Federal Court of Appeal  Cour d'appel fédérale

Date: 20130705

Docket: A-428-11

Citation: 2013 FCA 176

CORAM: **PELLETIER J.A.**
TRUDEL J.A.
MAINVILLE J.A.

BETWEEN:

INDUSTRIES PERRON INC.

Appellant

and

HER MAJESTY THE QUEEN

Respondent

Heard at Montréal, Quebec, on December 13, 2012.

Judgment delivered at Ottawa, Ontario, on July 5, 2013.

REASONS FOR JUDGMENT BY: PELLETIER J.A.

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

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REASONS FOR JUDGMENT

PELLETIER J.A.

INTRODUCTION

[1] This is an appeal from the decision of the Tax Court of Canada reported as *Industries Perron Inc. v. Canada*, 2011 TCC 433, 2011 T.C.J. No. 367. As a result of certain preliminary determinations made by American trade authorities, the appellant, Industries Perron Inc. (Perron) was required to post security to cover its potential liability for countervailing and anti-dumping duties with respect to goods which it exported to the United States. The arrangement by which

Perron posted security involved its bank, the Royal Bank of Canada (the Royal Bank or the Bank) and an insurance company, the Washington International Insurance Company (the Insurance Company). Under that arrangement, Perron deposited funds with the Royal Bank in term deposits which were then hypothecated in favour of the Bank as security for obligations undertaken by the Bank in favour of the Insurance Company. The issue in this appeal is the deductibility of the amount of these term deposits.

FACTS

[2] Perron is a softwood lumber producer who exports softwood lumber to the United States.

[3] In March 2001, the Canada-U.S. Softwood Lumber Agreement expired. Days later, the American softwood lumber industry filed a petition with the U.S. Department of Commerce (DOC) seeking the imposition of countervailing and anti-dumping duties. In the United States, the responsibility for assessing allegations of unfair subsidies and dumping is divided between the DOC and the International Trade Commission (the ITC).

[4] On May 23, 2001, the ITC made a preliminary determination that there were reasonable grounds to believe that imports of Canadian softwood lumber constituted a threat of serious injury to the U.S. softwood lumber industry. On August 17, 2001, the DOC made a preliminary determination that Canadian softwood lumber exports to the United States were unfairly subsidized and fixed the "estimated subsidy rate" at 19.31%. As a result, the U.S. customs authorities ordered "[t]he posting of a cash deposit, bond, or other security, as the administering authority deems

appropriate, for each entry of the subject merchandise …": *United States Code*, Title 19, article 1671b(*d*)(1)(B).

[5] On November 6, 2001, the DOC made a preliminary determination that there were reasonable grounds to believe that certain softwood lumber products were being dumped into the U.S. market. The DOC determined that the "estimated weighted average dumping margin" was 12.58%. As a result, the U.S. authorities ordered "[t]he posting of a cash deposit, bond, or other security, as the administering authority deems appropriate, for each entry of the subject merchandise…": *United States Code*, Title 19, article 1673b(*d*)(1)(B).

[6] These preliminary determinations were subject to a final determination which was to be made on a broader evidentiary basis than the preliminary determinations. In the meantime, however, Canadian exporters had to comply with the requirement that they post a cash deposit or other security with respect to each entry of their goods into the American market. In other words, in order to continue doing business in the United States, Canadian exporters had to put up a cash deposit or other security in an amount sufficient to cover their potential liability should the preliminary determinations be confirmed.

[7] Perron chose to post security but, rather than simply paying a bonding company a fee for a bond or guarantee in the appropriate amount, it entered into a more complicated arrangement. The Insurance Company agreed to guarantee a Perron's potential liability to a maximum of US $1,530,000 (CAN $2,371,500) to allow it (Perron) to continue to do business in the United States. In

these reasons, I will use the words "bond" and "guarantee" interchangeably to refer to the obligation undertaken by the Insurance Company on behalf of Perron.

[8] One of the conditions of the bond was that the full amount of the bond be secured by irrevocable letters of credit in favour of the Insurance Company. The Royal Bank issued the letters of credit but it, in turn, required Perron to purchase term deposits for the full amount of the letters of credit and to hypothecate them to the Bank as security for the letters of credit. Pursuant to these arrangements, Perron deposited $2,371,500, in term deposits with the Royal Bank and hypothecated the term deposits in favour of the Bank. The result was that the amount of $2,371,500 stood to Perron's credit on the Royal Bank's books but Perron was unable to access those funds in any way so long as the Bank remained liable to pay on the irrevocable letters of credit.

[9] Following the preliminary determinations referred to above, the U.S. Government continued its examination of the status of the Canadian softwood lumber industry to see if it was unfairly subsidized and whether it was dumping softwood lumber into the American market to the detriment of American producers. The U.S. Government confirmed the preliminary determinations by orders dated April 2, and May 22, 2002. However, it also decided that no countervailing duties or anti-dumping duties were payable for entries prior to May 22, 2002 and ordered the release of cash deposits or bonds guaranteeing the payment of duties for entries prior to that date. As a result, the Insurance Company was released from any further obligation, the letters of credit were allowed to expire and the hypothecation of the term deposits was discharged.

[10] In filing its income tax return for its fiscal year ending December 31, 2001, Perron deducted from its income the sum of $3,576,088. In its income tax return for the 2002 taxation year, Perron recognized as income the same $3,576,088 which it had deducted in the previous year, given that the hypothecation agreement with respect to its terms deposits was discharged.

[11] The amount which Perron deducted from its income for the 2001 taxation year, and included in its income in the subsequent year, includes the $2,371,500 invested in term deposits hypothecated to the Royal Bank as well as a further $1,204,588 which, according to the Perron's Memorandum of Fact and Law represents the amount of security which would have been required on Perron's exports to the United States from May 2001 to August 2001, had such security been required. No security was required with respect to that period and no amounts were paid by Perron with respect to that period, though it may have been restricted in its ability to dispose of goods which entered the U.S. during that period: see Appellant's Memorandum of Fact and Law, paragraph 3 (note 1) and paragraph 17. Perron made no argument with respect to this amount and so, while it may not have abandoned the argument, it did not pursue it. As a result, I am of the view that the only amount in issue in this appeal is the amount of the term deposits hypothecated to the Royal Bank.

[12] On February 3, 2005, the Canada Revenue Agency disallowed the deduction of $3,576,088 from Perron's income for the 2001 taxation year. Perron filed a notice of objection to the reassessment. When the reassessment was confirmed, Perron launched this appeal.

THE DECISION UNDER APPEAL

[13] After setting out the Agreed Statement of Facts which the parties had put before him, Mr. Justice Angers (the Tax Court Judge, or simply the Judge) identified the issue as whether the $2,371,500 was "an outlay or expense made or incurred for the purpose of gaining or producing income from business", as provided in paragraph 18(1)(*a*) of the *Income Tax Act*, R.S.C. 1985 c. (5th Supp.)(the Act). Specifically, the Tax Court Judge asked himself whether the amount in issue was non-deductible because it was paid in connection with a reserve, a contingent liability or a sinking fund, contrary to paragraph 18(1)(*e*) or whether the deduction was permitted pursuant to paragraph 20(1)(*vv*) of the Act as an amount paid in respect of an existing or proposed countervailing or anti-dumping duty.

[14] For ease of reference, these statutory provisions are set out below:

18. (1) In computing the income of a taxpayer from a business or property no deduction shall be made in respect of	**18.** (1) Dans le calcul du revenu du contribuable tiré d'une entreprise ou d'un bien, les éléments suivants ne sont pas déductibles :
(*a*) an outlay or expense except to the extent that it was made or incurred by the taxpayer for the purpose of gaining or producing income from the business or property;	*a*) les dépenses, sauf dans la mesure où elles ont été engagées ou effectuées par le contribuable en vue de tirer un revenu de l'entreprise ou du bien;
(*e*) an amount as, or on account of, a reserve, a contingent liability or amount or a sinking fund except as expressly permitted by this Part;	*e*) un montant au titre d'une provision, d'une éventualité ou d'un fonds d'amortissement, sauf ce qui est expressément permis par la présente partie;
20. (1) Notwithstanding paragraphs 18(1)(*a*), 18(1)(*b*) and 18(1)(*h*), in computing a taxpayer's income for a taxation year from a business or property, there may be deducted such of the following amounts as are wholly applicable to that source or	**20.** (1) Malgré les alinéas 18(1)*a*), *b*) et *h*), sont déductibles dans le calcul du revenu tiré par un contribuable d'une entreprise ou d'un bien pour une année d'imposition celles des sommes suivantes qui se rapportent entièrement à cette source de revenus ou la partie des sommes suivantes qu'il est

such part of the following amounts as may reasonably be regarded as applicable thereto	raisonnable de considérer comme s'y rapportant :
…	…
…(*vv*) an amount paid in the year by the taxpayer as or on account of an existing or proposed countervailing or anti-dumping duty in respect of property (other than depreciable property); and	*vv*) un montant payé par le contribuable au cours de l'année au titre d'un droit compensateur ou antidumping en vigueur ou proposé sur des biens (sauf des biens amortissables);

[15] The Tax Court Judge found that the first question before him was whether Perron was bound to make a payment in the 2001 taxation year. He rejected Perron's submission that the amount of the term deposits was a deductible expense, given that the term deposits were shown on Perron's financial statements as an asset, albeit subject to the contingency that they could be used to reimburse the Bank, should it be required to honour the irrevocable letters of credit in favour of the Insurance Company.

[16] The Tax Court Judge also found that there was no obligation to pay countervailing and anti-dumping duties until a final determination had been made by the competent U.S. authorities that such duties were payable. Since no such determination was made in 2001, Perron had no obligation to pay countervailing duties or anti-dumping duties. Perron was simply faced with an estimate of its potential liability for those duties and an obligation to post security in respect of that potential liability.

[17] In substance, the Tax Court Judge found that even though Perron had paid the face amount of the term deposits to the Royal Bank, the deposits remained in Perron's name and were merely hypothecated to the Bank. This did not amount to a change in the title to the term deposits. In effect,

the Tax Court Judge found that there had been no alienation or divesting of Perron's interest in the funds sufficient to constitute an expense or an outlay.

[18] The Tax Court Judge then turned his attention to the argument that the $2,371,500 payment was deductible pursuant to paragraph 20(1)(*vv*) as an amount paid in respect of "existing or proposed" duties. Perron argued that $2,371,500 was in fact paid to the Royal Bank and that the payment was in respect of proposed duties.

[19] The Tax Court Judge rejected the paragraph 20(1)(*vv*) argument on the basis that Perron did not pay any amount in respect of countervailing or anti-dumping duties. Perron chose to post security for any amounts for which it might become liable. Its only liability was to the Bank, initially to deposit funds to secure the Bank's exposure under the irrevocable letters of credit, and contingently, to reimburse the Bank from the security deposits for any amounts which the Bank was required to pay under those letters of credit. The Tax Court Judge found that any payments made by Perron were not made in respect of countervailing or anti-dumping duties.

[20] As a result, the Tax Court Judge dismissed the appeal.

STATEMENT OF ISSUES

[21] In this Court, Perron makes many of the same arguments which it made before the Tax Court Judge. It says that the Tax Court Judge erred in failing to recognize that Perron was under an obligation to make payment to a third party and that the obligation did not constitute a contingent

liability. In addition, Perron argues that the amounts were deductible under paragraph 20(1)(*vv*) since they were paid pursuant to an obligation to pay proposed countervailing or anti-dumping duties.

ANALYSIS

[22] This is an appeal of the decision of a trial court made after a trial. As such, the standard of review is that set out in *Housen v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235 (*Housen*). Findings of fact are reviewable on a standard of palpable and overriding error: *Housen*, at paragraph 10. Questions of law are reviewable on a standard of correctness: *Housen*, at paragraph 8. Questions of mixed fact and law are reviewable on the standard of palpable and overriding error, unless one can identify an extricable question of law; if so, that question is reviewed on a standard of correctness: *Housen*, at paragraph 36.

[23] I agree with Perron that it had a present obligation with respect to each shipment of softwood lumber it exported to the United States after the effective date of the preliminary determinations by the DOC and the ITC. If Perron was to continue to export softwood lumber to the United States, it could only do so by satisfying the obligation imposed on it by articles 1671b(*d*)(1)(B) and 1673b(*d*)(1)(B) of Title 19 of the United States Code, specifically by either making a cash deposit or by arranging for a bond or other security. To that extent, the obligation to provide a cash deposit or security was a present obligation, but this fact is not determinative of the deductibility of the amounts used to satisfy that obligation. I agree with the respondent that Perron did not have an obligation to pay countervailing or anti-dumping duties in 2001.

[24] Perron did not make a cash deposit. Perron chose to satisfy the obligation imposed on it by U.S. law by posting security. Any premium or fee charged by the Insurance Company would presumably be deductible from income as an expense or outlay made or incurred for the purpose of gaining income from its business. But, on the record before us, Perron did not pay a fee or premium to the Insurance Company. Instead, it entered into a complex arrangement which required it to deposit funds with the Royal Bank in an amount equal to the Bank's liability under the irrevocable letters of credit it issued in favour of the Insurance Company.

[25] Perron argues its obligation to purchase term deposits and to hypothecate them to the Bank gives rise to a deductible expense.

[26] This case is comparable to *Canada v. Nomad Sand and Gravel Ltd*, [1991] 2 F.C. 172 (C.A.), [1990] F.C.J. No. 1105 (Q.L.) (*Nomad*). The issue in *Nomad* was whether an outlay which was deductible from income for accounting purposes was, by that fact, deductible from income for tax purposes. The outlay was an amount levied on each ton of material removed from a pit or quarry which amount was returned to the operator if the pit or quarry was properly rehabilitated at the end of its useful life. If it was not, the levies paid were forfeited to the Crown, to be used for rehabilitation purposes. The expert evidence before the Tax Review Board was that, in accounting terms, these amounts were properly deductible from income in the year in which they were paid. The Minister took the position that, as a matter of law, these amounts were not deductible as they were caught by paragraph 18(1)(*e*) as an amount paid on account of a reserve or a contingent liability.

[27] This Court decided that the correct treatment of these amounts for income tax purposes was a question of law to be decided "having regard to the facts of the particular case": see *Nomad*, at page 139. After reviewing the facts, Urie J.A., writing for the Court, found that while the payments were required to be made for the purpose of earning income, they were not deductible:

> …while the annual payments made pursuant thereto have to be made in order to earn income, in that to obtain and maintain the licence issued under that Act (subsection 4(1)) to operate the pit and thereby to earn that income the payments had to be made, they do not have the characteristic of deductible expenses for tax purposes, in that they are not made once and for all, without recourse. [Emphasis in the original.]
>
> *Nomad*, at page 180

[28] The notion that a deductible expense is one made "once and for all without recourse" suggests that a deductible expense is one where the payor retains no interest in the amount paid. Urie J.A.'s analysis led him to conclude that this was not the case with the levies in question::

> There is no doubt in my mind that the foregoing analysis demonstrates that the annual payments are made as deposits to secure the rehabilitation of the site. That they may be insufficient to achieve that purpose does not change their character to that of an expense incurred for the purpose of gaining or producing income. *The deposits do not become the absolute property of the province until they are forfeited as a result of the operation of the Act, for the purpose of paying, or to assist in paying, the Respondent's obligations under the Act to rehabilitate*. If they are not forfeited they will be returned to the taxpayer together with simple interest calculated at 6% per annum. *That is the substance of their character as well as their form, and clearly differentiates them from business expenses deductible under paragraph 18(1) (a)*. [My emphasis.]
>
> *Nomad*, at pages 181-182

[29] In this case, it is clear that the amounts deposited in term deposits with the Royal Bank remained to Perron's credit. Perron's financial statements showed them as an asset, though subject to a contingent liability: see Appeal Book, pages 70 and 74. Perron was a creditor of the Bank to the extent of the principal amount of the term deposit together with any accrued interest. As a result,

these amounts were not deductible pursuant to paragraph 18(1)(*a*) since they were not made "once and for all, without recourse", as Perron retained an interest in the funds.

[30] Furthermore, the amounts paid to the Royal Bank were in the nature of a reserve, or a fund set up to cover a contingent liability, as was the case in *Nomad*. Perron had no liability for countervailing or anti-dumping duties until such time as a final determination was made. Until that time, Perron simply had an obligation to ensure that it was in a position to pay the duty owing in the event of an adverse final determination. If no adverse determination was made, the funds would be returned to Perron. On the facts, that is exactly what happened. I am therefore of the view that the amounts paid to the Royal Bank were not deductible because they were in respect of a contingent liability, as provided in paragraph 18(1)(*e*) of the Act.

[31] Perron's second argument seeks to avoid the issue of whether the deposit of funds with the Royal Bank was "an expense or an outlay" by focusing on the words "an amount paid" and "as or on account of countervailing or anti-dumping duties" as provided in paragraph 20(1)(*vv*) of the Act. Perron's argument is one of economic substance. It says that it is in exactly the same position financially as a result of acquiring the term deposits as it would have been had it satisfied its obligations to the U.S. authorities by making a cash deposit.

[32] Perron says that if it had deposited the same funds with the U.S. Government, as it was entitled to do, paragraph 20(1)(*vv*) would have allowed it to deduct the amount paid from its income in the year of payment. Paragraph 12(1)(*z.6*) would have required it to include in income any

amounts returned to it by the U.S. Government as a result of the ruling that no countervailing or anti-dumping duties were payable prior to May 22, 2002.

[33] Perron argues that the deposit of funds with the Royal Bank so as to secure the payment of existing or proposed countervailing or anti-dumping duties should be treated the same as would a cash deposit. The two transactions are undertaken to satisfy the same legal obligation (existing or proposed duties) and they do it in the same way, that is by making the funds available to satisfy Perron's ultimate liability for countervailing and anti-dumping duties. Paragraph 20(1)(*vv*) does not specify the person or entity to whom the payment must be made so that the fact that the payment was made to the Royal Bank is not determinative, as long as the payment was made "as or on account of countervailing or anti-dumping duties."

[34] The parties are agreed that paragraph 12(1)(*z.6*) of the Act was enacted to deal with the problem described in *Nomad*, namely that funds paid as a deposit against an eventual liability are not deductible from income as an expense or outlay. In the case of duties, it frequently takes many months before a final determination is made, which imposes a hardship on exporter firms as their funds are tied up for a period of time and are unavailable to discharge other obligations. The deductibility of these amounts pursuant to paragraph 12(1)(*z.6*) provides exporter firms with financial relief during this process.

[35] Does it follow from this that any payment made by a taxpayer will come within paragraph 12(1)(*z.6*) so long as the ultimate goal is to provide security against an eventual liability to pay countervailing and anti-dumping duties? In my view, it does not.

[36] In tax law, form matters. In *Shell Canada Ltd. v. Canada*, [1999] 3 S.C.R. 622, [1999] S.C.J. No. 30 (*Shell*), the Supreme Court of Canada held that the courts are not to re-characterize a taxpayer's transaction unless the label attached by the taxpayer to the transaction does not properly reflect its actual legal effect:

> To the contrary, we have held that, absent a specific provision of the Act to the contrary or a finding that they are a sham, the taxpayer's legal relationships must be respected in tax cases. Recharacterization is only permissible if the label attached by the taxpayer to the particular transaction does not properly reflect its actual legal effect: *Continental Bank Leasing Corp. v. Canada*, [1998] 2 S.C.R. 298, at para. 21, *per* Bastarache J.
>
> *Shell*, cited above, at paragraph 39

[37] The corollary of this proposition is that the taxpayer will be held to the form of transaction which it has chosen so long as that form is consistent with the actual legal effect of the transaction.

[38] In this case, Perron satisfied its obligation with respect to existing or proposed duties by arranging for the Insurance Company to guarantee its potential liability for those duties. Having done so, Perron had satisfied its obligations under U.S. law. The Insurance Company's requirements for assuming this obligation on Perron's behalf are a matter between it and Perron. The fact that Perron looked to its bank for assistance in meeting the Insurance Company's requirements is a matter between Perron and the Bank. Having chosen to satisfy its obligations to the U.S. authorities in a particular way, Perron is not well placed to argue that it should be treated as though it had satisfied those obligations in a different way.

[39] In order to come within paragraph 20(1)(*vv*) of the Act, Perron must have paid an amount as or on account of existing or proposed duties. This argument turns on the nature of the transaction by which Perron placed $2,371,500 in the Bank's hands to be held in a term deposit account which

bore interest at a rate which varied between 1.35% and 2.05%. Perron qualifies this as an amount paid to the Bank. It can equally be qualified as a deposit of funds with the Bank by which Perron became a creditor of the Bank to the extent of the sum deposited plus accrued interest. The fact that this transaction was part of a series of transactions does not change its character. Consequently, even if the placement of funds with the Bank is treated as having been paid to the Bank, it was not paid on account of duties, existing or proposed.

[40] In the Tax Court of Canada, Perron made an argument based on the definition of "payment" in article 1553 *Civil Code of Québec* which provides that "payment means not only the turning over of a sum of money in satisfaction of an obligation, but also the actual performance of whatever forms the object of the obligation." I am unable to see how this argument assists Perron. It's obligation under U.S. law was to post a cash deposit or to post security for its potential liability for countervailing and anti-dumping duties. It satisfied that obligation by posting security. According to article 1553 of the *Civil Code of Québec*, the posting of security constituted payment of the obligation created under American law. I am unable to accept that all of the steps which preceded or accompanied the posting of security also constituted payment.

[41] As a result, I would dismiss the appeal with costs.

"J.D. Denis Pelletier"

J.A.

"I agree.
Johanne Trudel J.A."

"I agree.
Robert M. Mainville J.A."

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

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