Federal Court of Appeal  Cour d'appel fédérale

Date: 20121121

Docket: A-92-12

Citation: 2012 FCA 306

CORAM: **EVANS J.A.**
SHARLOW J.A.
STRATAS J.A.

BETWEEN:

MORGUARD CORPORATION

Appellant

and

HER MAJESTY THE QUEEN

Respondent

Heard at Toronto, Ontario, on November 20, 2012.

Judgment delivered at Toronto, Ontario, on November 21, 2012.

REASONS FOR JUDGMENT BY: SHARLOW J.A.

CONCURRED IN BY: EVANS J.A.
STRATAS J.A.

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REASONS FOR JUDGMENT

SHARLOW J.A.

[1] This is an appeal of a judgment of the Tax Court of Canada in which Justice Boyle dismissed Morguard Corporation's appeal of a reassessment under the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) for the 2000 taxation year (2012 TCC 55).

[2] The facts are well and fully stated in Justice Boyle's reasons for judgment. For the purposes of this appeal, only a summary is necessary here.

[3] In 1997, Morguard adopted a business strategy of acquiring controlling interests in real estate companies. It entered into a number of transactions in pursuing that strategy. One was the acquisition in 1998 of a 19.2% interest in Acanthus Real Estate Corporation. Another was Morguard's takeover bid in June of 2000, in which it sought to acquire all of the Acanthus shares it did not already own. The bid was preceded by negotiations with the directors of Acanthus which led to a preacquisition agreement in which the directors agreed to support a Morguard bid at $8.25 per share, and to pay Morguard a break fee of $4.7 million if an unsolicited competing bid was made and the directors of Acanthus withdrew their support of the Morguard bid.

[4] A competing bid was made at $8.50 per share. The directors of Acanthus withdrew their support of the Morguard bid and paid the $4.7 million break fee. Morguard increased its bid to $9.00 per share, and the preacquisition agreement was amended to increase the break fee to $7.7 million. However, the competing bid was increased to $9.30 per share and then, following negotiations with Morguard, to $9.40 per share. Morguard declined to increase its bid further.

[5] The directors of Acanthus supported the $9.40 competing bid. At that point Acanthus became obliged to pay Morguard the additional $3 million break fee, which was paid in July of 2000. Morguard, which by then held 19.9% of the shares of Acanthus, accepted the competing bid and realized a capital gain of approximately $4.8 million on the sale of its Acanthus shares.

[6] Morguard has never sold any of its interest in real estate companies, except for its shares of Acanthus. Up to the date of the Tax Court hearing, it had never received another break fee.

[7] In filing its income tax return for the 2000 taxation year, Morguard reported its taxable capital gain on the sale of its Acanthus shares. It also reported the break fee of $7.7 million, net of bid expenses of approximately $1.8 million, as a capital gain. The reported taxable capital gain (2/3 of the gain) was approximately $4 million.

[8] In this Court, counsel for Morguard conceded, correctly in my view, that the break fee was not received as the proceeds of disposition of capital property. Therefore, for income tax purposes it is either income or a non-taxable capital receipt. I note parenthetically that the 2006 amendments to the definition of "cumulative eligible capital" in subsection 14(5) of the *Income Tax Act* may bring within its scope any amounts received on account of capital in respect of a business. However, that amendment was not in effect in 2000 when Morguard received the break fee in issue in this case.

[9] In 2005, the Minister reassessed Morguard to remove the taxable capital gain related to the $7.7 million break fee, replacing it with an income inclusion of $7.7 million less the reported bid expenses. The net increase to Morguard's income was approximately $1.9 million. Morguard appealed unsuccessfully to the Tax Court, and now appeals to this Court.

[10] Justice Boyle found as a fact that the break fee was paid pursuant to an agreement negotiated by Morguard in connection with its potential acquisition of Acanthus, that Morguard pursued the acquisition in accordance with its established business strategy and in the ordinary course of its normal business operations, and that the receipt of the break fee was a normal and expected incident

of its business activities. These factual conclusions were reasonably open to Justice Boyle on the evidence presented. Indeed, as findings of fact they were not challenged by Morguard in this appeal.

[11] Morguard's appeal is based primarily on the statements from Justice Boyle's reasons to the effect that Morguard was "essentially in the business of doing acquisitions and take-overs" (paragraph 45). Morguard argues that this statement is wrong in law because it is not consistent with *Neonex International Ltd. v. Canada* (1978), 22 N.R. 284, [1978] C.T.C. 485, 89 D.T.C. 6339 (F.C.A.). Morguard argues that *Neonex* is authority for the proposition that the acquisition of capital properties does not and cannot, as a matter of law, be a business in itself.

[12] Neonex was a corporation that carried on an electric sign and advertising business. It also, over a relatively short period of time, acquired the shares of over 60 corporations to which it provided management services and financing in the form of loans. Neonex incurred legal expenses in the course of an unsuccessful attempt to acquire a particular corporation. This Court held that the legal expenses were not deductible because they were outlays on account of capital. Morguard relies particularly on the following passage from *Neonex* dealing with this issue (at page 6346, D.T.C.) (my emphasis):

> In his Memorandum of Fact and Law counsel [for Neonex] put his case on this issue as follows:
>
> > In the course of carrying out those business activities [of acquiring target companies, Neonex] incurred expenses in respect of staff, travel and legal and accounting advice, all with a view to being able to earn income from its business and property. Throughout, as a conglomerate [Neonex] constantly entertained the necessary and incidental risk of having its pursuits fall apart either because the target companies which it investigated were unsuitable for its purposes, unavailable on terms

> acceptable to vendor and purchaser, or unavailable because [Neonex] and others involved in the transactions were unable, for whatever reason to perform and carry out the arrangements agreed upon. A necessary and incidental risk, although an infrequent reality was the possibility of being engaged in legal disputes about rights and obligations assumed or acquired in the course of its business. Expenses incurred in those circumstances were necessary and incidental to the conduct of [Neonex]'s business and are deductible in computing income […].
>
> A similar argument was made before the learned Trial Judge who found it difficult to accept that the buying of shares with a view to retaining them can itself be said to be a business. Rather, he held, [Neonex] was in the business of making and selling signs and, as well, in the business of supplying management expertise, services and funds to the companies, the control of which it had acquired by the purchase of shares. The acquisition of the shares was, in his view, not in itself a business but was, in each case, an investment made with a view to earning income, a fact that, as will be seen from the above quotation from [Neonex]'s Memorandum of Fact and Law, was admitted by [Neonex].
>
> I wholly agree with this finding. I also agree with the Trial Judge that the legal expenses at issue herein -- those incurred in an effort to complete the takeover and those incurred in seeking compensation in lieu of shares -- were outlays associated with an investment transaction and thus were made on capital account.

[13] As I read *Neonex*, this Court accepted the finding of the trial judge that Neonex was not carrying on a business consisting of the acquisition of income producing assets. I do not understand the Court to be establishing a rule of law that the acquisition of income producing assets can never be a business in itself.

[14] Morguard also relies on *Firestone v. Canada*, [1987] 3 F.C. 200 (F.C.A.). In that case, this Court held that the costs incurred by Mr. Firestone in investigating 50 business opportunities with a view to acquiring medium sized manufacturing companies in financial difficulty and turning them to profitable account were not deductible. Most of the companies investigated were not acquired.

The facts were found to be indistinguishable from the facts in *Neonex*, and accordingly the investigation expenses were held not to be deductible because they were outlays on account of capital. I do not read *Firestone* as authority for a legal principle to the effect that the acquisition of income producing assets can never be a business in itself.

[15] The conclusion that Morguard received the break fee on income account is consistent with the principles stated by the Supreme Court of Canada in *Ikea Ltd. v. Canada*, [1998] 1 S.C.R. 196, which is the main case upon which Justice Boyle relied. I agree with Justice Boyle that it is now the leading case on the characterization of extraordinary or unusual receipts in the business context (see his reasons, at paragraph 40).

[16] Morguard argues that Justice Boyle misapplied the principles in *Ikea*, because the result in *Ikea* was based on a factual conclusion that the payment in issue was a reimbursement of rent (an expense on income account), and in this case there is no analogous finding. I do not read *Ikea* as being based solely the conclusion that, in commercial terms, the receipt of a tenant inducement payment may be associated with a higher rent. The test actually applied in *Ikea* involved consideration of a number of factors, including the commercial purpose of the payment and its relationship to the business operations of the recipient.

[17] The issue in *Ikea* was whether a tenant inducement payment received in respect of a long term lease of store premises was on income or capital account. It was held to be an income receipt because, on the facts as found by the trial judge, it was received as part of the ordinary business

operations of Ikea and was inextricably linked to such operations, even though it was received as a result of negotiations for a long term lease which would be a capital property.

[18] I see no error of law in Justice Boyle's understanding or application of *Ikea*. Specifically, he made no error in applying the linkage test set out in *Ikea*. Given the facts as he found them, it was open to him to conclude that Morguard received the break fee on income account.

[19] For these reasons, I would dismiss the appeal with costs.

"K. Sharlow"
J.A.

"I agree
John M. Evans J.A."

"I agree
David Stratas"

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

DOCKET:	A-92-12
(APPEAL FROM THE JUDGMENT OF JUSTICE BOYLE OF THE TAX COURT OF CANADA DATED FEBRUARY 24, 2012)	
STYLE OF CAUSE:	MORGUARD CORPORATION v. HER MAJESTY THE QUEEN
PLACE OF HEARING:	TORONTO, ONTARIO
DATE OF HEARING:	NOVEMBER 20, 2012
REASONS FOR JUDGMENT BY:	SHARLOW J.A.
CONCURRED IN BY:	EVANS J.A. STRATAS J.A.
DATED:	NOVEMBER 21, 2012

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