. The Minister admits that the process of converting sludge into granules ("granulation") for commercial purposes constitutes a commercial activity within the meaning of section 123 of the *ETA*, and that the tax paid on that portion of the operating cost of the granulation plant grants entitlement to ITCs under section 169 of the *ETA*. The Minister calculated that the ITCs attributable to the granulation process amounted to \$8,399.10.



[6] However, the Minister considers that the entire waste water purification process, as well as the treatment of wastes prior to the granulation process, constitutes a supply of services between a regional municipality (the CUO) and its local municipalities (the three cities of Aylmer, Hull and Gatineau). Accordingly, in the Respondent's view, this constitutes an exempt supply of services within the meaning of paragraph 28(c), Part VI, Schedule V, of the *ETA*, which does not grant entitlement to ITCs under section 169 or the definition of "commercial activity" in subsection 123(1) of the *ETA*.

[7] In the Appellant's view, the only exempt supply made by the CUO, that is to say the only service rendered to the three municipalities by the CUO, was to accept the waste water. Apart from the transfer of ownership of the waste water between the three municipalities and the CUO, the Appellant contends that the CUO rendered no service to them and that the entire water purification process therefore cannot constitute an exempt supply for the purposes of the *ETA*. In the Appellant's view, since the purification process is necessary to the granulation of marketable sludge, it is therefore entitled to all the ITCs initially claimed.

### Facts

[8] Jacques Nadeau, director of the water treatment and residual materials management service for the public works and environment branch of the City of Gatineau, explained, with the aid of a document filed as Exhibit A-1, how the CUO's waste water treatment plant, with its sludge drying and granulation process, operates. First, each municipality collects waste water through its sewer system. That waste water is forwarded to the treatment plant by the main interceptor, which is owned by the CUO. The CUO becomes responsible for the waste water from the moment it receives it. The purpose of the purification process is to purify the water, that is to say to remove suspended materials and debris.

[9] To do this, the raw water undergoes a pre-treatment involving two operations. First, coarse screening is conducted as the water enters the pumping station, and this procedure protects the pumps by preventing large floating objects that may block the various pieces of equipment from entering. The water is then pumped to the fine screen by means of four pumps. The fine screen is used to extract fibrous materials and other debris found in the sludge extraction equipment and in the granules, thus affecting the quality of the finished product, which is a source of income for the CUO. In fact, the fine-screening stage has been added in recent years to improve sludge quality.

[10] After screening, the waste water is forwarded by gravity to the grit removers. The purpose of grit removal is to remove more or less fine gravel, sand and mineral particles. This prevents deposits in the channels and pipes, protects the pumps and other devices from abrasions and also thickens the sludge.

[11] The pre-treated effluent then flows by gravity to the primary settling tanks, which allow suspended particles and settleable solids to settle out and make it possible to remove floating material such as grease, scum and oil. This is the first stage in the extraction of sludge that is recovered from the bottom of the settling tank.

[12] Settled sludge is then pumped to the sludge treatment unit, and the second purification stage then begins. The first operation is performed in an aeration tank, in which the development of bacterial flock (activated sludge) is stimulated. In this tank, the sludge is mixed by surface aerators to maintain it in suspension and to provide it with the oxygen necessary for the proliferation of aerobic micro-organisms. The mixture is then forwarded to a settling tank to separate treated water from sludge. The sludge is returned to the aeration tank in order to maintain a sufficient concentration of activated sludge. Excess sludge is extracted and forwarded to sludge treatment. At that point, the water is discharged into the Ottawa River.

[13] Sludge treatment continues, and the sludge is then forwarded to the thickeners. This is another settling process. The thickened sludge is then pumped into the digesters, where anaerobic digestion takes place. This process occurs in the absence of air, thus without oxygen, resulting in an approximate 30 percent reduction of sludge volume. Among other things, anaerobic digestion produces methane gas, which is captured for the treatment plant (to heat the digesters and buildings; the gas can also fuel the rotary dryer of the sludge drying and granulation unit).

[14] The digested sludge is then concentrated by centrifugation and forwarded to the sludge drying and granulation unit. The granules are then sold for agricultural purposes.

[15] Mr. Nadeau explained that, when the treatment plant was built in 1982, the sludge was buried. The CUO subsequently considered processing the sludge, and the granulation plant went into operation in 1992. Only the fine-screening and granulation stages were added to the water purification process existing at the time.

A new thickener and a new digester were also added. According to Mr. Nadeau, the CUO has been using the sludge extraction process to convert sludge since 1992. Waste water is essential to fertilizer production. In a way, it constitutes the raw material for producing granules. The CUO earns between \$30,000 and \$60,000 in income each year from the sale of this fertilizer. Another 13 to 27 percent of the sludge is not transformed into granules, but is buried instead. In addition, of the 20 thousand tonnes of sludge that enter the treatment plant, two to three percent of that solid material is intercepted at the coarse-screening stage and systematically buried (sand, gravel and wood).

[16] Before 1992, the thickener, anaerobic digester and centrifugal dryer were installed for sludge digestion and ultimately for methane gas production (as explained above). In addition, the centrifugation stage following secondary settling was also used to bury the sludge (otherwise a liquid was produced that was not buried). However, the digesters were not essential to burial, but could be used to reduce the quantity of materials buried. Mr. Nadeau added that it was relatively less costly for the CUO to bury materials than to manufacture granular fertilizer.

[17] The CUO set a budget each year and determined the share of each municipality based on the estimated flow of its waste water volume. Each municipality was billed for its share. If the actual flow of each municipality varied, the share of the total budget initially established by the CUO could vary depending on the municipality, but the CUO absorbed any surplus or deficit relative to the pre-established initial budget.

### Legislation on Water Purification

[18] According to the *ACUO*, the CUO had competence in the area of water purification (section 84), which was addressed by sections 113 to 127. Those sections read in part as follows:

#### **DIVISION VI**

#### **COMPETENCE OF THE COMMUNITY [CUO]**

Competence of the Community.

**84.** The Community has such competence as is provided in this Act in the following fields:

[...]

2. Water purification and drinking water supply

[...]

§ 2. — *Water purification and drinking water supply*

By-law for standards of work.

**113.** The Community, by by-law, may establish minimum standards for all of its territory respecting the methods of carrying out all work respecting waterworks, sewers, and the construction of water treatment plants or works, and the materials used in the carrying out of such works. Such by-laws shall be binding upon all the municipalities in its territory; they shall not come into force except upon the approval of the Minister of the Environment.

Certain projects submitted for approval.

**114.** Such municipalities shall submit to the Council for approval any project for the construction, enlargement or alteration of a waterworks system, sewers and of plants or works for water treatment, before passing the resolution or the by-law necessary for implementing such project.

Nature of project.

Within 30 days after receiving the application, the Council shall determine whether the project is of a purely local nature or has any intermunicipal repercussions.

Intermunicipal repercussions.

If the Council decides that the project has intermunicipal repercussions, the Council may, by resolution, subject to the approval of the Minister of the Environment, order such alterations as it deems expedient to the plans and specifications of the proposed works and authorize the municipality to carry out such work. Failing an agreement between the Community and the municipalities involved concerning the apportionment of the cost of the work, the apportionment is fixed by the Minister of the Environment, at the request of the Community or any municipality concerned.

Restricted powers.

**115.** In no case may the Minister of the Environment, as regards waterworks, sewers or plants or water treatment works, exercise in respect of a municipality whose territory is included in that of the Community any power provided in section 29, 32, 34, 35, 41 or 43 of the Environment Quality Act (chapter Q-2)

before calling upon the Community to make the representations to him it considers appropriate.

Execution of intermunicipal work.

Where the Minister of the Environment exercises the powers provided in section 35 of the Environment Quality Act, he shall order the execution of intermunicipal work by such municipalities as he may designate, unless the Community has indicated to the Minister that it consents to execute it. If the Community consents to execute the work, the Minister shall not then order its execution except by the Community. The Minister shall not establish the apportionment of the cost of the works, and the cost of maintenance and operation thereof, determine the mode of payment or fix the indemnity, periodic or otherwise, payable by the municipalities for the use of the works or services provided before calling upon the Community to make its representations on this matter.

Order.

**116.** Subject to the Environment Quality Act (chapter Q-2), the Community may, by by-law, order the carrying out, even outside its territory, of works relating to water treatment plants or works or water mains or main sewers intended to serve the territories of two or more municipalities included in its territory.

Order.

**117.** Subject to the Environment Quality Act (chapter Q-2), the Community may, by by-law, order the carrying out of works contemplated in section 116 even if the plants, works or mains being the subject thereof are not intended to serve the territories of two or more municipalities.

Exclusion.

A by-law made by the Community under the first paragraph excludes the competence of a municipality over the works contemplated by the by-law.

Acquisition of water works.

**118.** The Community may, by by-law, acquire, with the approval of the Minister of the Environment, the ownership of any water treatment works or plant, or any water main or main sewer owned by a municipality whose territory is included in that of the Community and serving or capable of serving the territories of one or more such municipalities.

Exclusion.

A by-law made by the Community under the first paragraph excludes the competence of a municipality over any plant, works or main acquired by the Community.

Intermunicipal water system.

**119.** The filtration plants and sewage treatment plants of the Community and the works located between the plants and the source of water supply, in the case of a filtration plant, and the works located between the plants and the place where purified water is discharged in the case of a sewage treatment plant, constitute intermunicipal parts of the drinking water supply system or, as the case may be, of the water purification system of the Community.

By-laws.

The Community shall, by by-law,

(1) determine that part of its drinking water or waste water conduit system which is of an intermunicipal nature or which, owing to the importance of its main function within the system, must be subject to the same rules as the intermunicipal part;

(2) determine the other components of its drinking water or waste water conduit system which must be considered to be for the sole benefit of the municipality in whose territory they are situated.

[...]

Apportionment of expenses.

**120.** The expenses of the Community incurred in the exercise of a power provided for in sections 116 to 118 and relating to the intermunicipal part of its system, and the expenses arising from the operation and maintenance of that part of the system are apportioned among the municipalities in proportion to the volume of water consumed by each of them, respectively, as regards expenses relating to drinking water supply, and in proportion to the volume of water discharged by each of them, respectively, as regards the expenses relating to water purification.

Payment of expenses.

The expenses of the Community relating to each component of its system contemplated in a by-law made under subparagraph 2 of the second paragraph

of section 119 are payable by the municipality in whose territory that component is situated.

[...]

Apportionment.

**120.1.** Notwithstanding section 120, the Community may, by by-law passed by a three-quarters majority of the votes cast by the representatives of the municipalities whose territories are served, establish a different apportionment of the expenses contemplated in section 120.

Power to establish works forfeited.

**121.** When all the water treatment works or plants of a municipality in the territory of the Community are acquired by the Community, such municipality shall no longer have power to establish such works or plants.

Powers not restricted.

This Act does not have the effect of restricting the power of a municipality to distribute to its territory drinking water supplied to it by the Community or to collect waste water from that territory to convey such waste water to the works of the Community.

[...]

Waste water.

**123.** The Community may receive for treatment purposes, from a person other than a municipality, waste water from its territory or elsewhere.

Consent.

Before making any contract for such purpose, the Community shall obtain the consent of the local municipality in whose territory the waste water originates.

Consent of the Community.

**124.** From the date of coming into force of a by-law made under section 118, no municipality which receives water from the Community or conveys waste water to the works of the Community, may supply water to the territory of another municipality or receive, for treatment purposes, waste water from the territory of another municipality, without the consent of the Community.

Prior contracts.

**125.** Nothing in section 124 shall be construed as preventing any municipality from supplying water to the territory of another municipality, or receiving waste water from the territory of another municipality by virtue of contracts made before the date referred to in section 124 if the plants, works or conduits necessary to do so have not been acquired by the Community.

By-laws.

**126.** The Community may make by-laws to:

(1) supply drinking water in the territory of the municipalities, receive waste water from their territory; and dispose of sludge from septic installations;

(2) maintain, manage and operate its water treatment plants or works, water mains or main sewers;

[...]

[19] It is also helpful here to reproduce certain provisions of the *Environment Quality Act*, R.S.Q., chapter Q-2.

R.S.Q., chapter Q-2

## **ENVIRONMENT QUALITY ACT**

### **CHAPTER I**

#### **PROVISIONS OF GENERAL APPLICATION**

##### **DIVISION I**

###### **DEFINITIONS**

Interpretation:

**1.** In this Act, unless the context indicates a different meaning, the following words and expressions mean or designate:

"water";

(1) "water": surface water and underground water wherever located;

[...]



"environment";

(4) "environment": the water, atmosphere and soil or a combination of any of them or, generally, the ambient milieu with which living species have dynamic relations;

"contaminant";

(5) "contaminant": a solid, liquid or gaseous matter, a microorganism, a sound, a vibration, rays, heat, an odour, a radiation or a combination of any of them likely to alter the quality of the environment in any way;

"pollutant";

(6) "pollutant": a contaminant or a mixture of several contaminants present in the environment in a concentration or quantity greater than the permissible level determined by regulation of the Government, or whose presence in the environment is prohibited by regulation of the Government;

[...]

"source of contamination";

(8) "source of contamination": any activity or condition causing the emission of a contaminant into the environment;

[...]

"municipality";

(10) "municipality": any municipality, the Communauté métropolitaine de Montréal, the Communauté métropolitaine de Québec, as well as an intermunicipal management board;

[...]

"Minister";

(18) "Minister": the Minister of the Environment;

[...]

## **DIVISION II**

### **FUNCTIONS AND POWERS OF THE MINISTER**

Power.

**2.** The Minister may:

[...]

(c) prepare plans and programmes for the conservation, protection and management of the environment and emergency plans to fight any form of contamination or destruction of the environment and, with the authorization of the Government, see to the carrying out of those plans and programmes;

[...]

(j) devise and implement a programme to abate the discharge of contaminants resulting from the operation of industrial establishments and to monitor the discharge of contaminants resulting from the operation of municipal wastewater treatment works.

[...]

## **DIVISION IV**

### **PROTECTION OF THE ENVIRONMENT**

Emission of a contaminant.

**20.** No one may emit, deposit, issue or discharge or allow the emission, deposit, issuance or discharge into the environment of a contaminant in a greater quantity or concentration than that provided for by regulation of the Government.

Emission of a contaminant.

The same prohibition applies to the emission, deposit, issuance or discharge of any contaminant the presence of which in the environment is prohibited by regulation of the Government or is likely to affect the life, health, safety, welfare or comfort of human beings, or to cause damage to or otherwise impair the quality of the soil, vegetation, wildlife or property.

[...]

Order.

**29.** The Minister may, after inquiry, order a municipality to exercise the powers relating to the quality of the environment conferred on such municipality by this Act or by any other general law or special Act.

[...]

Regulations.

**31.** The Government may make regulations to:

[...]

(c) prohibit, limit and control sources of contamination as well as the emission, deposit, issuance or discharge into the environment of any class of contaminants throughout all or part of the territory of Québec;

(d) determine for any class of contaminants or sources of contamination a maximum permissible quantity or concentration of emission, deposit, issuance or discharge into the environment throughout all or part of the territory of Québec;

(e) define standards for the protection and quality of the environment or any of its parts throughout all or part of the territory of Québec;

(e.1) establish measures providing for the use of economic instruments, including tradeable permits, emission, effluent and waste-disposal fees or charges, advance elimination fees or charges, and fees or charges related to the use, management or purification of water, for the purpose of protecting the environment and achieving environmental quality objectives for all or any part of the territory of Québec, and establish any rule necessary or relevant to the functioning of the measures pertaining in particular to the determination of the persons or municipalities required to pay such fees or charges, the conditions applicable to their collection and the interest and penalties exigible in case of non-payment;

[...]

Depollution attestation to municipalities.

**31.33.** The Minister shall issue a depollution attestation to every municipality which operates wastewater treatment works.

Depollution attestation.

**31.34.** Every depollution attestation shall set out the following elements:

(1) the nature, quantity, quality and concentration of every contaminant emitted, deposited, released or discharged into the environment, which results from the operation of municipal wastewater treatment works;

(2) the nature, origin and quality of the wastewater treated by municipal wastewater treatment works;

(3) the contaminant discharge standards prescribed by regulation under paragraphs *c* and *d* of section 31 and paragraphs *c* and *f* of section 46, for every contaminant emitted, deposited, released or discharged into the environment, which results from the operation of municipal wastewater treatment works, except those standards which are incompatible with those set down by the Minister under section 31.37;

(4) the standards prescribed by regulation under paragraph *e* of section 31, paragraph *g* of section 46 and section 70, as well as those standards with respect to the operation of a sewer or water treatment system prescribed by regulation under paragraph *d* of section 46, to the extent that such standards apply to municipal wastewater treatment works;

[...]

(6) any other element prescribed by regulation.

[...]

Responsibilities of attestation holder.

**31.38.** The holder of a depollution attestation shall:

(1) comply with every element set out in its attestation;

(2) furnish, at the request of the Minister, any information necessary to ascertain compliance of the contaminant discharge with the standards referred to in paragraph 3 of section 31.34 and in paragraph 1 of section 31.35;

[...]

**34.** [...]

Orders.

The Minister may, as regards a municipality, issue those orders he deems necessary in matters respecting the supplying of drinking water and the management of waste water.

[...]

Integration.

**35.** When the Minister, after inquiry made on his own initiative or upon the application of anyone interested, considers that necessity or advantage requires that two or more municipalities have a common waterworks, sewer system or water treatment plant, he may prescribe the necessary measures.

Orders.

He may in particular order:

(1) that the execution, maintenance and operation of the works be done jointly by all the municipalities concerned or in whole or in part by a single municipality, or

(2) that the works in the territory of one or more of such municipalities be used, or

(3) that the service be furnished in whole or in part by one municipality to the other or others. [Emphasis added.]

Costs.

In all such cases, the Minister may establish the cost and apportionment of the cost of the works and the maintenance and operating costs and the mode of payment or fix the indemnity, periodic or otherwise, payable for the use of the works or for the service provided by a municipality. [Emphasis added.]

[...]

Regulations.

**46.** The Government may make regulations to:

[...]

(c) determine, for every class of contaminant or source of contamination, the maximum quantity or concentration the discharge of which is allowed into

water either for all the territory or for a region, constant or intermittent watercourse, lake, pond, marsh, swamp, bog or underground body of water;

(d) determine the standards of quality for any source of water supply and the standards of operation for any waterworks, sewer or water treatment service;

[...]

(g) determine the mode of discharging and treatment of waste water;

[...]

(l) determine construction standards for waterworks, sewer and water treatment systems;

[...]

### Appellant's Argument

[20] Counsel for the Appellant contends that, under its incorporating act (*ACUO*), the CUO has an obligation to receive the municipalities' waste-water and to treat it before returning the purified water to the river. The CUO has taken the initiative of commercializing the dried sludge resulting from the waste water purification process. The Appellant admits that granule production occurs only at the end of the purification process and that the costs associated with that commercial activity constitute only a small percentage of the total cost of operating the waste-water treatment plant. However, considering that the CUO makes no exempt supply after receiving the waste-water, as the Appellant claims, the operating cost of the treatment plant is thus part of the overall process for ultimately manufacturing granular fertilizer, and the whole thus constitutes a commercial activity granting entitlement to ITCs.

[21] In the Appellant's view, the CUO makes no exempt supply under paragraph 28(c), Part VI, Schedule V, of the *ETA*. That paragraph provides that supplies between the regional municipality (the CUO) and its local municipalities (Hull, Gatineau and Aylmer) are exempt supplies. However, for there to be a supply, in this case, services must be provided by the CUO to the three municipalities that receive those services (see definitions of "supply" and "recipient" in section 123 of the *ETA*). In the Appellant's view, by returning the purified water to the river, the CUO renders no service to the three municipalities. In its opinion, from the moment ownership of the waste water is transferred to the CUO, the municipalities expect nothing further from the CUO, since that water is

not returned to them. The water is purified for the welfare of the community, pursuant to an obligation conferred on the CUO by the *ACUO*.

[22] Furthermore, as regards the treatment of sludge, that sludge becomes the property of the CUO, which either buries or markets it. The sludge is not returned to the three municipalities, and the CUO renders no service to them by treating or adding value to the sludge in the manner it wishes. The Appellant contends that the entire process triggered to purify the water and derive marketable sludge from it is indivisible.

[23] The approximately \$9 million that the three municipalities pay annually represents the cost to them to dispose of their waste water, in accordance with the method provided for in section 120 of the *ACUO*. However, it is not a consideration paid in respect of the purification of waste water, since that operation is the responsibility of the CUO, and is carried out for the welfare of the community.

#### Respondent's Argument

[24] The Respondent is more of the view that the CUO provides a water purification service to the three municipalities in return for a consideration provided for in section 120 of the *ACUO*. That consideration is based on an allocation of expenses based on the volume of water forwarded to the water treatment plant. The three municipalities want to have their waste water purified, and the CUO is competent to do so. The CUO thus renders that service to the three municipalities. The fact that the purified water is not subsequently returned to them or that the CUO has decided to market the dried sludge resulting from water purification in no way alters the fact that the CUO has first rendered a service to the three municipalities, which have agreed to pay the price set by the CUO for the purification of their waste water. That service constitutes an exempt supply within the meaning of paragraph 28(c), Part VI, Schedule V, of the *ETA*. The raw material used by the CUO to manufacture granular fertilizer is not the waste water it receives, but the sludge derived from the purification of waste water. The water purification service must therefore be considered separately, just as the collection of recyclable materials (exempt supply) was considered in the context of the recyclable materials sorting operation (which in itself constitutes a commercial activity) in *Montréal (City) v. Canada*, [2003] G.S.T.C. 131 (T.C.C.). Similarly, the construction of a real estate complex to house employees in accordance with a municipal by-law (exempt supply) as part of the construction of a hotel complex (this last operation constituting a commercial activity) also had to be considered

separately (see *398722 Alberta Ltd. v. Canada*, [2000] F.C.J. No. 644 (F.C.A.) (Q.L.)).

[25] In the Respondent's view, from the moment a consideration is paid (which is the case here under the *ACUO*), there is a supply within the meaning of the *ETA*. That supply is the purification of water by the CUO. This is logical since the cities send their waste water to the CUO's water treatment plant, not to a sludge granulation and fertilizer plant. It is the treatment process that generates the waste, which is subsequently buried or converted. In the Respondent's view, the three municipalities clearly paid the annual sum of approximately \$9 million for the CUO to purify the water, not simply to receive that water without providing the purification service.

[26] Since the purification service is provided by the CUO for the three municipalities, it is therefore an exempt supply. The Minister was thus correct in disallowing the Appellant ITCs in respect of the tax it had paid on the goods and services acquired for the operation of its waste water purification plant, before addressing the granulation process which, as a commercial activity, grants entitlement to ITCs of \$8,399.10 for the period in issue.

### Analysis

[27] I am of the same view as the Respondent. It appears from the provincial legislation on environmental quality, and more particularly on water purification, that all municipalities must comply with the measures put in place by the provincial government to protect the environment and to achieve environmental quality objectives. Paragraph 31(e.1) of the *Environment Quality Act* also provides that those municipalities may be required to pay fees or charges for the operation of those measures.

[28] Section 35 of the *Environment Quality Act* provides *inter alia* that the Minister of the Environment may order that the water treatment service be supplied in whole or in part by one municipality to the other or others. In that case, the Minister may establish the cost and the apportionment of the cost of the works and the maintenance and operating costs and the mode of payment payable for the service provided by a municipality. No statutory instrument could be clearer. The legislator refers specifically to a water treatment (or other) service provided by one municipality to other municipalities under a government policy on water purification.



[29] This is precisely what the *ACUO* provides for. Section 113 states that the CUO, by by-law, may establish minimum standards for all of its territory (which covers those of the three municipalities here in question) respecting the methods of carrying out all work related to waterworks. These by-laws are binding on all municipalities in its territory. In addition, section 116 provides that the CUO may, by by-law, order the carrying out of work relating to water treatment plants or works intended to serve the territories of more than one municipality. Also, section 118 provides that the CUO may, by by-law, acquire, with the approval of the Minister of the Environment, the ownership of any water treatment works or plant, or any water main owned by a municipality whose territory is included in that of the Community and serving or capable of serving the territories of one or more such municipalities. In those cases, the expenses of the CUO are apportioned among the municipalities in proportion to the volume of water discharged by each of them, respectively, as regards the expenses relating to water purification (section 120 of the *ACUO*).

[30] It is therefore clear from the legislation cited above that the three municipalities of Hull, Aylmer and Gatineau, as they existed at the time, paid an annual lump sum of \$9 million to the CUO, in accordance with their respective shares, so that the CUO would proceed with the purification of their waste water. Each municipality was required to comply with environmental legislation, and each municipality thus paid its share for the CUO to proceed with the purification of their respective waste water. In *Commission scolaire Des Chênes v. Canada*, [2001] F.C.J. No. 1559, the Federal Court of Appeal held that, in order for a payment to constitute consideration, it must have been made pursuant to a legal obligation and must be closely enough linked to a supply that it can be regarded as having been made for that supply (in accordance with the definition of "supply" in section 123 of the *ETA*). In my view, it cannot be said in the instant case that the three municipalities paid a consideration for the supply of a service, within the meaning of the *ETA*, which service extends far beyond the mere transfer of waste water to the CUO, as the Appellant claims.

[31] I therefore conclude that the annual payment of \$9 million made by the three municipalities to the CUO is directly linked to the water purification service rendered by the latter. Moreover, the three municipalities did not have to pay GST on that amount which is a factor more clearly showing that all the parties in issue considered that the water purification service rendered by the CUO was an exempt supply.

[32] On the question as to where the water purification service rendered by the CUO to the municipalities stopped and the sludge marketing process began, I find that the Appellant did not adduce sufficient evidence for me to conclude that the Respondent's calculation was incorrect. Mr. Nadeau explained in his testimony that only the fine-screening (at the very start of the water purification process) and granulation (which occurs at the very end) stages were added to the existing water treatment process. It is also apparent from the evidence that water purification included sludge treatment since, even before the CUO began marketing the sludge, it had to be treated before it was buried. This is all the more true since *Le Petit Larousse Illustré* (1998) defines the term "assainissement" [purification] as follows:

[TRANSLATION]

**assainissement [purification]:** [...] 2. Set of techniques for discharging and treating waste water and residual sludge.

[33] It also appears from Mr. Nadeau's testimony that the treatment plant already included all the stages he described (with the exception of fine screening and granulation) before granular fertilizer was marketed. The full process was necessary in order to be able to bury the sludge. Even now, between 13 and 27 percent of sludge that is not processed is buried.

[34] Moreover, counsel for the Appellant himself admitted in his argument that granule production occurs only at the end of the purification process and that the cost associated with that commercial activity constitutes only a small percentage of the total cost of operating the waste-water purification plant. Although Mr. Nadeau mentioned that the waste water was the raw material for the ultimate manufacturing of granules, that does not alter the fact that the municipalities had an obligation to purify their waste water. As I noted above, the CUO provided that service to them. It was only once the purification process had been made functional that the CUO decided to market the settled sludge resulting from the water purification process. The CUO had the option of burying that sludge or marketing it in the form of granules. In my view, it was only at that point, once the sludge had settled and was ready to move on to the granulation process, that the CUO's commercial activity began, and not before.

[35] In my view, *Midland Hutterian Brethren v. Canada*, [2000] F.C.J. No. 2098 (Q.L.), cited by counsel for the Appellant, cannot be applied in the context of the instant case. In that case, the Minister had disallowed ITCs in respect of the purchase price of material used to make work clothing for its members to use in its

farming business. The issue in that case was whether the cloth had been acquired by the communal colony for at least partial use in the context of its farming business. The ITCs claimed in respect of the work cloth were disallowed on the ground that the cloth had not been acquired for use in the context of the commercial activity, but mainly for personal use. The Federal Court of Appeal considered how close an expense had to be to the commercial activity itself. In a majority decision, the Court held that, once an item is found to be acquired and used in connection with the commercial activities of a GST registrant, and that item directly or indirectly contributes to the production of articles or the provision of services that are taxable, then an ITC is available under subsection 169(1) of the *ETA*. The Court had to conclude that the cloth in question contributed to the commercial activities of the communal colony in that it saved the colony money over the long term. Given that the Respondent had previously conceded that the acquisition of other items such as work gloves and boots granted entitlement to ITCs, it was held that the connection with the work cloth in issue was not too remote.

[36] In the instant case, I have come to the conclusion that the commercial activity begins only once the purification process is completed. I find that the granulation process, the commercial activity as such, cannot be said to begin until the sludge is extracted at the end of the purification process (following centrifugation), settled and suitable for making granular fertilizer. The entire water purification process, including sludge extraction, is part of the water purification service rendered by the CUO to the three municipalities in consideration for the annual sum of \$9 million. As I stated above, this constitutes an exempt supply within the meaning of paragraph 28(c), Part VI, Schedule V, of the *ETA*. The supplies acquired in the context of purification and sludge extraction are not acquired in the context of a commercial activity. The definition of commercial activity in section 123 of the *ETA* clearly states that a commercial activity means a business carried on, except to the extent to which the business involves the making of exempt supplies by the person.

[37] In *398722 Alberta Ltd., supra*, the Federal Court of Appeal held as follows at paragraphs 21 and 22:

¶ 21 [...]

Thus, the question is whether the Respondent's business involves, to any extent, the making of exempt supplies.

¶ 22 Any business may consist of a number of components, each of which is integral to the business as a whole. The definition of "commercial activity" recognizes that possibility but requires, for GST purposes, that any part of the business that consists of making exempt supplies be notionally severed. [...]

[38] As the purification of waste water constitutes an exempt supply in the instant case, that activity must be notionally severed and is not part of the commercial activity of selling granules. All the costs related to the water purification service before the granulation stage are thus costs connected with an exempt supply, which cannot grant entitlement to ITCs. Those costs are not incurred in the context of a commercial activity, but rather in the context of an exempt supply.

[39] Furthermore, I am aware that the CUO has not been in existence since January 1, 2002, and that the new City of Gatineau has taken over the water purification process under the act under which it was created. Paragraph 28(c) of Part VI, Schedule V, of the *ETA* thus no longer applies, since that service is rendered by the new City of Gatineau for other municipalities. However, this does not alter the legislation as it previously stood.

[40] I therefore find that the Appellant did not show on a balance of probabilities that the assessment in appeal was unfounded.

[41] The appeal is dismissed, with costs.

Signed at Ottawa, Canada, this 20th day of May 2005.

"Lucie Lamarre"

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Lamarre J.

Translation certified true  
on this 11th day of January 2006.

Garth McLeod, Translator

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APPEARANCES:

For the Appellant: Michael Kaylor

For the Respondent: Benoît Denis

COUNSEL OF RECORD:

For the Appellant:

Name: Michael Kaylor

Firm: Lapointe Rosenstein

For the Respondent: John H. Sims, Q.C.  
Deputy Attorney General of Canada  
Ottawa, Canada