Docket: 2003-3783(IT)G

BETWEEN:

WABUSH IRON COMPANY LIMITED,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on September 22, 23 and 24 2008,
at Montreal, Quebec

Before: The Honourable Justice B. Paris

Appearances:

Counsel for the Appellant:	Stephane Eljarrat Olivier Fournier
Counsel for the Respondent:	Pierre Cossette Annick Provencher

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JUDGMENT

The appeal from the reassessments made under the *Income Tax Act* for the 1993, 1994, 1995, 1996, 1997 and 1998 taxation years is allowed in part, with costs to the Respondent, in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 15th day of May 2009.

"B.Paris"

Paris J.

Citation: 2009 TCC 239
Date: 20090515
Docket: 2003-3783(IT)G

BETWEEN:

WABUSH IRON COMPANY LIMITED,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Paris, J.

[1] This is an appeal from reassessments of the Appellant's 1993 to 1998 taxation years.

[2] The Appellant is a member of a joint venture known as Wabush Mines, which operates an iron ore mine and concentrator in Wabush, Labrador and a processing facility in Pointe Noire, Québec where the iron ore concentrate is made into iron pellets.

[3] Under the Joint Venture Agreement, the Appellant received its proportionate share of the iron pellets that were produced. In turn, the Appellant sold those pellets to its own shareholders.

Issues

[4] The first issue in this appeal is the price the shareholders paid the Appellant for the pellets. This turns on the interpretation of an Agreement entered into between the Appellant and its shareholders entitled the “Pellet Sales Agreement”. According

to that Agreement, the price of the pellets was set at the greater of fair market value or the cost of producing the pellets.

[5] From 1991 to 1994, the cost of production of the pellets exceeded their fair market value, and the shareholders therefore paid amounts to the Appellant in excess of the fair market value of the pellets. In filing its tax returns for 1991 to 1994, the Appellant reported its income on the basis that the price it received from its shareholders for the pellets was the fair market value of the pellets, and that the amounts paid by the shareholders in excess of the fair market value were contributions of capital that were not required to be included in its income. The Appellant says that the excess was a contribution of capital by the shareholders to the Appellant to cover the Appellant's share of the operating costs of the joint venture.

[6] The Minister reassessed the Appellant on the basis that all of the amounts paid by the shareholders under the Pellet Sales Agreement were consideration for the pellets and were required to be included in its income. The Minister therefore reassessed the Appellant to increase its income from business by the following amounts:

1991 - $12,449,256
1992 - $10,307,919
1993 - $3,768,693
1994 - $1,549,296

[7] The Appellant is appealing the reassessments of its 1993 and 1994 taxation years on the basis that the excess of the payments from its shareholders over the fair market value of the pellets was not income.

[8] The second issue arises because the reassessments of the Appellant's 1991 and 1992 taxation years were nil assessments. At the time the reassessments were issued, the Appellant requested, and the Minister allowed, additional capital cost allowance (CCA) deductions in 1991 and 1992 in order to offset the increase in business income. The increased CCA deductions resulted in no tax being payable by the Appellant for those years.

[9] The Appellant now takes the position that it correctly reported its revenue from pellet sales on its original returns and, although it cannot appeal the reassessments of its 1991 and 1992 taxation years, it is seeking to dispute the inclusion of the additional pellet sales revenue in its income in those years by appealing reassessments of its 1996 and 1997 taxation years. It says that the deductions of CCA

it claimed in 1991 and 1992 to offset the increase to the pellet sales revenue should be reversed, resulting in an increase of $22,757,175 to its opening cumulative undepreciated capital cost balance for 1996 and 1997.

[10] At the hearing, the Court was advised that an unrelated issue pertaining to the 1994 taxation year had been settled and that the Respondent was consenting to a reduction of $6,279,378 to the Appellant's income for that year. The Appellant's counsel also withdrew the issues it had raised in respect of the 1995 and 1998 taxations years, with the result that only the reassessments for the 1993, 1994, 1996 and 1997 taxation years remain in dispute.

Facts

[11] The background to the development of Wabush Mines was related to the Court by Mr. Leo Kipfstuhl, a retired executive of Cleveland-Cliff Inc., the parent company of Cliff Mining. Cliff Mining is a shareholder of the Appellant, and is the managing agent of Wabush Mines.

[12] The original shareholders of the Appellant were Pickands Mather and Company, the original managing agent of the joint venture, and five large integrated steel companies: Acme Steel Company, Inland Steel Company, LTV Steel Company, Pittsburgh Wheeling Steel Company and Societa Finanziaria Siderurgica Finsider per Azioni. Pickands Mather was purchased by Cleveland-Cliff in 1987 and renamed Cliff Mining.

[13] Wabush Mines is an unincorporated joint venture between the Appellant, The Steel Company of Canada Ltd. ("Stelco") and Dominion Foundries and Steel Ltd. ("Dofasco"). The joint venture was started in the early 1960s to develop large iron ore deposits in the Wabush Lake area of Labrador. Along with Stelco and Dofasco, the shareholders of the Appellant were interested in securing long-term supplies of iron at a reasonable cost. Large amounts of capital were needed to build the mine, concentrator, pelletizing facility and related infrastructure, and the parties chose to carry on the operation as a joint venture in order to spread the risk related to the project.

[14] The most recent Wabush Mines Joint Venture Agreement, and the one which is relevant to these proceedings, was entered into on January 1, 1967.

[15] A number of other agreements were entered into concurrently with the Joint Venture Agreement, including: the Wabush Mines Participants Agreement, the

Wabush Mines Pellet Sales Agreement, the Wabush Mines General Provisions Agreement, and a First Mortgage and Collateral Trust Deed.

[16] Pursuant to the Joint Venture Agreement, Wabush Mines was to be operated on behalf of the joint venturers by the managing agent. The joint venturers were each required to pay their share of the expenses and were each entitled to a proportionate share of the pellets that were produced and to any income derived from the operation.

[17] The joint venturers were liable for the expenses of constructing, developing and operating Wabush Mines as well as investments in subsidiaries connected with it. These expenses are detailed in Articles IV and V of the Joint Venture Agreement. The operating expenses included all costs associated with the Wabush Mines, including any incidental costs, such as royalties to third parties, taxes, rent, and insurance. The construction and investment disbursements included all costs associated with the acquisition, development and construction of the Wabush Mines, the cost of all replacement property acquired in connection with the Wabush Mines and certain advance minimum royalty payments, as well as required investments in project subsidiaries or parties connected with the Wabush Mines.

[18] In order to finance its interest in the joint venture, the Appellant issued $138 million of bonds to institutional investors. It sold $112 million of Series A bonds in 1962 and $26 million of Series B bonds in 1964. The Royal Trust Company acted as trustee for the bondholders. Both series of bonds matured in 1991.

[19] To secure the payment of the principal and interest on the bonds, the Appellant granted Royal Trust, in its capacity as trustee for the bondholders, a mortgage and floating charge over all of its property including its 58% undivided interest in the joint venture assets. This Agreement was entitled “First Mortgage and Collateral Trust Deed and Trust Deed of Hypothec, Mortgage and Pledge”.

[20] Royal Trust was also made a party to the Joint Venture Agreement in order to protect its security interest in the Appellant’s interest in the Joint Venture. The rights and powers of the Trustee under the Joint Venture Agreement were to terminate when the bonds were repaid.

[21] Pursuant to the Pellet Sales Agreement, the Appellant sold its share of the pellets produced by the Wabush Mines to its shareholders, in proportion to their shareholding in the Appellant. The Pellet Sales Agreement set out, among other things, the Appellant's obligation to sell to the shareholders, and the shareholders’

obligation to purchase, their share of the pellets produced by the joint venture, and the means of calculating the purchase price of the pellets.

[22] Section 3 of the Pellet Sales Agreement, required that each shareholder pay the Appellant each year, as the purchase price of pellets sold to it, an amount equal to the greater of i) the fair market value of pellets sold to the shareholder in the year, or ii) its share of the "Wabush Iron Costs" for the year. The relevant portion of section 3 reads as follows:

> 3. *Purchase Price of Pellets and Payments Thereof by Wabush Iron Stockholders.* Each Wabush Iron Stockholder hereby agrees, severally and not jointly or jointly and severally, to pay in each year as the purchase price of Pellets sold to it hereunder an amount equal to the greater in such year of (i) the Fair Market Value of Pellets sold to such Wabush Iron Stockholder in such year (which Fair Market Value shall be determined at the time of the sale thereof except that if the Fair Market Value of Pellets shall change during any year, the amounts thereafter payable under this clause (i) shall be adjusted so that the amounts payable under this clause (i) during such year by each Wabush Iron Stockholder shall be the average Fair Market Value during such year weighted according to the deliveries of Pellets by Wabush Iron to all Wabush Iron Stockholders during each period during which a different Fair Market Value shall prevail) and (ii) such Wabush Iron Stockholder's Basic Proportion of the Wabush Iron Costs for such year (the obligation of such Wabush Iron Stockholder to pay the amounts payable under this clause (ii) being, subject to the third paragraph of this Section 3, unaffected by any failure to produce or deliver Pellets during such year);

[23] The Wabush Iron Costs were all of the costs that the Appellant incurred in relation to the joint venture, calculated in accordance with generally accepted accounting principles and excluding any amounts chargeable to capital accounts, except for interest on the bonds.

[24] Wabush Iron Costs were defined at page 42 of the General Provisions Agreement to include:

> -all amounts payable by the Appellant pursuant to the joint venture agreement for operating expenses
>
> -all costs of the Appellant for construction disbursements under the joint venture agreement
>
> -provision for depreciation and depletion in each month equal to the aggregate of 1/12 of the annual sinking fund payment in respect of the Series A and Series B bonds

> -all interest, commitment fees and finance charges including interest and fees in respect of the bonds, and
>
> -all other costs, expenses, liabilities and charges of the Appellant in respect of the joint venture.

[25] Section 3 of the Pellet Sales Agreement also provided that, in the event that the Appellant failed to produce or deliver pellets during the year to the shareholders, the shareholders were still obliged to pay their proportionate share of the Wabush Iron Costs for the year. Mr. Kipfstuhl said that there was never any year in which the joint venture did not produce any pellets.

[26] Under section 4 of the Pellet Sales Agreement, shareholders were liable to make payments of principal and interest on the bonds if the Appellant failed to do so at any time. Any payments made by the shareholders under section 4 could be deducted from payments they were required to make to the Appellant under section 3. According to the evidence, the shareholders were never required to make any payments under section 4.

[27] Section 15 of the Pellet Sales Agreement provided that the Agreement would terminate only upon the repayment of all of the indebtedness represented by the bonds.

[28] Mr. Kipfstuhl said that the Pellet Sales Agreement ensured that the Appellant would have enough funding from its shareholders to meet its obligations under the Joint Venture Agreement and was designed to protect the other joint venturers, Stelco and Dofasco, as well as Royal Trust. He said that the bondholders looked to the Pellet Sales Agreement to provide security for the repayment of the bonds.

[29] The Participants Agreement was entered into by the shareholders of the Appellant along with Stelco and Dofasco. Among other things, in Article V of the Agreement, the Appellant’s shareholders agreed to purchase their respective proportionate shares of the Appellant’s share of the pellets produced by the joint venture, and at a price equal to the greater of fair market value and the shareholders’ respective share of the Wabush Iron Costs. Mr. Kipfstuhl said that this term was included in the Participants Agreement as a means of obligating the Appellant’s shareholders to Stelco and Dofasco to provide the Appellant with enough money to pay its share of the operating expenses.

[30] The General Provisions Agreement set out the definitions of terms found in the Joint Venture Agreement, the Participants Agreement, the Pellet Sales Agreement and other related documents, provided for the arbitration of disputes under the agreements, placed restrictions on the transfer and encumbering of interests in the Joint Venture, and dealt with the rights and powers of the trustee, Royal Trust.

[31] For each of the years from 1991 to 1994, the Wabush Iron Costs incurred by the Appellant were greater than the fair market value of the pellets that it sold to its shareholders and, pursuant to the Pellet Sales Agreement, the Appellant's shareholders paid the Appellant aggregate amounts equal to the Wabush Iron Costs.

[32] In its financial statements prepared for the years ending December 31, 1991 to 1994 inclusive, the Appellant recorded all of the amounts received from its shareholders under the Pellet Sales Agreement as revenue from the sale of pellets. For tax purposes, the Appellant reduced its income shown in its financial statements on the basis that the price it received for the pellets was the fair market value of the pellets, rather than the amounts it received under the Pellet Sales Agreement. This adjustment was done each year on Schedule T2 S1 filed with its returns, and reduced sales revenue and income by the following amounts:

1991 - $12,449,256
1992 - $10,307,919
1993 - $3,768,693
1994 - $1,549,296

[33] Mr. Kipfstuhl said that recording the amounts received by the Appellant under the Pellet Sales Agreement as revenue on the financial statements rather than as advances from the shareholders did not affect the bottom line of the financial statements. If the amounts had been shown as advances from the shareholders rather than revenue, the closing balance for the Appellant's liabilities and equity on the balance sheet would not have changed. He said that the method of reporting had been used for many years by the Appellant and was appropriate, given that the only parties who relied on the financial statements were the shareholders and bondholders. Mr. Kipfstuhl also pointed out that the auditor's cover letter to the financial statements for 1991 to 1994 included the caution that, since 100% of the Appellant's share of the production from Wabush Mines was sold to its shareholders, "it is possible that the terms of these sales transactions are not the same as those which would result from transactions among wholly unrelated parties."

[34] In Mr. Kipfstuhl's view, the amounts received by the Appellant from its shareholders under the Pellet Sales Agreement were in part consideration for the pellets and in part a contribution of capital by the shareholders to the Appellant to cover the Appellant's share of the operating costs of the joint venture. Mr. Kipfstuhl said that in addition to dealing with the sale of pellets to the shareholders, the Pellet Sales Agreement was intended to provide additional security to the bondholders because of the special nature and remote location of the Appellant's assets. He said that the Pellet Sales Agreement protected the bondholders and the other Wabush Mines joint venturers by ensuring that Appellant would always have enough money to meet its obligations under the Joint Venture Agreement and in respect of the bonds. He said that the fact that Royal Trust was made a party to the Pellet Sales Agreement was evidence that it was intended as security for the bondholders.

[35] Mr. Kipfsthul also made reference to the bankruptcy of two of the Appellant's shareholders and the effects that had on the operation of the joint venture. LTV and Wheeling Pittsburg went bankrupt in 1985 and 1986, and stopped making payments to the Appellant. The joint venturers agreed to continue the operations of Wabush Mines, Stelco and Dofasco and the Appellant's shareholders took over the bankrupts' share of production and operating costs, exclusive of the bankrupts' share of the bond costs.

[36] The relative interests of the Appellant, Stelco and Dofasco in the joint venture were adjusted in consequence of the bankruptcies, and the shareholdings of LTV and Wheeling Pittsburgh in the Appellant were transferred to the other shareholders in 1994. Proceeds received by the Appellant from the settlement of the bankruptcies were used to retire, in part, the bonds. Also, apparently as a result of the restructuring due to the bankruptcies, the bonds were not fully repaid until 2000.

[37] The evidence also showed that in 2000, 2001 and 2002, the shareholders of the Appellant paid the Appellant amounts in excess of the fair market value of the pellets they acquired from the Appellant. On its financial statements, the Appellant included the full amount in its income, while for tax purposes the Appellant reported the sales of the pellets at fair market value.

<u>Appellant's position</u>

[38] The Appellant takes the position that upon a proper construction of the Pellet Sales Agreement, the price paid by the shareholders for the pellets was the fair market value of the pellets, and the amounts that they paid in excess of the fair

market value in 1991, 1992, 1993 and 1994 were advances of capital to finance the Appellant's share of the joint venture operations.

[39] In the Appellant's view, the objective of the Pellet Sales Agreement was to provide the Appellant with a secure stream of income from the shareholders for the payment of its share of the costs of the joint venture and for the payment of its obligations respecting the bonds and that this Agreement was required by the Lenders.

[40] Although the payments were referred to in the Pellet Sales Agreement as being on account of the purchase price of the pellets, counsel said that this wording did not reflect the true legal nature of the payments. In such a case, the terms used by the parties to describe the payments cannot override the legal character and effect of the payments. In support of this position, counsel referred to the case of *Dominion Taxicab Assn. v. M.N.R.*, 54 DTC 1020 (S.C.C.).

[41] Counsel submitted that the parties' intention regarding the payments made by the shareholders to the Appellant must be considered in the context of all of the agreements relating to the joint venture entered into by all of the parties, including the Trustee. Their intention was to ensure funding for the joint venture and to ensure that the Appellant had the ability to pay the obligations in respect of the bonds issued to the institutional investors. This was done by including the Appellant's obligations with respect to the bonds in the Wabush Iron Costs for which the shareholders were liable under the Pellet Sales Agreement. This indicates an intention to make advances of capital to the Appellant to the extent that the Wabush Iron Costs exceeded the fair market value of the pellets.

[42] In addition it was submitted that the requirement in the Pellet Sales Agreement that the shareholders pay their respective share of the Wabush Iron Costs even if no pellets were produced conflicts with the notion that the Agreement was a contract for the sale of the pellets. Counsel said that the drafters of the Agreement could not have intended the payment provision in the Agreement to simply set a purchase price for the pellets since the obligation to make payments to the Appellant existed even in the event that no pellets were produced. He said that the primary purpose of the Pellet Sales Agreement was to provide for the funding of the Appellant's interest in the joint venture.

[43] Furthermore, he argued that the rights given the Trustee under the Pellet Sales Agreement are inconsistent with the characterization of the agreement contract for the sale of pellets. Section 7 of the Agreement provides that the obligations in the

Agreement were entered into in order to induce the bondholders to purchase the bonds and that every obligation of the shareholders and the Appellant under the Agreement were also obligations to the Trustee. The Agreement could not be terminated until the bonds were fully repaid. Therefore the parties intended the Agreement to be a means of financing the Appellant and its share of the joint venture operations rather than as a contract for the sale of pellets. The Agreement guaranteed that the shareholders would be responsible for meeting the Appellant's costs regardless of the fair market value of the pellets or even whether any pellets were produced.

[44] The Appellant says the fact that when the two shareholders of the Appellant went bankrupt, the solvent shareholders assumed the bankrupts' share of the Appellant's Wabush Iron Costs is consistent with its interpretation of the Pellet Sales Agreement. This conduct shows that the Appellant and its shareholders were acting in concert to ensure that the Appellant had sufficient funds to pay its share of the operating costs of the joint venture.

[45] Counsel also pointed out that the purchase price of the pellets would be reduced if shareholders paid any principal or interest on the bonds directly to the bondholders under section 4 of the Agreement.

[46] Counsel said that the treatment of the receipts as revenue in its financial statements was not determinative because the legal character of the payments was a question of law. In any event, the amounts were recorded in the advance accounts of the shareholders and did not affect the bottom line of the financial statements.

[47] With respect to the issue of whether the Appellant could challenge the 1991 and 1992 reassessments, counsel said it was open to the Appellant to seek relief from those reassessments in years in which the adjustments made for 1991 and 1992 had an impact on the Appellant's taxable income, in order to correct what he called "overclaims" of CCA. He said that the Court had the power to order the Minister to revise the opening UCC balance in years that were not statute barred. Counsel relied on the decisions of the Federal Court of Appeal in *Clibetre Exploration Ltd. v. The Queen*, 2003 FCA 16 and the decision of this Court in *Aallcann Wood Suppliers Inc. v. The Queen*, 94 DTC 1475. He also referred to the administrative policy of the CRA set out in Information Circular IC84-1 dealing with revision of CCA claims. Paragraph 10 of the Circular states:

> <u>Revisions requested in non-taxable years</u>

> 10. Where a taxpayer requests a revision of capital cost allowance claimed in a taxation year for which a notification that no tax is payable had been issued. . ., such request will be allowed provided there is no change in the tax payable for the year or any other year filed, including one that is statute barred, for which the time has expired for filing a notice of objection. . .

Respondent's position

[48] The Respondent contends that the amount received by the Appellant each year from its shareholders under section 3 of the Pellet Sales Agreement was the price of the pellets, and that the Appellant transferred the pellets to the shareholders in consideration for the payments. Therefore, the payments from the shareholders were income to the Appellant.

[49] Counsel for the Respondent asserted that all of the amounts paid by the shareholders could only be payments for the pellets because the shareholders had no other obligation to make any payments to the Appellant.

[50] Counsel argued that, even though the price for the pellets was determined in part by reference to the Appellant's share of the operating costs of the joint venture, this alone does not result in the payments being payments or advances of capital by the shareholders. He also submitted that the Appellant is in effect asking the Court to recharacterize the transaction based on its economic substance.

[51] Counsel also submitted that the consistent treatment of the amounts as revenue in the Appellant's financial statements showed that the Appellant itself recognized that the payments were consideration for the pellets. The financial statements also contradicted the Appellant's assertion that the amounts paid by the shareholders in excess of the fair market value were capital contributions because the amounts were not shown on them as capital contributions. Furthermore, there was no indication that the Appellant was liable to repay the amounts to its shareholders. From the materials related to the bankruptcy of LTV and Wheeling Pittsburgh, it does not appear that any of the amounts of excess they paid for the pellets over the fair market value was claimed by them from the Appellant.

[52] Counsel also said that the Appellant has not shown that the payments in excess of fair market value for the pellets were intended primarily to ensure repayment of the Appellant's bond obligations. Counsel said that the evidence showed that even after the bond debt was completely paid off, the shareholders and the Appellant continued to adhere to the terms of the Pellet Sales Agreement regarding the price for

pellets, and in 2001 and 2002, the shareholders paid the Appellant their proportionate share of the Wabush Iron Costs which were in excess of the fair market value of the pellets. This showed that the purpose of section 3 of the Pellet Sales Agreement was to fix the sale price of the pellets and not to protect the bondholders or require a capital contribution from the shareholders.

[53] In addition, the obligation of the shareholders to pay the greater of cost or fair market value for the pellets was also found in the Participants Agreement, to which the Trustee was not a party. This was confirmation that the obligation to pay more than fair market value where this was less than the cost of production was not intended solely for the protection of the bondholders.

[54] Respondent's counsel says that even if the amounts paid by the shareholders in excess of fair market value for the pellets was not intended to be part of the purchase price of the pellets, this would not change the assessment of the Appellant's income from business. The receipts would be either revenue or reimbursements of its operating costs, which would lead to the conclusion that the amounts were received on revenue account rather than on capital account. (*Ikea Ltd.* v. *The Queen*, [1998] 1 S.C.R. 196, *Johnson and Sons (Arborg) Ltd., v. M.N.R.*, 82 DTC 1041, *Radio Engineering Products Limited v. Minister of National Revenue,* 73 DTC 5071 and *No. 734 v. M.N.R.*, 61 DTC 418.)

[55] On the second issue, the Respondent takes the position that the Appellant is not entitled to have its opening UCC balance for its 1996 and 1997 taxation years revised to reverse the CCA claimed in its 1991 and 1992 taxation years, even if it is successful on the first issue. Counsel said that the Minister must determine the opening UCC balance for each class of depreciable property in accordance with the *Act*. The definition of "undepreciated capital cost" in subsection 13(21) of the *Act* requires that the UCC must be reduced by all CCA allowed to the taxpayer for the class before that time. In this case, the Appellant claimed and was allowed CCA for 1991 and 1992 and those amounts must be taken into account in calculating the opening UCC for all subsequent years. If the amounts were excluded from the calculation of UCC, the Appellant would receive the benefit of the CCA deductions a second time.

[56] Counsel said that a revision of UCC balances is different from revisions which have been allowed by the Courts to other tax balances carried forward from statute-barred years. In *Papiers Cascades Cabano Inc. v The Queen,* 2005 TCC 396, for example, the Court allowed the Minister to revise the balance of investment tax credits carried forward from statute barred years, but this was because the Court

found that there had been an error in the calculation of the investment tax credits in the statute barred years. In this case counsel said that the Appellant has not shown that there was an error in the CCA claim made in 1991 and 1992, and therefore there is no basis upon which to revise the UCC balance in 1996 and 1997. The Appellant claimed the CCA and it was properly allowed to reduce taxable income in 1991 and 1992. The Appellant did not dispute the inclusion of the additional revenue from pellet sales in those years.

Analysis

[57] The first issue before the Court is the interpretation of the Pellet Sales Agreement and, in particular, section 3 of the Agreement.

[58] Although the Agreement states in section 19 that it is to be governed by and construed in accordance with the laws of the State of New York, there was no evidence of New York law relating to the construction of contracts. In such a case, the law of that jurisdiction is presumed to be the same as in the jurisdiction in which this appeal arose. In *Backman v. The Queen*, [2000] 1 F.C. 555, the Federal Court of Appeal said, at paragraph 38:

> Where foreign law is relevant to a case, it is a question of fact which must be specifically pleaded and proved to the satisfaction of the Court. Professor J.-G. Castel has summarized the effect of the failure of a party to establish foreign law as a fact before the Court:
>
> > If foreign law is not pleaded and proved or is insufficiently proved, it is assumed to be the same as the *lex fori*. This seems to include statutes as well as the law established by judicial decision.

[59] This appeal was heard in the province of Quebec, and so it must be interpreted in accordance with the general requirements of arts. 1425 to 1432 of the *Civil Code of Québec*, S.Q. 1991, c. 64 ("*C.C.Q.*"). The following articles are relevant to this case:

> **1425.** The common intention of the parties rather than adherence to the literal meaning of the words shall be sought in interpreting a contract.
>
> **1426.** In interpreting a contract, the nature of the contract, the circumstances in which it was formed, the interpretation which has already been given to it by the parties or which it may have received, and usage, are all taken into account.

[60] According to Pineau and Gaudet, in *Theorie des Obligations*, 4th ed. at page 400, the principle set out in article 1425 does not raise any difficulty when the terms used by the parties are ambiguous or manifestly do not reflect their common intention. However, the authors go on to say that :

> where the terms of the contract are not ambiguous, we must clearly presume that they accurately reflect the actual intentions of the parties. Also, where the terms used by the parties do not raise any interpretive difficulties, the judge must apply the terms without seeking exceptions under the pretext of interpretation, unless evidence is successfully adduced to support the belief that, despite the absence of ambiguity in the terms used, these terms betray—more they do not clearly communicate—the actual intentions of the parties.

[translation]

[61] The Appellant maintains that despite the clear language of section 3, the parties intended the payment of any excess amount over the fair market value of the pellets to be a contribution or advance of capital rather than payment for the pellets. It says that the label used to describe the payments was incorrect in law and therefore not determinative. Counsel says that the parties' true intention respecting the payments can be seen from the nature of the contract and circumstances in which it was formed, and that intention determines the legal character of the payments in issue.

[62] In my view, the language of section 3 of the Pellet Sales Agreement, while convoluted, is unambiguous in setting a purchase price for the pellets. The provision states that each Wabush Iron shareholder agrees "to pay in each year as the purchase price of Pellets sold to it hereunder" the greater of two amounts: the fair market value of the pellets or the shareholder's proportionate share of the Wabush Iron Costs. The apparent intention of the parties was that their relationship, for the purposes of the transfer of the pellets, be that of vendor and purchasers and that the purchase price be the entire amount specified by them. This intention was carried out by the transfer of the pellets to the shareholders and the payment of the amounts calculated in accordance with section 3.

[63] The evidence presented by the Appellant regarding the context in which the Pellet Sales Agreement arose and the other agreements entered into by the parties at the same time does not show that the parties' intention was other than that which I have found to have been clearly expressed in section 3.

[64] I accept that one of the motivating factors behind the Pellet Sales Agreement was to provide financing for the Appellant's operations in order to protect the bondholders. However, the means chosen by the parties to achieve this purpose was a guaranteed purchase price for the pellets. According to the terms of section 3, the parties ensured that the Appellant would be able to fund its share of the joint venture by setting a purchase price for the pellets at least equal to the Appellant's share of the joint venture operating costs including debt service charges. It is true that if the shareholders had not agreed to these terms for the purchase of the pellets, the Appellant would have been required to obtain additional operating capital in the years in which its share of the operating costs of the joint venture exceeded its revenues and any retained earnings, but that does not lead to the conclusion that the payments in excess of fair market value by the shareholders were capital contributions. The economic effect of the payments is not determinative of their legal character, and cannot be used to recharacterize a taxpayer's bona fide legal relationships (*Shell Canada Ltd. v. Canada* [1999] 3 S.C.R. 622, at paragraph 39)

[65] The parties were free to structure their affairs as they wished and their choice with respect to the nature of their relationship insofar as the transfer of the pellets is concerned must determine the tax consequences of those transactions to each party. (*Friedberg v. Canada* [1991] F.C.J. No. 1255)

[66] It is true that, as the Appellant points out, the shareholders would have been required to pay their respective share of the Wabush Iron Costs even if they did not receive any pellets from the Appellant. The Appellant says that the provision for payment even if no pellets were transferred to the shareholders is evidence that section 3 of the Agreement was intended to do something in addition to setting a purchase price for the pellets.

[67] I agree that any amounts that might become payable in a year where no pellets were produced might not be characterized as the being for the purchase of pellets, but I do not believe that it follows that the payments would be inconsistent with a relationship of vendor and purchaser or that any such payments could only be a contribution of capital by the shareholders in their capacity as shareholders.

[68] In order to appreciate the nature of this obligation, it is important to recall that when the Agreement was first entered into, the shareholders wished to obtain a long-term supply of pellets from the Appellant. In those circumstances it would not have been unreasonable for them, as purchasers dependent on this supply, to want to ensure the long-term viability of the Appellant's operations, and it was not inconsistent with their interests as purchasers therefore to agree to defray the

Appellant's costs if production was interrupted. That obligation is not incompatible with a vendor-purchaser relationship and, for this reason, I do not find that this term of the Pellet Sales Agreement shows that the shareholders were intending to deal with the Appellant in their capacity of shareholders rather than purchasers.

[69] On the evidence, I am unable to conclude that the intention of the parties was that the excess paid by the shareholders over fair market value for the pellets was payable by the shareholders, qua shareholders, as a contribution of capital. The Appellant has not shown that the source of the obligation to make the payments was other than section 3 of the Pellet Sales Agreement. On the proper construction of that provision the payments in issue were part of the sale price of the pellets.

[70] I would also add that, having found that the payments that flowed from the shareholders to the Appellant as a consequence of the vendor-purchaser relationship between them, the payments would be income to the Appellant rather than receipts of capital even if they were intended as a reimbursement to the Appellant for any shortfall between its revenue and its share of the operating expenses of the joint venture. The amounts were received by the Appellant as part of its ordinary business operations and were paid by the shareholders as customers of the Appellant. In such circumstances, the payments would be income to the Appellant. In this regard I would refer to the decision of this Court in *Hall v. The Minister of National Revenue*, 90 DTC 1431 where the issue was whether a government subsidy received by the taxpayer to assist in developing a blueberry farm was a receipt on capital or income account. While Rip J. (as he then was) held that the receipt was on capital account, he said at page 1435:

> The most significant factor in determining whether the subsidy was received on capital or revenue account is the purpose of the subsidy. A subsidy whose purpose is to assist the business operations is received on revenue account; a subsidy whose purpose is to create or extend a business structure is on capital account.

[71] This is consistent with the Supreme Court of Canada's decision in *Ikea Limited v. The Queen* (supra) where a tenant inducement payment was found to be an income receipt to the taxpayer because it was received as part of its ordinary business operations. At paragraph 33 the Court said:

> In my view, Bowman J. was entirely correct in finding that the TIP received by Ikea was on revenue account and should have been included in income for tax purposes. The payment was clearly received as part of ordinary business operations and was, in fact, inextricably linked to such operations. On the evidence, no question of

> linkage to a capital purpose can seriously be entertained. Had Ikea wished, it could have requested that the TIP be advanced expressly for the specific purpose of fixturing, or to defray some other capital cost. It did not do so, however, and the payment was in fact made free of any conditions for or stipulations as to its use. Therefore, whether the TIP represented a reduction in rent or a payment in consideration of Ikea's assumption of its various obligations under the lease, it clearly cannot be treated as a capital receipt and should have been included in Ikea's income. The question that remains, however, is in which taxation year should this inclusion have taken place.

[72] In this case the payments were made by the shareholders to assist the business operations of the Appellant and are revenue receipts.

[73] For the above reasons, I conclude that the amounts in issue were correctly included in the Appellant's income.

[74] Given my decision on the first issue, it is not necessary for me to address the matter of the redetermination of the UCC opening balances for the 1996 and 1997 taxation years of the Appellant.

[75] The appeal will be allowed in part, on the basis of the concession made by the Respondent outlined at paragraph 10 of these Reasons, with costs to the Respondent.

Signed at Ottawa, Canada, this 15th day of May 2009.

"B.Paris"

Paris J.

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