

Federal Court
of Appeal



Cour d'appel
fédérale

Date: 20100805

Docket: A-443-08

Citation: 2010 FCA 206

**CORAM: BLAIS C.J.
DAWSON J.A.
STRATAS J.A.**

BETWEEN:

HER MAJESTY THE QUEEN

Appellant

and

MERCHANT LAW GROUP

Respondent

Heard at Winnipeg, Manitoba, on June 22, 2010.

Judgment delivered at Ottawa, Ontario, on August 5, 2010.

REASONS FOR JUDGMENT BY:

DAWSON J.A.

CONCURRED IN BY:

BLAIS C.J.
STRATAS J.A.

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REASONS FOR JUDGMENT

DAWSON J.A.

[1] The respondent is a law firm. The Minister of National Revenue (Minister) assessed the respondent in respect of Goods and Services Tax (GST) under Part IX of the *Excise Tax Act*, R.S.C. 1985, c. E-15 (Act). The assessment related to the respondent's treatment of certain disbursements it incurred in the course of providing legal services to its clients. The disbursements included money spent in respect of searches, courier costs, office supplies, witness fees, recording services, transcript production, birth certificates, death certificates, marriage certificates, travel expenses and expert reports and testimonies.

[2] It was the position of the Minister that such disbursements were consideration for the supply of legal services and so were taxable supplies, and that the respondent had failed to collect and remit GST in respect of those taxable supplies. The respondent challenged the assessment, arguing that it had incurred the disbursements as the agent for its clients. It followed, the respondent argued, that the disbursements were not in respect of a taxable supply and so it was not obliged to collect and remit GST on those disbursements.

[3] A judge of the Tax Court, in reasons reported at [2008] T.C.J. No. 265, 2008 TCC 337, concluded that, except in respect of one class of disbursements (office expenses), the respondent had met the onus upon it to establish that it had incurred the disbursements as agent for its clients. It followed that, with that exception, the disbursements were not subject to GST. Judgment issued allowing the appeal from the Minister's assessment and remitting the matter to the Minister for reconsideration and recalculation in accordance with the reasons of the Judge.

[4] A single issue is raised on this appeal: did the Tax Court Judge err by concluding that the respondent had met its onus to establish that it acted as agent for its clients when it incurred the disbursements in question? No challenge is made to the Judge's conclusions with respect to the respondent's liability to pay GST on invoices sent to Legal Aid Manitoba, the calculation of certain input tax credits or the imposition of penalties under paragraph 280(1)(a) of the Act.

The Facts

[5] The respondent is a partnership that carries on the practice of law in Saskatchewan and elsewhere. As noted above, in the course of providing legal services, the respondent acquired various goods or services from third-party suppliers and treated the cost of those goods and services as disbursements billed to clients.

[6] The respondent collected and remitted GST on some of the disbursements.

[7] The respondent did not collect and remit GST on disbursements it viewed as having been incurred as agent for its clients.

[8] The evidence adduced by the respondent with respect to how disbursements were incurred and treated was adduced through Gerald Heinrichs, a lawyer who had practised with the respondent, or its predecessor(s), since 1988. He testified about the following 11 categories of disbursement: appraisal reports, accident reports, courier costs, transcripts, investigation reports, hospital records, security reports, medical reports, parking fees, travel expenses, and searches and certificates. With respect to each, he described in general terms when each item would be incurred, how each disbursement was usually paid and the ownership of any documents that were acquired.

[9] The following points emerged from his testimony:

- when lawyers provide estimates to clients concerning their legal fees the estimate includes taxes and disbursements;

- clients are generally told in advance about large disbursements such as medical reports, land title fees and appraisal reports;
- clients are not typically consulted about minor disbursements such as a land title search, a marriage certificate or courier fees;
- the lawyers of the firm generally dealt directly with third-party suppliers;
- disbursements were generally paid by the firm from monies held in trust for the relevant client;
- documents obtained from third-party suppliers were viewed as being the property of the client;
- documents received by the firm, for example, accident reports, were not altered by the firm;
- clients were not charged more than the firm paid for any disbursement; and
- lawyers “often” have authority as lawyers to affect their client’s position.

[10] No evidence was led concerning:

- the terms of any retainer agreements between the respondent and its clients;
- invoices from third-party suppliers in respect of the disbursements;
- the understanding third-party suppliers had concerning who was liable to pay for the goods and services supplied by the third parties;
- whether third-party suppliers knew that the respondent purported to contract with them as agent and not principal; and
- what clients understood about their liability to third-party suppliers.

The Legislative Scheme

[11] As a general principle, Division II of Part IX of the Act imposes GST on "every recipient of a taxable supply made in Canada." See: subsection 165(1) of the Act. The terms "recipient," "supply" and "taxable supply" in material part are defined in subsection 123(1) of the Act as follows:

123(1). "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,

[...]

"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;

"taxable supply" means a supply that is made in the course of a commercial activity;

123(1). « acquéreur »

a) Personne qui est tenue, aux termes d'une convention portant sur une fourniture, de payer la contrepartie de la fourniture;

...

« fourniture » Sous réserve des articles 133 et 134, livraison de biens ou prestation de services, notamment par vente, transfert, troc, échange, louage, licence, donation ou aliénation.

« fourniture taxable » Fourniture effectuée dans le cadre d'une activité commerciale.

[12] Disbursements incurred by a lawyer can be incurred in one of two ways. Disbursements can be incurred by a lawyer as the client's agent, or can be the lawyer's own expense incurred in the course of providing legal services. There is no dispute about how disbursements should be treated in either situation.

[13] In the former situation, the lawyer is not the recipient of the supply as defined by subsection 123(1) of the Act so long as the lawyer is not the entity liable to pay the consideration

owing under the agreement with the third-party supplier. The lawyer does not provide a supply. The lawyer is simply acting as an agent or conduit of his or her principal. In such case, the disbursement does not form part of the lawyer's expenses. It is the client's obligation and the lawyer pays the account on the client's behalf.

[14] In the latter situation, where the lawyer is a "recipient" of a supply, the disbursement is the lawyer's expense. The client may reimburse the lawyer for the expense, but the client had no obligation to pay the third-party supplier. The lawyer incurred the expense in order to provide legal services to the client. Because the goods or services were acquired for use or consumption in the course of providing legal services, lawyers who are GST registrants may claim an input tax credit so as to remove GST from the original disbursement. The pre-GST disbursement is then charged by the lawyer to the client. If exigible, GST is then levied on the entire account to the client, including the pre-GST disbursement.

[15] What is in dispute in this case is whether the disbursements at issue were incurred by the respondent as agent for its clients. Canada Revenue Agency's position concerning whether one person acts as an agent for another is set out in the GST/HST Policy Statement P-182R. This Court has previously found the policy to not be binding upon the Court, but nonetheless to be "a useful tool in determining whether an agency relationship exists." See: *Glengarry Bingo Assn. v. Canada* (1999), 237 N.R. 63.

[16] P-182R lists three essential qualities of an agency relationship. For the purpose of this appeal the relevant quality is that an agent must possess the authority to affect the principal's legal position.

[17] It is settled at common law that for an agency relationship to exist the agent must be able to affect the principal's legal position with third parties by entering into contracts on the principal's behalf or by disposing of the principal's property. See, for example, G.H.L. Fridman, *Canadian Agency Law*, (Markham: LexisNexis Canada Inc., 2009) at page 4, and F.M.B. Reynolds, *Bowstead and Reynolds on Agency*, 17th ed. (London: Sweet & Maxwell, 2001) at paragraph 1-001. In the words of Professor Fridman, citing *Royal Securities Corp. Ltd. v. Montreal Trust Co.*, [1967] 1 O.R. 137 at 155 (H.C.J.) aff'd [1967] 2 O.R. 200 (C.A.), "the law of agency will apply only when the acts of one person on behalf of another make a difference to that other's legal position, that is to say, his or her rights against, and liabilities towards, others. The grant of the right to exercise another person's legal powers, thereby potentially affecting the grantor's legal position, is an essential feature of agency."

[18] P-182R goes on to discuss eight indicators that are said to be helpful when determining whether the essential qualities of agency exist in respect of a transaction. They include the following indicators which are relevant to this appeal:

- Accounting Practices: While agents are not necessarily required to keep segregated funds, the fact a person segregates from their own funds any monies

received or paid in connection with another person is indicative of an agency relationship.

- **Alteration of Property Acquired:** In general, agents do not alter the nature of property acquired from a third-party before passing it on. However, this is also true in many other cases where someone other than an agent acquires property from a third-party.
- **Liability under Contract/Liability for Payment:** Where a person purchases goods on behalf of another person and the other person is liable to pay for whatever it is that the supplier has sold, the person acting on behalf of the purchaser is considered to be an agent of the purchaser.
- **Ownership of Property:** Generally, an agent does not acquire an interest in any property the agent acquires as agent on behalf of the principal. This is because ownership of the property passes directly to the principal. However, a principal and an agent may agree that the agent will hold title to the property.

The Decision of the Tax Court

[19] The Judge began his analysis by referring to P-182R, as revised in July of 2003. He noted its recitation of the three essential qualities of an agency relationship and the eight indicators of such relationship set out above. The Judge's analysis followed and is contained at paragraphs 20 to 23 of his reasons where the Judge wrote:

- [20] It is trite to say that the relationship that exists between a solicitor and his client is one of principal and agent. In the case at bar, the evidence shows that all essential qualities constituting an agency relationship exist. The Appellant adduced specific evidence with respect to its practices on legal disbursements and the relationship

that exists between the Barristers and Solicitors and their respective clients. The evidence went to establish that an agency relationship existed in this particular case as it usually would in any case involving a lawyer and his or her clients. The agency relationship is even more present in this particular case because almost all of the disbursements were paid directly out of the trust funds impressed with the Appellant by the clients. The evidence clearly established that the following types of disbursements, which were incurred by the Appellant for and on behalf of its clients, were paid directly out of the client's trust fund and were incurred for and upon the instructions of the clients at the consent of both parties.

Appraisal Reports;

Motor Vehicle Accident Reports;

Courier Fees;

Transcript Fees;

Investigative Reports;

Hospital Records;

Security Reports;

Medical Reports;

Parking Fees;

Travel Expenses;

Security and Search Certificates;

Birth Certificates;

Marriage Certificates;

Death Certificates.

[21] The evidence is equally clear that there were no add-ons to these disbursements, nor were they altered by the Appellant. Furthermore, the property ownership of the reports, certificates, et cetera, received by the Appellant, rested with the client and everything was paid out of the trust funds save and except for small disbursements.

[22] In assessing the Appellant, the Minister relied upon GST/HST Policy Statement P-209R entitled "Lawyers and Disbursements" which states in part as follows:

Decision

Generally, the Canada Revenue Agency will treat a disbursement described in this policy statement in the manner indicated, unless there is strong evidence to the contrary that it should not be so treated. If in a specific case strong evidence does exist that a contrary treatment should apply to a particular disbursement, then the general position taken in this policy statement will not apply to that disbursement for that specific case and a separate analysis of the facts surrounding the particular disbursement will be completed. [Emphasis added].

The policy goes on to discuss the disbursements which will be incurred, as an agent or not incurred as an agent, in various areas of law practice including real estate, intellectual property, business law, civil law litigation and wills and estates practice. Of particular concern in this policy are the common disbursements designated as - "not incurred as an agent" - in the area of civil litigation. In that area the policy is irrational and nonsensical. For example, it is difficult to comprehend why witness fees, fees paid for service of a document, fees for recording services or transcript production or fees for the preparation of experts' reports or an attendance fee for expert witnesses, fees for Court transcripts or any other fees of this nature, are any less incurred by a Barrister and Solicitor as an agent for his client, than are the filing fees for pleadings in the Court or registration fees or anything of that nature. They are necessary expenses and are only incurred with the client's consent. The line drawn by CRA's Policy Statement P-209R between legal disbursements "not incurred as an agent" and legal disbursements "incurred as an agent" seems arbitrary and lacks legal support or obvious forethought. Indeed, the only witness called by the Respondent at the trial, the appeals officer, basically said, and this was admitted by the Respondent, that this policy was king. No advice was sought with respect to the application of the policy; no direction was sought with respect to how the policy applies in a case by case basis. The policy was applied automatically as the auditor or appeals officer saw fit without consideration of the nature of the disbursement or other factors arising out of the relationship between the principal and its agent. If a disbursement was not one described in the Policy Statement as exempt, CRA would automatically conclude that GST is applicable. The policy was followed blindly regardless of the strength of evidence that would indicate otherwise. Someone with some civil litigation experience could have been consulted with respect to whether or not the principles of an agency relationship are applicable in a case such as the one before this Court.

- [23] There is no doubt but that the Appellant has discharged the onus on Issue No. 1 and as such answered Issue No. 3. Having reviewed the lawyer's disbursements for each year under appeal, I am satisfied that all of the lawyer's disbursements presented by the Appellant as contested ought not to have been subject to GST and as such the appeal will be allowed, (except as herein stated), in relation to the sums of \$10,139.65 for 2000, (Working Paper 5005), \$8,697.87 for 2001, (Working Paper 5000), \$32,041.50 for 2002, (Working Paper 5003), and \$9,795.16, (Working

Paper 5004), for the period of January 1 through April 30, 2003. On the review of various exhibits produced on this issue almost all of these disbursements are broken down into courier, searches, medical reports, appraisal reports, investigative reports, marriage certificates or similar certificates, transcripts, court reporting fees, assessments and a variety of appraisals. There is a reference to office expenses and the appeal with respect to these office expenses is not allowed, as no evidence or explanation was presented in that regard. Therefore, the legal disbursements consisting of office expenses are subject to GST. [Emphasis added.]

[20] Other aspects of the Judge's decision are not the subject of appeal.

Analysis

[21] As discussed above, for a lawyer who acquires goods or services not to be the "recipient" of the goods or services, the lawyer must establish that he or she was acting as agent on behalf of their client when the goods or services were acquired. The onus is on the lawyer to establish the existence of the agency relationship. See: *Glengarry Bingo* at paragraph 10.

[22] This Court has previously recognized that an essential quality of agency is whether the putative agent has the capacity to affect the legal position of the principal. Thus, in *Glengarry Bingo*, once the Court determined that the putative agent did not have the capacity to affect the legal position of its alleged principal, the Court found it unnecessary to address any of the other factors indicative of an agency relationship. The absence of the ability to affect the legal position of the alleged principal conclusively determined that there was no agency relationship. See: *Glengarry Bingo* at paragraph 32. The Court then went on to explain, at paragraph 33, that:

The most common example of how an agent might affect the legal position of its principal is by entering a contract on the principal's behalf. It is clear here that GBA was not authorized to enter contracts with third parties on behalf of the members. For instance, GBA could not have entered into a contract for purchase of

bingo equipment on behalf of its Members. It was only empowered to bind itself. In the contract of purchase, GBA bound itself; it did not purport to act for its Members nor did it expose them to risk. The fact that the Members were insulated from risk is demonstrated by the reaction of ABS when GBA was in arrears on its equipment payments: ABS made no attempt to seek compensation from the Members and the Members did not entertain the idea that they might be liable. These events illustrate that GBA could not effect the legal position of its Members, which demonstrates that an essential element of agency was not present. [Emphasis added.]

[23] Other cases have considered the importance of the ability of an agent to affect the legal position of the principal and the assumption of risk by the principal, and reach the same conclusion. See, for example, *Kinguk Trawl Inc. v. Canada* (2003), 301 N.R. 89 (F.C.A.) at paragraphs 35-36, *Parkland Crane Service Ltd. v. Canada*, [1994] G.S.T.C. 58 (T.C.C.) at pages 58-10, 58-11, and *Shvartsman v. Canada*, [2002] T.C.J. No. 148 at paragraph 12.

[24] In the present case the Judge, while referencing liability under contract as being an indicator of an agency relationship, failed to address whether the respondent or its client was liable under the agreements with third-party suppliers to pay the consideration owing under those agreements. He made no finding of fact with respect to whether the clients assumed any risk or liability with third-party suppliers. In oral argument counsel for the respondent could not point to any evidence that was before the Judge on this point. Instead, the Judge relied upon the general nature of the solicitor-client relationship, reasoning that it was "trite to say that the relationship that exists between a solicitor and his client is one of principal and agent."

[25] In my respectful view, the Judge erred in law by relying upon the general nature of the solicitor-client relationship. As a matter of law it does not follow that, because the solicitor-client

relationship is generally one of agency, all financial obligations incurred by a lawyer while providing legal services are incurred as agent of its clients. Indeed, the Judge recognized this by dismissing that portion of the appeal that related to office expenses incurred by the respondent on behalf of clients. Application of the proper test required the Judge to determine whether the respondent's clients were bound by the contracts with third-party suppliers and were, therefore, liable for payment under the contracts and also exposed to any risk as a party to the contracts. If so, it follows that the respondent made payments to the suppliers only as an agent.

[26] The absence of any evidence to support the conclusion that it was the respondent's clients who were bound to the contracts with third-party suppliers means that the respondent could not meet the onus upon it to establish that it acted as agent for its clients when it incurred disbursements. It follows that goods and services that attracted the disbursements were taxable supplies received by the respondent so that it was required to collect and remit GST on the disbursements.

[27] This conclusion is sufficient to dispose of the appeal. However, the following arguments were raised by the respondent.

[28] Both the Judge and the respondent placed reliance upon the fact that almost all of the disbursements were paid for by monies held in trust by the respondent. I agree that the segregation of funds and payment of disbursements from a segregated fund is consistent with the existence of an agency relationship. However, the presence of this *indicia* of agency is, as a matter of law, insufficient to establish an agency relationship in the absence of evidence establishing an essential

quality of the agency relationship: the ability to affect the principal's legal position with respect to the particular transaction at issue. Moreover, provincial law societies require the segregation of client funds held by a lawyer. In my view, in the absence of further evidence this renders the fact of segregation a neutral factor.

[29] The Judge and the respondent also placed reliance upon the fact that the clients owned the various reports and certificates obtained by the respondent. Again, I agree that the ownership of the documents is one *indicia* of the agency relationship. However, I accept the submission of the appellant that the relevant question is not the ultimate ownership of the documents, but rather is whether the client acquired the goods or services in issue from the third-party supplier or from the respondent. As noted above, there was no evidence before the Court about the client's relationship with third-party suppliers.

[30] Two additional factors relied upon by the Judge and the respondent are that the respondent did not charge clients additional amounts on the disbursements and that documents, such as certificates or reports provided by third-parties, were not altered by the respondent. However, as noted by the respondent, provincial law societies do not allow lawyers to add surcharges to disbursements. In that circumstance, the lack of a surcharge must be seen as a neutral factor. Similarly, documents such as birth, death and marriage certificates, accident reports or medical reports would lose their reliability and legitimacy if altered after the fact by the respondent. Again, the lack of alteration in that circumstance must be seen to be a neutral factor.

[31] Finally, the respondent makes the following additional submissions:

- i. The federal government may not tax goods and services, such as marriage and death certificates, provided by a province. By requiring the respondent to collect and remit GST on such disbursements the Minister "seeks to back door tax what it may not tax."
- ii. Where lawyers pay GST on disbursements the Minister "wants GST to be charged a second time."
- iii. Requiring each disbursement to be treated "individually and in isolation from the entire agent-principal relationship" is an effort by the Minister "to succeed with a wrong and unfair tax collection by creating an insurmountable evidentiary burden."

[32] In my view, these concerns may be answered in the following way.

[33] First, it is correct that an exempt disbursement may become taxable if it is an input to a lawyer's services. Equally, a disbursement that was subject to GST and was an input to a lawyer's services may become a zero-rated disbursement if the client is not resident in Canada. The concern that exempt disbursements may become taxable may, for example, be addressed to an extent by the existence of a written agreement appointing the lawyer as the client's agent, expressly delineating the scope of a genuine agency relationship between the lawyer and client and directing that certain disbursements be incurred and paid on the client's behalf.

[34] Second, law firms, such as the respondent, that are GST registrants are required to collect GST on supplies made to clients. At the same time, they are entitled to claim input tax credits for tax paid on goods or services they acquire for consumption, use or supply in the provision of legal services. GST registrants are only required to remit the difference between GST collected or

collectible on the supply of goods and services and the GST payable on supplies used in the provision of legal services. This means that where an input tax credit is claimed, the lawyer adds the pre-GST disbursement amount to the lawyers account before calculating any GST. It follows that disbursements are not taxed a second time as the respondent argues.

[35] Finally, as explained above, it is an error in law to conclude that because the solicitor-client relationship is generally one of agency every action taken by a lawyer is taken as the agent of the client. To establish the lawyer was not the recipient of a taxable supply at least some evidence must be led with respect to the particular transaction and the extent of the lawyer's ability to bind his or her client to the transaction. Exhibit A-11, tendered at trial by the respondent, included written advice provided to members of The Law Society of Saskatchewan by that Law Society in or about 1995 concerning the GST. The first of three "critical points" lawyers were advised to incorporate into their procedures was:

1. Have, in every instance, proof positive that a genuine agency relationship does exist. Consider having your clients sign up front a document [appointing] you as their agent and directing you to make certain disbursements on their behalf.

[36] No such documents were tendered in evidence. Such written evidence would provide an evidentiary basis for a lawyer's treatment of disbursements and in a particular case might constitute sufficient evidence to oust the otherwise normal treatment of lawyers' disbursements by the Minister as articulated in "Policy Statement P-209R entitled 'Lawyers and Disbursements'" and as discussed by the Judge.

Conclusion

[37] For these reasons, I would allow the appeal with costs. Pronouncing the judgment that should have been given by the Tax Court, I would allow in part the appeal from the Minister's assessment and refer the matter back to the Minister for reconsideration and recalculation on the basis of these reasons and the following three conclusions of the Tax Court which were not challenged on this appeal:

- (1) Merchant Law Group is not liable to pay GST on invoices issued to Legal Aid Manitoba as described in Audit Working Paper #5500 as shown in Exhibit R-2;
- (2) Merchant Law Group is entitled to receive an additional \$9,000 as input tax credits for the taxation years 2000, 2001, 2002, and January 1 to April 30, 2003 in addition to the ones already granted to the Merchant Law Group;
and
- (3) Merchant Law Group is not subject to penalties under paragraph 280(1)(a) of the Act, but interest under paragraph 280(1)(b) is payable and shall be calculated accordingly.

“Eleanor R. Dawson”

J.A.

“I agree.
Pierre Blais C.J.”

“I agree.
David Stratias J.A.”

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

DOCKET: A-443-08

STYLE OF CAUSE: Her Majesty the Queen v.
Merchant Law Group

PLACE OF HEARING: Winnipeg, Manitoba

DATE OF HEARING: June 22, 2010

REASONS FOR JUDGMENT BY: Dawson J.A.

CONCURRED IN BY: Blais C.J.
Stratas J.A.

DATED: August 5, 2010

APPEARANCES:

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