Docket: 2004-4248(IT)G

BETWEEN:

C.R.I. ENVIRONNEMENT INC.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

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Appeals heard on October 17, 2006, at Montréal, Quebec

Before: The Honourable Justice Paul Bédard

Appearances:

Counsel for the Appellant: Bertrand Leduc

Counsel for the Respondent: Jean Lavigne

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**JUDGMENT**

The appeals from the assessments made under the *Income Tax Act* for the 1998, 1999 and 2000 taxation years are dismissed, with costs, in accordance with the attached Reasons for Judgment.

Signed at Ottawa, Canada, this 1st day of May 2007.

"Paul Bédard"

Bédard J.

Translation certified true
on this 20th day of February 2008.

François Brunet, Revisor

Citation: 2007TCC206
Date: 20070501
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BETWEEN:

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Appellant,

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## REASONS FOR JUDGMENT

Bédard J.

[1] These are appeals pursuant to the General Procedure from reassessments made in respect of the Appellant for its taxation years ending on March 31, 1998, January 31, 1999, and March 31, 2000 (the "years concerned"). In making the reassessments, the Minister of National Revenue (the "Minister") disallowed the Appellant's claim to a Canadian manufacturing and processing profits deduction (the "deduction") under section 125.1 of the *Income Tax Act* (the "Act") for each of the years concerned.

[2] The only issue in this appeal is the following: Were the goods manufactured or processed by the Appellant for sale as prescribed under subsection 125.1(3) of the Act?

Facts

[3] The Appellant is in the business of managing residual hazardous materials ("industrial waste"). Its processing centre (the "Centre") has a highly qualified staff and modern equipment, allowing it to store and consolidate industrial waste. The Appellant holds all the government permits and authorizations required to collect any type of industrial waste, except for materials contaminated with explosive, radioactive or pathogenic substances.

[4] The Centre accepts liquid, semi-liquid and solid industrial waste, as well as contaminated water and hazardous domestic waste.

[5] The Appellant's main activity consists in storing this industrial waste, sorting and consolidating it in a highly selectively manner and finally reshipping the processed waste to authorized destinations in Canada and the United States.

[6] Whenever a producer of industrial waste sends in a shipment, the Appellant takes possession of the industrial waste and undertakes the following activities:

> (i) a representative of the Appellant collects a sample of the industrial waste or obtains a data sheet from the producer for submission to the Appellant's laboratory;
>
> (ii) samples of the industrial waste are characterized and analyzed at the Appellant's laboratory;
>
> (iii) the Appellant issues a waste code and then makes a quotation to the waste producer;
>
> (iv) the industrial waste is transported to the Appellant's centre to be checked;
>
> (v) on arrival, the Appellant takes samples of the industrial waste and analyzes them to ensure they conform to the sample supplied;
>
> (vi) the industrial waste is accepted, given a different code or refused, as the case may be;
>
> (vii) the industrial waste is then weighed and unloaded by the Appellant;
>
> (viii) the Appellant fills out a receiving report for the industrial waste;
>
> (ix) the industrial waste is then removed from its containers, sorted and processed to treat and/or stabilize it to meet the acceptance criteria of the various destinations to which it will be shipped for disposal by incineration or burial;

(x) industrial waste which may be optimized is sent to a destination where it will be reclaimed, in certain cases as a supplemental fuel or otherwise;

(xi) once the containers are emptied, they are consolidated and sorted according to their physical and chemical characteristics and the acceptance criteria of the recycling centres where they are reclaimed, if they are made of metal, for use in the manufacture of steel or aluminum.

[7] The Appellant collects a cash payment from the producers of industrial waste in order to process and eliminate the waste.

[8] Once it has processed the industrial waste, the Appellant pays to have it shipped to authorized destinations in Canada and the United States.

[9] The Appellant hires transportation companies to carry the waste to its final destination.

[10] Sales of cardboard and metal obtained from the empty containers processed by the Appellant do not exceed 5% of its total sales.

[11] The relevant provisions of the Act for the years concerned read as follows:

**125.1. Manufacturing and processing profits deductions**

(1) There may be deducted from the tax otherwise payable under this Part by a corporation for a taxation year an amount equal to 7% of the lesser of

(*a*) the amount, if any, by which the corporation's Canadian manufacturing and processing profits for the year exceed, where the corporation was a Canadian-controlled private corporation throughout the year, the least of the amounts determined under paragraphs 125(1)(*a*) to 125(1)(*c*) in respect of the corporation for the year, and

(*b*) the amount, if any, by which the corporation's taxable income for the year exceeds the total of

(i) where the corporation was a Canadian-controlled private corporation throughout the year, the least of the amounts determined under paragraphs 125(1)(*a*) to 125(1)(*c*) in respect of the corporation for the year,

(ii) 10/4 of the total of the amounts that would be deductible under subsection 126(2) from the tax for the year otherwise payable under this Part by the

> corporation if those amounts were determined without reference to section 123.4, and
>
> (iii) where the corporation was a Canadian-controlled private corporation throughout the year, its aggregate investment income for the year (within the meaning assigned by subsection 129(4).

[12] Reference should also be made to the following definitions to determine which activities are included in the notion of "manufacturing and processing" for the years concerned. These definitions are found in subsection 125.1(3) of the Act:

> **"Canadian manufacturing and processing profits"**
>
> of a corporation for a taxation year means such portion of the total of all amounts each of which is the income of the corporation for the year from an active business carried on in Canada as is determined under rules prescribed for that purpose by regulation made on the recommendation of the Minister of Finance to be applicable to the manufacturing or processing in Canada of goods for sale or lease;
>
> "**manufacturing or processing" does not include:**
>
> (*l*) any manufacturing or processing of goods for sale or lease, if, for any taxation year of a corporation in respect of which the expression is being applied, less than 10% of its gross revenue from all active businesses carried on in Canada was from
>
> (i) the selling or leasing of goods manufactured or processed in Canada by it, and
>
> (ii) the manufacturing or processing in Canada of goods for sale or lease, other than goods for sale or lease by it.

[13] This provision refers to the *Income Tax Regulations* (the "Regulations"). Section 5202 of the Regulations is the only regulation relevant to this case. This regulation concerns which activities qualify or do not qualify for the deduction. It reads as follows:

> (*a*) any of the following activities, when they are performed in Canada in connection with manufacturing or processing (not including the activities listed in subparagraphs 125.1(3)(*b*)(i) to (ix) of the Act) in Canada of goods for sale or lease:
>
> (i) engineering design of products and production facilities,

(ii) receiving and storing of raw materials,

(iii) producing, assembling and handling of goods in process,

(iv) inspecting and packaging of finished goods,

(v) line supervision,

(vi) production support activities including security, cleaning, heating and factory maintenance,

(vii) quality and production control,

(viii) repair of production facilities, and

(ix) pollution control,

(*b*) all other activities that are performed in Canada directly in connection with manufacturing or processing (not including the activities listed in subparagraphs 125.1(3)(b)(i) to (ix) of the Act) in Canada of goods for sale or lease, and

(*c*) scientific research and experimental development, as defined in section 2900, carried on in Canada,

but does not include any of

(*d*) storing, shipping, selling and leasing of finished goods,

(*e*) purchasing of raw materials,

(*f*) administration, including clerical and personnel activities,

(*g*) purchase and resale operations,

(*h*) data processing, and

(*i*) providing facilities for employees, including cafeterias, clinics and recreational facilities;

[14] These statutory provisions provide that the Appellant must abide by the following conditions to have the benefit of the deduction:

(i) it must actively operate an enterprise in Canada;

(ii) it must manufacture or process goods;

(iii) the goods must be manufactured or processed for sale or lease; and

(iv) at least 10% of its gross yearly income must come from the manufacture or processing of goods for sale or lease.

[15] The analysis will essentially address the last two conditions, especially the third one, because the Minister admitted that the first two have been met.

[16] The relevant provisions of the *Civil Code of Québec* (the "C.C.Q.") for the purposes of this case are articles 1708 and 2098. Article 1708 defines the contract of sale as follows:

> 1708. Sale is a contract by which a person, the seller, transfers ownership of property to another person, the buyer, for a price in money which the latter obligates himself to pay.
>
> A dismemberment of the right of ownership, or any other right held by the person, may also be transferred by sale.

[17] Article 2098 of the C.C.Q. defines the "contract for services" as follows:

> A contract of enterprise or for services is a contract by which a person, the contractor or the provider of services, as the case may be, undertakes to carry out physical or intellectual work for another person, the client or to provide a service, for a price which the client binds himself to pay.

Appellant's submissions

[18] The Appellant submits as follows:

(i) Its activities consisted in acquiring hazardous waste materials, which were products having a negative value, to process them to reduce the negative value and then sell the materials at a lesser negative price so as to make a profit.

(ii) The contracts concluded with its suppliers and third-person purchasers were not contracts for services. Indeed, the Appellant submits that it did not

process a supplier's hazardous materials only to then return them so that the supplier could dispose of them afterward. According to the Appellant, the supplier of hazardous materials was totally unaware of the type of processing it did to this hazardous waste and did not in any way request that the Appellant process this waste. The Appellant submits that the only requirement of the supplier was that it assume ownership of the supplier's industrial waste so it would be free of any environmental liability related to the ownership of this industrial waste. Likewise, the Appellant submits that it did not require any services from the third-party purchaser, except that it become owner of the industrial waste so that the Appellant in turn would be free of any environmental liability related to the ownership of this waste.

(iii) The contract by which the supplier transferred ownership of the hazardous waste to the Appellant could only be a contract of sale, since it could not be described as a contract for services. Likewise, it submits that the contract by which it transferred ownership of the processed industrial waste to third parties could only be a contract of sale, since it could not be qualified as a contract of service.

(iv) The only objective in processing the hazardous waste was to reduce its negative value so it could be re-sold to third parties for profit. The Appellant notes that all it had to do to make a profit was sell the waste at a negative price that was less than the processing costs and (negative) acquisition costs.

(v) For these reasons, the transfer of ownership of the processed hazardous waste to third parties was merely a sale, although the price was negative.

Analysis and conclusion

[19] Since it is admitted that the Appellant was engaged in the Canadian manufacturing or processing of goods, the only issue in this case is whether the Appellant processed or manufactured industrial waste for the purposes of sale. In other words, was the industrial waste processed by the Appellant transferred to third persons by contracts of sale?

[20] In *Will-Kare Paving & Contracting Ltd. v. Canada*, 2000 SCC 36, the Supreme Court of Canada had an opportunity to consider the meaning and scope of "sale" in the phrase "to be used directly or indirectly by him in Canada primarily for the purpose of manufacturing or processing goods for sale or lease" in the context of applying the deduction for an accelerated capital cost allowance for Class 39 goods. Although this is not exactly the case here, I am of the opinion that the pronouncements of the Supreme Court of Canada in this judgment are helpful for resolving the present case. Writing for the majority, Major J. acknowledged the various trends in the case law at that time and made the following observations with regard to this expression:

> Manufacturing or Processing Goods for Sale
>
> **19** Canadian jurisprudence to this point has adopted two divergent interpretations of the activities that constitute manufacturing and processing goods for sale. Without canvassing these authorities exhaustively, it may be helpful to outline briefly those cases which delineate these two distinct approaches.
>
> **20** One point of view is expressed in *Crown Tire Service Ltd. v. The Queen*, [1984] 2 F.C. 219 (T.D.), where the court imports common law and provincial sale of goods law distinctions in defining the scope of the manufacturing and processing incentives' application. Only capital property used to manufacture or process goods to be furnished through contracts purely for the sale of such goods qualifies. Property used to manufacture or process goods to be supplied in connection with the provision of a service, namely through a contract for work and materials, is not viewed as being used directly or indirectly in Canada primarily in the manufacturing or processing of goods for sale, and as such, does not qualify for either the accelerated capital cost allowance or the investment tax credit.
>
> . . .
>
> **22** A second line of authority departs from the point of view in *Crown Tire* and declines to apply statutory and common law sale of goods rules in delineating that capital property to which the manufacturing and processing incentives apply. Rather, these cases advocate a literal construction of "sale" such that the provision of a service incidental to the supply of a manufactured or processed good does not preclude receiving the benefit of the incentives. Any transfer of property for consideration would suffice. See *Halliburton Services Ltd. v. The Queen*, 85 D.T.C. 5336 (F.C.T.D.), aff'd 90 D.T.C. 6320 (F.C.A.), and *The Queen v. Nowsco Well Service Ltd.*, 90 D.T.C. 6312 (F.C.A.).

**23** *Halliburton* and *Nowsco* considered the form of contract entered into between the taxpayer and customer to be irrelevant. In both cases the Federal Court of Appeal quoted with approval language from Reed J.'s decision in *Halliburton* at the Trial Division that appears to suggest an alternative test based upon the source of the taxpayer's profit. As stated by Reed J., at p. 5338:

> . . . I do not find any requirement that the contract which gives rise to the taxpayer's profit must be of a particular nature, eg: one for the sale of goods and not one of a more extensive nature involving work and labour as well as the goods or material supplied. In my view it is the source of the profit, (arising out of processing) that is important . . . not the nature of the taxpayer's contract with its customers.

**24** *Rolls-Royce (Canada) Ltd. v. The Queen*, 93 D.T.C. 5031 (F.C.A.), attempted to reconcile these diverging lines of authority by restricting *Crown Tire*'s reasoning to circumstances that do not evidence the manufacture of a discrete and identifiable good prior or contemporaneous to the provision of a service. As stated by MacGuigan J.A. at p. 5034:

> The crucial distinction between *Crown Tire* and *Halliburton* seems to me to be . . . that the processing in *Crown Tire* "did not involve the creation of a good antecedent to its use in the provision of a service". . . . The rubber strip in *Crown Tire* was not on the evidence manufactured or processed by the taxpayer, whereas the cement in *Halliburton* was made by the taxpayer, indeed was custom-made according to very exact specifications.

**25** In *Hawboldt Hydraulics*, *supra*, the respondent taxpayer relied upon the *Rolls-Royce* interpretation of *Crown Tire* to claim a Class 29 accelerated capital cost allowance and s. 127(5) investment tax credit with respect to property used to manufacture parts for use in repair services. Rejecting the taxpayer's claim, the court reverted to the original *Crown Tire* approach. Isaac C.J. wrote at p. 847:

> We are invited by the modern rule of statutory interpretation to give those words their ordinary meaning. But we are dealing with a commercial statute and in commerce the words have a meaning that is well understood . . . . Strayer J. was right, in my respectful view, to say in *Crown Tire*, at page 225 that:
>
> > . . . one must assume that Parliament in speaking of "goods for sale or lease" had reference to the general law of sale or lease to give greater precision to this phrase in particular cases.

. . .

> **29** Notwithstanding this absence of direction, the concepts of a sale or a lease have settled legal definitions. As noted in *Crown Tire* and *Hawboldt Hydraulics*, Parliament was cognizant of these meanings and the implication of using such language. It follows that the availability of the manufacturing and processing incentives at issue must be restricted to property utilized in the supply of goods for sale and not extended to property primarily utilized in the supply of goods through contracts for work and materials.
>
> . . .
>
> **31** To apply a "plain meaning" interpretation of the concept of a sale in the case at bar would assume that the Act operates in a vacuum, oblivious to the legal characterization of the broader commercial relationships it affects. It is not a commercial code in addition to a taxation statute. Previous jurisprudence of this Court has assumed that reference must be given to the broader commercial law to give meaning to words that, outside of the Act, are well-defined. See *Continental Bank Leasing Corp. v. Canada*, [1998] 2 S.C.R. 298. See also P. W. Hogg, J. E. Magee and T. Cook, *Principles of Canadian Income Tax Law* (3rd ed. 1999), at p. 2, where the authors note:
>
> The Income Tax Act relies implicitly on the general law, especially the law of contract and property . . . . Whether a person is an employee, independent contractor, partner, agent, beneficiary of a trust or shareholder of a corporation will usually have an effect on tax liability and will turn on concepts contained in the general law, usually provincial law.
>
> **32** Referring to the broader context of private commercial law in ascertaining the meaning to be ascribed to language used in the Act is also consistent with the modern purposive principle of statutory interpretation. As cited in E. A. Driedger, *Construction of Statutes* (2nd ed. 1983), at p. 87:
>
> Today there is only one principle or approach, namely, the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament.
>
> See *Rizzo & Rizzo Shoes Ltd. (Re)*, [1998] 1 S.C.R. 27, at para. 21. The modern approach to statutory interpretation has been applied by this Court to the interpretation of tax legislation. See *65302 British Columbia Ltd. v. Canada*, [1999] 3 S.C.R. 804, at para. 5, *per* Bastarache J., and at para. 50, *per* Iacobucci J.; *Stubart Investments Ltd. v. The Queen*, [1984] 1 S.C.R. 536, at p. 578.

[21] This judgment stands for the proposition that it must be presumed that, when referring to sale, Parliament intended that this word be interpreted by referring to the general law of sale.

[22] In my opinion, in the case at bar, "sale" must be analyzed in the light of the Quebec civil law where the applicable provincial law is that of Quebec. On this point, suffice it to read the decision of the Federal Court of Appeal in *St-Hilaire v. Canada*, [2004] 4 F.C. 289 (F.C.A.) and section 8.1 of the *Interpretation Act* (R.S.C., c. I-21) to find that proposition irrefutable.

[23] According to article 1708 of the C.C.Q., there is a sale when:

> (i) the seller transfers ownership of property to another person; and
>
> (ii) in exchange for the transfer of ownership, the buyer obligates himself to pay a price in money.

[24] Therefore, article 1708 of the C.C.Q. requires that the Court deal with the following two issues:

> (i) First of all, did the Appellant acquire ownership of the unprocessed industrial waste from its suppliers? In the years concerned, according to the environmental statutes then applicable to the ownership of industrial waste, was the Appellant actually only in temporary possession of this industrial waste and therefore could not transfer the ownership of processed industrial waste to third parties?
>
> (ii) Secondly, were third parties required to pay the purchase price in money in exchange for the transfer of ownership of the processed industrial waste?

[25] Although the first question is of considerable interest, I am of the opinion that it is not necessary to answer it to determine if the contracts concluded between the Appellant and third persons in this case were actually contracts of sale within the meaning of article 1708 C.C.Q. Indeed, even if I ruled that the suppliers had transferred ownership of the industrial waste to the Appellant and that the Appellant could therefore in turn transfer ownership of the processed industrial waste to third parties, these contracts nevertheless cannot be qualified as contracts of sale, because in the first case the Appellant had no obligation to pay the purchase price in money to its suppliers, and in the second case the third parties had no obligation to pay a purchase price in money to the Appellant. Indeed, in the first case, the evidence showed that it was the suppliers who paid the Appellant so that it could acquire ownership or take possession of their industrial waste, while in the second case, the evidence showed that it was rather the Appellant who paid the third parties so that they could acquire ownership or take possession of the processed industrial waste.

[26] As regards the Appellant's implicit argument to the effect that the contracts concluded with suppliers or third persons, as the case may be, had to be contracts of sale because they could not be qualified as contracts for services, it is in my opinion incorrect. The provisions of the C.C.Q. do not in any way lead to the conclusion that a contract must be a contract for services if it cannot be characterized as a contract of sale.

[27] As regards the Appellant's implicit argument to the effect that the contracts concluded with its suppliers or third parties could not be qualified as contracts for services because, in both cases, they involved a transfer of ownership of industrial waste between the parties, I am of the opinion that it is just as incorrect. Article 2098 C.C.Q. does not in any way specify that a contract cannot be a contract for services when there is a transfer of ownership between the parties.

[28] In this case, the contracts concluded between the Appellant and third parties were, in my opinion, contracts for services within the meaning of article 2098 C.C.Q., in that the third parties undertook to become owners or to take possession of the industrial waste which the Appellant had processed for the purpose of avoiding environmental liability related to its ownership for a price the Appellant was required to pay them.

[29] There is no doubt in this case that the Appellant processed industrial waste and made a profit from it. However, the profit that the Appellant made from processing this industrial waste was definitely not made under a contract of sale,

but rather a contract for services. In other words, I cannot allow the deduction, because the processed industrial waste was not for sale and therefore does not fall within subsection 125.1(3) of the *Act*.

[30] Given the controversies bearing on our planet's survival, the Appellant's industry possibly deserves to be encouraged. If Parliament decided it should be, in my opinion, it would have to use a criterion other than "goods for sale", that is, one based on the source of the taxpayer's profits.

[31] For these reasons, the appeals are dismissed with costs.

Signed at Ottawa, Canada, this 1st day of May, 2007.

"Paul Bédard"

Bédard J.

Translation certified true
on this 20th day of February 2008.

François Brunet, Revisor

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