Date: 20080611

Dockets: A-405-07
A-406-07
A-407-07

Citation: 2008 FCA 205

CORAM: **LÉTOURNEAU J.A.**
NOËL J.A.
TRUDEL J.A.

A-405-07

BETWEEN:

PROVIGO INC.

Appellant

and

HER MAJESTY THE QUEEN

Respondent

A-406-07

BETWEEN:

TEMBEC INC.

Appellant

and

HER MAJESTY THE QUEEN

Respondent

A-407-07

BETWEEN:

CASCADES INC.

Appellant

and

HER MAJESTY THE QUEEN

Respondent

Heard at Montréal, Quebec, on June 5, 2008.

Judgment delivered from the bench at Ottawa, Ontario, on June 11, 2008.

REASONS FOR JUDGMENT OF THE COURT BY: NOËL J.A.

CONCURRED IN BY: LÉTOURNEAU J.A.
TRUDEL J.A.

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REASONS FOR JUDGMENT

NOËL J.A.

[1] These are three appeals from decisions of Justice Lamarre Proulx of the Tax Court of Canada (the TCC judge), dismissing, for the same reasons, the appeals of Provigo Inc. (Provigo), Tembec Inc. (Tembec) and Cascades Inc. (Cascades) (the appellants) from assessments made by the Minister of National Revenue (the Minister) for the 1997 (in the case of Tembec and Cascades) and 1998 (in the case of Provigo) taxation years. The decisions disallowed the deductions claimed by each of the appellants under paragraph 20(1)(*f*) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.), c. 1 (the Act) as financing costs.

[2] Although the loan agreements underlying the three appeals are not identical, they all include a conversion privilege that was exercised by the lenders after the obligations (debentures and

promissory notes) were issued, at a time when the convertible shares were worth more than the value indicated in the loan agreements. By mutual agreements, the parties argue that the appeals raise the same question of law, namely, whether the deduction allowed under paragraph 20(1)(*f*) of the Act is limited to a one-time discount whose value must be established when an obligation is issued. If this is the case, the appeals could not succeed, as the discount claimed by the appellants is based upon the change in the value of the convertible shares after the obligations were issued.

[3] The TCC judge, relying on the Supreme Court's decision in *Imperial Oil Ltd. v. Canada; Inco Ltd. v. Canada*, 2006 SCC 46, [2006] 2 S.C.R. 447 [*Imperial Oil*], concluded that the deduction provided for in paragraph 20(1)(*f*) was limited to a discount whose amount has to be established when an obligation is issued. She therefore dismissed the appeals.

[4] In support of their appeals, the appellants insist on the fact that their situation can be distinguished from the one that the Supreme Court had dealt with. They explain that the obligations issued to finance their operations were convertible into shares according to the very terms of the loan agreement, while in *Imperial Oil*, the variation in the repayment amount was an extrinsic factor of the loan agreement. In that case, the variation resulted from the exchange rate, given that the loan had been made in U.S. dollars. According to the appellants, paragraph 20(1)(*f*) allows the deduction of a potential discount as long as the loan agreement stipulates how it should be calculated.

[5] The TCC judge concluded rightly, in my view, that *Imperial Oil* disposed of the three appeals despite the distinction raised by the appellants.

[6] It is true that in *Imperial Oil*, the deduction claimed as a discount under paragraph 20(1)(*f*) (i.e., the losses related to fluctuations in the value of the Canadian dollar relative to the currency of the loan) did not arise from the loan agreement as such. However, the reasoning of Justice LeBel (representing the majority view) for refusing the claimed deduction transcends this distinction. After citing paragraph 20(1)(*f*), Justice LeBel describes the issue at bar in the following terms (*Imperial Oil*, para. 15):

> On a proper interpretation, is the deduction in this provision limited to original issue discounts? Should it be viewed as encompassing a broader range of financing costs, including foreign exchange losses? …
>
> [Emphasis added.]

[7] Later, Justice LeBel reformulates the question as follows (*Imperial Oil*, para. 32):

> … Specifically, the question is whether the deduction provided for in para. (*f*) is exclusively one for original issue discounts or whether it is instead a broader deduction that applies more generally to the capital cost of borrowing.
>
> [Emphasis added.]

The minority shared this view of the issue to be decided, as can be seen in the following extract (*Imperial Oil*, Justice Binnie, para. 74):

> … I agree with him that "the question is whether the deduction provided for in para. (f) is exclusively one for original issue discounts or whether it is instead a broader deduction that applies more generally to the capital cost of borrowing" …

[8] The analysis that follows, both that of the majority and that of the minority, is a function of this question. The essence of Justice LeBel's reasoning for refusing the claimed deduction can be

found at paragraph 66 of his reasons. According to Justice LeBel, the deduction allowed in paragraph 20(1)(*f*) is limited to a "point-in-time expense", represented by the discount calculated at the time an obligation was issued. In saying this, he disallows any deductions that would reflect "the appreciation or depreciation of the principal amount over time" and "that can be ascertained only at the time of repayment" (*idem*). The effect of this reasoning is unequivocal: the deduction of financing costs provided for by paragraph 20(1)(*f*) is limited to the monetary discount granted when an obligation is issued.

[9] Aside from that obstacle, I question the other aspect of the appellants' argument according to which the difference between the value of the shares at the time the obligations were issued and their value at the time of the conversion would constitute a financing cost. On its face, the issuance of shares by the appellants from their share capital at a lower price than their actual value dilutes the shareholders' equity without anyone incurring any expenses.

[10] This question does not, however, need to be finally resolved, because the appellants in this case recognize that no discount was granted at the time the obligation was issued and that the deduction they are claiming is a function of the "appreciation … of the principal amount over time". The Supreme Court's decision in *Imperial Oil* precludes the possibility of the appellants being eligible for such a deduction.

[11] I would dismiss the appeals with costs.

"Marc Noël"

J.A.

"I concur.
Gilles Létourneau J.A."

"I concur.
Johanne Trudel J.A."

Certified true translation
Johanna Kratz

FEDERAL COURT OF APPEAL
SOLICITORS OF RECORD

DOCKETS:	A-405-07, A-406-07, A-407-07
(APPEAL FROM DECISIONS OF JUSTICE LOUISE LAMARRE PROULX OF THE TAX COURT OF CANADA, DATED JULY 11, 2007, DOCKET NOS. 2003-4340(IT)G, 2003-3999(IT)G and 2004-1916(IT)G, CITATION NO. 2007 TCC 395)	
STYLE OF CAUSE:	A-405-07 Provigo Inc. v. Her Majesty the Queen A-406-07 Tembec Inc. v. Her Majesty the Queen A-407-07 Cascades Inc. v. Her Majesty the Queen
PLACE OF HEARING:	Montréal, Quebec
DATE OF HEARING:	June 5, 2008
REASONS FOR JUDGMENT BY:	NOËL J.A.
CONCURRED IN BY:	LÉTOURNEAU J.A. TRUDEL J.A.
DATED:	June 11, 2008

APPEARANCES:

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