Docket: 2005-1631(IT)G

BETWEEN:

POTASH CORPORATION OF SASKATCHEWAN INC.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeal heard on common evidence with the appeal of
Potash Corporation of Saskatchewan Inc. *2005-1760(IT)G*
on September 30 and October 1, 2010 at Saskatoon, Saskatchewan

Before: The Honourable Justice J.E. Hershfield

Appearances:

Counsel for the Appellant:	Stéphane Eljarrat Olivier Fournier
Counsel for the Respondent:	Ifeanyi Nwachukwu Ryan Hall

JUDGMENT

The appeal from the assessment made under the *Income Tax Act* for the 1997 taxation year is allowed, with costs, and the assessment is referred back to the Minister of National Revenue for reconsideration and reassessment in accordance with the reasons set out in the attached Reasons for Judgment.

Signed at Winnipeg, Manitoba this 20th day of April 2011.

"J.E. Hershfield"

Hershfield J.

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Appearances:

Counsel for the Appellant:	Stéphane Eljarrat Olivier Fournier
Counsel for the Respondent:	Ifeanyi Nwachukwu Ryan Hall

JUDGMENT

The appeal from the assessment made under the *Income Tax Act* for the 1998 taxation year is allowed, with costs, and the assessment is referred back to the Minister of National Revenue for reconsideration and reassessment in accordance with the reasons set out in the attached Reasons for Judgment.

Signed at Winnipeg, Manitoba this 20th day of April 2011.

"J.E. Hershfield"

Hershfield J.

Citation: 2011 TCC 213
Date: 20110420
Dockets: 2005-1631(IT)G
2005-1760(IT)G

BETWEEN:

POTASH CORPORATION OF SASKATCHEWAN INC.,
Appellant,

and

HER MAJESTY THE QUEEN,
Respondent.

REASONS FOR JUDGMENT

Hershfield J.

Background

[1] In 1997 and 1998 the Appellant ("PCS") incurred legal and accounting fees totalling $157,695.39 and $1,753,654.88 respectively (the "consulting fees" or "subject expenses").

[2] The consulting fees were incurred by PCS in order to plan and implement a reorganization of a group of companies, none of which was PCS itself, the purpose of which was to reduce foreign withholding taxes on funds repatriated from a U.S. subsidiary.

[3] PCS deducted the full amount of the consulting fees in the year incurred on the basis that they were not precluded from being so treated by either paragraphs 18(1)(*a*) or (*b*) of the *Income Tax Act* (the "*Act*"). The deductions so claimed were denied on the basis that such paragraphs did preclude them and PCS was assessed accordingly in respect of each of its 1997 and 1998 years. PCS has appealed both assessments. The appeals were heard on common evidence.

[4] Essentially, all of the relevant facts relating to these appeals are set out in the Partial Agreed Statement of Facts (the “Agreed Facts”) appended to these Reasons as Schedule A. One area of controversy relating to the amount of the consulting fees was agreed to at trial. The sole issue to be decided in these appeals then is the extent to which the consulting fees are deductible, if at all. It is understood that if the subject expenses were not incurred for the purpose of gaining or producing income from a business or property no deduction will be allowed pursuant to paragraph 18(1)(*a*). It is also understood that although no deduction will be allowed pursuant to paragraph 18(1)(*b*) if the subject expenses are capital in nature, a deduction would be allowed if they are found to be eligible capital expenditures as defined in subsection 14(5) of the *Act*. That is how the issue in these appeals has been approached by the parties. The overall purpose of incurring the subject expenses was not disputed and neither party was open to my attempting to make an allocation of the subject expenses amongst the distinct steps of the reorganization. While the steps were entirely tax motivated, there is no suggestion of improper tax avoidance.

Factual Summary

[5] In 1995 PCS had a direct (80%) equity interest in each of a U.S. holding company and a U.S. limited liability finance company (“Finance LLC”). It held the remaining (20%) equity interest in both these U.S. companies indirectly through a wholly owned Canadian subsidiary. The U.S. holding company was the top company in a chain of U.S. companies all wholly owned by the company above it and included eight operating companies at the bottom of the chain. In 1995, Finance LLC was financed by PCS to the tune of US$730,000,000 by proportionate investments from PCS and its Canadian subsidiary. Finance LLC in turn financed a wholly owned U.S. subsidiary (“Phosphate Co”) of the U.S. holding company, by way of interest bearing loans.[1] The advances were used by Phosphate Co to fund acquisitions of certain operating entities. In 1997 Finance LLC financed a wholly owned U.S. subsidiary of Phosphate Co (“Nitrogen Co”), to the tune of US$950,000,000 by way of interest bearing loans. The advances were used by Nitrogen Co to fund certain acquisitions. The total loan amounts (referred to as the “Loans”) were evidenced by Phosphate Co notes and Nitrogen Co

[1] Finance LLC debt financed the acquisitions through two tiers of U.S. holding companies. The Appellant’s witness, Ms. Arnason, testified that this was to provide an extra level of security and a level of flexibility if the lower tier company wanted to divest itself of any of its newly acquired interests.

notes (referred to together as the "Notes") and were funded by proportionate equity investments in Finance LLC made by PCS and its Canadian subsidiary.[2]

[6] Interest payments on the Loans were distributed through Finance LLC back to Canada subject only to a 10% U.S. withholding tax. PCS's Canadian subsidiary's share was in turn distributed to PCS.

[7] In 1996 and 1997 Finance LLC made total distributions up the line to PCS and its Canadian subsidiary of some US$440,000,000. The distributions included both returns on investment which were subject to 10% U.S. withholding and returns of capital. The returns on investment were reported by PCS as dividend income received from Finance LLC and its Canadian subsidiary in the total amounts of Can.$182,000,000 and Can.$134,000,000 in each of 1996 and 1997, respectively. These amounts are *not* net of the 10% U.S. withholding tax.[3] Such dividends were exempt surplus in Canada under the *Act* so no further tax was incurred to repatriate this income.

[8] In August of 1997, it was announced that the Canada-U.S. tax treaty benefit on the flow through income of LLC to a non-resident was to be denied by an amendment to the *Internal Revenue Code*. The U.S. withholding rate on distributions from Finance LLC was increased from 10% to 30%. Since the repatriation of income to Canada was exempt surplus, the increase would substantially reduce the after tax return on PCS's U.S. investment.

[9] The reorganization steps taken in 1997 and 1998 are detailed in paragraphs 37-39 of the Agreed Facts. The steps taken over a period of months were elaborate, involving several foreign countries whose various tax rules and treaty provisions created a network through which corporate interests and the Notes were transferred. Ultimately, the Notes were transferred to an Irish branch of a Luxemburg entity the shares of which were owned by PCS and its Canadian subsidiary in the same proportions they held their interests in Finance LLC. That is, the Luxemburg entity replaced Finance LLC as the company entitled to the

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[2] Although the Agreed Facts do not make this clear, the evidence presented at the hearing confirmed this. That is, Finance LLC was funded by PCS and its Canadian subsidiary by way of proportionate capital contributions which in turn funded the Loans.

[3] This is not spelled out in the Agreed Facts but I take judicial notice of this fact based on historical currency exchange rates and my understanding of the reporting of pre-withholding tax dividend amounts.

Loan interest, subject to a 5% income tax in Luxemburg. The interest payments made on the Loans were not subject to U.S. withholding tax. The funds could be repatriated to Canada from Luxemburg at a withholding rate of 5% under its treaty with Canada.[4] This replaced, eliminated, the 30% U.S. withholding tax.

[10] The consulting fees were incurred by PCS to accomplish this result. That is the essence of the Agreed Facts.

[11] However, I note here that as early as April 1996 changes to the U.S.-Luxemburg tax treaty were announced that would subject the interest payments from the U.S. entities to the Luxemburg entity to a 30% U.S. withholding tax. That change although known to the Appellant when first announced, did not affect the decision to proceed as the change was not given effect or implemented until January 2001.

[12] The Luxemburg entity was wound-up in 2001. Its reported earnings from inception to its demise were as set out in paragraph 44 of the Agreed Facts.

[13] Throughout this period it paid no dividends to its two Canadian shareholders. Instead, very substantial loans were made from the Luxemburg entity to PCS as set out in paragraph 45 of the Agreed Facts. The Luxemburg entity reported no income from these loans to PCS and PCS reported no interest expense in respect of them.

[14] While this is, to say the least, a recitation of the facts in a proverbial "nutshell", it is sufficient, at this point, to put the evidence of the Appellant's witness in context.

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[4] The 5% withholding rate came into effect January 1, 2001 the year following the ratification of the treaty as per Article 29.

The Appellant's Witness

[15] The current vice-president of internal audit of PCS, Ms. Arnason, testified at the hearing. At the time of the reorganization she was the director of taxation of the company and I am satisfied that she was a well-informed witness who gave her testimony in a forthright manner.

[16] She testified that by 1994 PCS had become the world's largest potash producer by capacity with limited growth potential beyond that point. It had explored and exploited the most desirable potash opportunities on a global basis. Its focus in the years 1995 through 1997 moved to expanding beyond potash, seeking opportunities to exploit other fertilizer nutrients, namely phosphate and nitrogen. Its first purchase in 1995 was of a phosphate mining operation in North Carolina for some $800 million. Its second purchase, also in 1995, was another phosphate operation in Florida for another $280 million. These acquisitions were financed by Finance LLC and gave rise to the Phosphate Co note. The nitrogen operation was acquired by way of a merger in 1997. Finance LLC lent Nitrogen Co $950 million to allow it to make further acquisitions in 1997. This gave rise to the Nitrogen Co note and gave PCS, via subsidiaries, a significant number of nitrogen plants in both the U.S. and Trinidad. These acquisitions made it the world's largest integrated fertilizer operation by capacity. It was a player in all three of the main fertilizer elements. The acquisitions were believed to have an added value of approximately $1.6 billion off-set by the Notes on a consolidated basis.

[17] To achieve the acquisitions a decision was made not to raise additional share capital. The strength of PCS's balance sheet made debt financing a good option. That debt, incurred in Canada by PCS, needed to be serviced. The holding structure relating to the acquisitions needed to best accommodate a cashflow to Canada to meet that requirement.

[18] The use of Finance LLC was an ideal structural approach to maximize this cashflow. The U.S. tax rules did not tax the interest income it earned from the downstream debtor companies (Phosphate Co and Nitrogen Co) although they were allowed the interest deduction. Finance LLC was treated as a flow-through entity subject to withholding tax only on payments up-stream to PCS and the Canadian subsidiary. As noted above, the distributions were treated in Canada as tax free returns of capital and dividends. The dividends were eligible for exempt surplus treatment under the foreign affiliate provisions of the *Act* and not subject to tax in Canada. Under the tax rules of the two jurisdictions then, the 10% U.S. withholding was the only cost of repatriating the funds necessary to pay the debt

service on the Canadian borrowings. Ms. Arnason testified that it was intended that the interest income earned by Finance LLC was to be passed up to PCS in this way, including the portion going through the Canadian subsidiary.

[19] With a 10% U.S. withholding tax, this structure met PCS's cashflow requirements. On the other hand, a 30% U.S. withholding rate was significantly more than had been built into PCS's analysis and its debt servicing needs. PCS also had what Ms. Arnason referred to as robust operations in Canada that were also in need of the cashflow from its new acquisitions being flowed through Finance LLC.

[20] To avoid this increased U.S. withholding rate, PCS sought a new structure with preferential treaty arrangements both between the U.S. and the new host country and that country and Canada. That involved, as well, finding a host country whose security laws, tax laws, business practises and language all gave PCS a high comfort level without imposing an onerous administrative burden on the corporate group. The host country chosen was Luxemburg. That is, the entity to hold the Notes originally held by Finance LLC was to be a Luxemburg entity. The process to get there involved certain intermediary steps being taken. For example, a direct transfer of the Notes to Luxemburg was not as efficient as routing them for a short period through an Irish company and then having the Luxemburg entity hold them in a branch in Ireland. The terms of the Notes also had to be amended to minimize a capital tax in Ireland. The shares that PCS and its Canadian subsidiary held in Finance LLC had to be transferred for a short period to a British Virgin Islands company and then, for a short time as well, to an Irish company. Still, at the end of the day, the Luxemburg entity owned the Notes and PCS and its Canadian subsidiary owned the equity interests in the Luxemburg entity in the same proportions that they had held interests in Finance LLC.

[21] In addition to ensuring that the foreign tax consequences were as planned in respect of the movement of the Notes monitored, all the steps in the series of transactions were being planned by PCS's advisers to ensure that the transfers of the interests that PCS and its Canadian subsidiary had in Finance LLC, and the share transfers triggered by the liquidation of the short lived entities in which they would have held interests, were not subject to a tax in Canada in the course of creating the final result. Such tax, if inadvertently triggered in Canada, would be borne by PCS and its Canadian subsidiary. For example, attention had to be paid to the rollover provisions in subsection 85.1(3) of the *Act* applicable on the disposition of shares in a foreign affiliate.

[22] The details of the reorganization are not important. However, I do note that the cross-examination of Ms. Arnason focused on the purpose of each step and the fact that each Board of each company acted independently to approve the steps taken in respect of their respective separate entities. Ms. Arnason acknowledged this but maintained that it was all about achieving the end result, namely to replace Finance LLC with the Luxemburg entity to avoid the negative impact that the increased U.S. withholding tax would have had on PCS. The end result sought was achieved without any inadvertent consequences along the way. The Notes that Finance LLC acquired in the course of financing the down-stream acquisitions ended up in the Luxemburg entity and the interest payments on those Notes left the U.S. without any withholding tax, subject to only a 5% income tax in Luxemburg and a 5% withholding tax on repatriation to Canada.

[23] As well, the cross-examination of Ms. Arnason confirmed that PCS's business activities were the production, processing and sale of potash and that its strategy, to head a group that was to become a global leader in the integrated fertilizer arena, was growth oriented. That is, it was an investment strategy, not part of a trading activity. As well, she confirmed that a functional analysis of PCS's custodial costs entered in evidence confirmed that in addition to the potash business, PCS performed certain services for its subsidiaries (the costs for which were allocated to its subsidiaries on a time spent basis) and had a custodial function to maintain and monitor its investments. Ms. Arnason agreed that the consulting fees did not relate to these functions.

[24] In the miscellaneous category, I add the following which was brought out on Ms. Arnason's examination. PCS was not in jeopardy of defaulting on its bank loans during the relevant times. PCS incurred legal fees for consulting services on the 1995-97 acquisitions which were capitalized as part of the acquisition costs of those operations. Costs relating to replacing Finance LLC were not regarded as acquisition costs and were not capitalized. The acquisitions may have had a positive effect on PCS's share values. There was no legal requirement on Finance LLC to make distributions to its two Canadian shareholders. Distribution decisions were made by the board of the entity making them. A read-in from an examination of discovery also confirmed that decisions of each of the companies involved in the reorganization that replaced Finance LLC with the Luxemburg entity, including the decisions of the Luxemburg entity, were made by the respective boards of those companies.[5]

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[5] That read-in also addresses an issue raised with Ms. Arnason during her cross-examination. The consulting fees were initially put in a deferred account pending the company making a decision on

[25] Ms. Arnason made it clear, and I accept her testimony on this as I have for all her testimony, that the actual implementation fees respecting each step in the series of transactions that constituted the overall reorganization were not part of the consulting fees. Each entity paid its own transactional costs. I have accepted her view that the purpose for incurring the subject expenses was for the benefit of PCS, not the downstream related companies. That input and advice from Canada may have assisted and influenced foreign entities that bore their own professional costs, does not mean that they did not act independently, in a legal sense. Their *raison d'être* did not inherently put them in a conflict of interest with PCS. Their interest, for example, in saving taxes on any assets acquired, held or disposed of, would not conflict with the interest of a shareholder no matter how far up the corporate chain.

[26] In any event, Ms. Arnason made it clear that the entire reorganization was undertaken, and the consulting fees were incurred, by PCS for one reason, namely, to replace Finance LLC with something better than what was being imposed by the new 30% U.S. withholding tax. The final structure ensured that there was no U.S withholding tax on the payments leaving the U.S.

The Appellant's Submissions

[27] In oral argument, Appellant's counsel likened the reorganization to a repair of a broken structure that needed fixing. The structure was the channel or pipeline through which income from property flowed and expenses incurred to repair it were incurred, in the normal course as in the case of maintaining a pipeline, with the view to maintain and enhance the receipt. In his written submission he highlighted the purpose for incurring the subject expenses as follows:

> 25. Put plainly, the purpose of incurring the Consulting Fees was to implement the Reorganization to address the increase in U.S. withholding tax and to maximize PCS's income from property net of foreign withholding taxes.

[28] I acknowledge that the point of the reorganization was to relocate the Notes so as to avoid the increase in the U.S. withholding tax on repatriation of the funds to Canada. I accept, as Appellant's counsel argued, that but for that increase, the structure utilizing Finance LLC would have been maintained. I acknowledge as well, as Appellant's counsel argued, that there was a reasonable expectation of

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how to treat them. For income tax purposes they were eventually expensed on the basis that they ensured a greater cashflow to the company.

continued significant income from the downstream entities. He argues that the future availability of such significant amounts, as would thereby be available for distribution to PCS, is a relevant factor supporting the purpose of incurring the subject expenses.

[29] It is argued that that meets the requirement in paragraph 18(1)(*a*) of an expense incurred "for the purpose of gaining -- income from -- property". It is argued that it is the intention at the time the expense is incurred that is relevant and whether or not dividends were paid from the Luxemburg entity should not, does not, impact the determination of the requisite purpose once identified. Appellant's counsel cites authorities for this latter proposition including ones that deal more broadly with the application of the purpose test and its subjective and objective elements.

[30] That it is the intention at the time the expense is incurred that governs is supported by the decisions in *722540 Ontario Inc. v. R.* (sub nom. *Novopharm Limited v. R.*)[6] and *Ludmer et al v. R.* (sub nom. *Ludco Enterprises Ltd. et al v. The Queen*).[7] The Appellant cites the following passage from the decision of the Supreme Court of Canada in *Ludco* in support of its position:

> 54 Having determined that an ancillary purpose to earn income can provide the requisite purpose for interest deductibility, the question still remains as to how courts should go about identifying whether the requisite purpose of earning income is present. What standard should be applied? In the interpretation of the Act, as in other areas of law, where purpose or intention behind actions is to be ascertained, courts should objectively determine the nature of the purpose, guided by both subjective and objective manifestations of purpose: see *Symes*, *supra*, at p. 736; *Continental Bank of Canada*, *supra*, at para.45; *Backman*, *supra*, at para. 25; *Spire Freezers Ltd.*, *supra*, at para. 27. In the result, the requisite test to determine the purpose for interest deductibility under s. 20(1)(c)(i) is whether, considering all the circumstances, the taxpayer had a reasonable expectation of income at the time the investment is made.
>
> 55 Reasonable expectation accords with the language of purpose in the section and provides an objective standard, apart from the taxpayer's subjective intention, which by itself is relevant but not conclusive. It also avoids many of the pitfalls of the other tests advanced and furthers the policy objective of the interest deductibility provision aimed at capital accumulation and investment, as discussed in the next section of these reasons. (Emphasis added by the Appellant.)

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[6] 2003 DTC 5195 (F.C.A).

[7] [2001] 2 S.C.R. 1082.

[31] These highlighted passages make the Appellant's point quite clearly on the basis that the same reasoning applies to paragraph 18(1)(*a*) and subparagraph 20(1)(*c*)(i). Even if the reorganization failed (which it did not) or dividends were never paid, the purpose test would still be met provided what was sought to be gained by incurring the expenditure was income at the time the expense was incurred.

[32] In what I believe was a response to a question I asked during argument dealing with whether or not PCS's "income" was affected at all by the U.S. withholding tax, Appellant's counsel made the following argument:

> 45. In addressing this point, relevant background is provided by the FCA in *Novopharm*, in which it applied the "income" test under 18(1)(a) of the Act based on the test applied to 20(1)(c) by the SCC in the *Ludco* decision. Paragraphs 19 and 20 of *Novopharm* read as follows:
>
>> 19 However, more recent decisions of the Supreme Court of Canada indicate that, at least with respect to subparagraph 20(1)(c)(i), income is not equivalent to profit or net income. At paragraph 59 of *Ludco*, Iacobucci J. states:
>>
>>> Because it is left undefined in the *Act*, this Court must apply the principles of statutory interpretation to discern what is meant by "income" in the context of s. 20(1)(c)(i). The plain meaning of s. 20(1)(c)(i) does not support the interpretation of "income" as the equivalent of "profit" or "net income". Nowhere in the language of the provision is a quantitative test suggested. Nor is there any support in the text of the Act for an interpretation of "income" that involves a judicial assessment of sufficiency of income. Such an approach would be too subjective and certainty is to be preferred in the area of tax law. Therefore, absent a sham or window dressing or similar vitiating circumstances, courts should not be concerned with the sufficiency of the income expected or received.
>>
>> Although his determination is with respect to the definition of income in subparagraph 20(1)(c)(i), the relevant words are so close to those in paragraph 18(1)(a) that it would be difficult to justify a different interpretation with respect to paragraph 18(1)(a).

> 20 The Minister submits that paragraph 18(1)(a) is generally aimed at deductions of outlays which are not profit motivated. However, I think the rationale outlined by Iacobucci J. in *Ludco*, as to why income in subparagraph 20(1)(c)(i) is not equivalent to profit or net income, is equally applicable to paragraph 18(1)(a). Nowhere in the language of paragraph 18(1)(a) is a quantitative test suggested. Nor is there any support in the words of paragraph 18(1)(a) that suggests a judicial assessment of the sufficiency of income. And, as with subparagraph 20(1)(c)(i), such an assessment would be too subjective where certainty is to be preferred. For these reasons, I am of the opinion that the view of Pigeon J. in *Lipson*, *supra*, to the extent that it may have been applied to paragraph 18(1)(a), must now be considered to have been superseded by the rationale in *Ludco*. (Emphasis added by the Appellant.)

[33] The argument then is that incurring expenses to increase income net of foreign withholding taxes meets the income test under paragraphs 18(1)(*a*) and 21(1)(*c*) of the *Act*. The Appellant equates additional cashflow with additional income. To further support the Appellant's position the following paragraph in *Ludco* is also cited:

> 61 I agree. Indeed, when one looks at the immediate context in which the term "income" appears in s. 20(1)(c)(i), it is significant that within the provision itself the concept of "income" is used in contradistinction from the concept of tax-exempt income. Viewed in this context, the term "income" in s. 20(1)(c)(i) does not refer to net income, but to income subject to tax. In this light, it is clear that "income" in s. 20(1)(c)(i) refers to income generally, that is an amount that would come into income for taxation purposes, not just net income. (Emphasis added by the Appellant.)

[34] The Appellant's argument goes on to assert that the consulting fees were also incurred for the purpose of earning income from the business of PCS. The reorganization was designed to increase cash available for distribution to PCS for use in its business.

[35] The Appellant submits that the decision in *BJ Services Co. Canada v. R.*[8] stands for the proposition that expenses that are not directly related to income earning activities can nevertheless be deductible if they meet a business need of the corporation. Paragraph 18(1)(*a*) cannot apply to limit their deduction in such

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[8] 2004 DTC 2032 (T.C.C.).

circumstances. In that case, professional fees were incurred to make changes to the corporation's capital structure to fend off an unsolicited takeover bid.

[36] In *BJ Services*, this Court, referring to the *Symes* decision of the Supreme Court of Canada (cited thereunder) held as follows:

> 29 (…) [T]he Supreme Court, in *Symes v. R.* (1993), [1994] 1 C.T.C. 40 (S.C.C.), is clear that if the expenses are business in nature, instead of personal, the test for deductibility may be met by showing the expense satisfied a need of the company. Expenses incurred by a business, which are ancillary to its primary functions and activities, are not immediately excluded from being deductible. As a result this renders the paragraph 18(1)(a) restriction porous and allows the Nowsco expenses to pass through the excluding provisions, as long as they are business in nature and not personal. There need not be a direct link between expenses and revenue. Expenses may be deductible, provided they are not personal and meet some business need of the taxpayer.
>
> 30 The expenses here were certainly ancillary expenses. However the hello and break fees, as well as the other expenses, must be viewed in the larger context of the commercial operations of Nowsco. (…) (Emphasis added by the Appellant.)

[37] While the consulting fees may not have been directly related to PCS's business of mining, processing and selling potash, in the larger context of its commercial operations, it was argued that PCS needed the subject cashflow in both its operations and to service its external debt. I acknowledge that there was a business need for the cashflows expected from Finance LLC. The activities of PCS in Canada were, as Ms. Arnason testified, robust and like any thriving enterprise, PCS might well rely on strong cashflows from downstream sources.

[38] Appellant's counsel also referred me to *International Colin Energy Corp. v. R.*[9] and *Boulangerie St-Augustine Inc. v. Canada*.[10] In *International Colin*, consulting fees paid by a failing corporation to find a suitable merger candidate was held to have been incurred for the purpose of improving its ability to earn income and deductible on that basis. The Appellant argues that this test of satisfying some business need is not restricted to dire circumstances such as needing cash to the point where one would otherwise be in a default position.

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[9] 2002 DTC 2185 (T.C.C.).

[10] 95 DTC 56; 95 DTC 164 (T.C.C.); aff'd 97 DTC 5012 (F.C.A.).

[39] In *Boulangerie St-Augustine* it was held that professional fees incurred in relation to preparing a circular for shareholders concerning a takeover bid were deductible. Justice Archambault found that adopting a more generous interpretation of the requirement in paragraph 18(1)(*a*) that the expense be incurred for the purpose of earning income from a business was required. It was not necessary that the expense relate directly to the business operation.

[40] The Appellant's counsel's submissions also deal with paragraph 18(1)(*b*) of the *Act*. He maintains that the deduction of the consulting fees is not precluded by that paragraph.

[41] It is noted, as a starting point, that the consulting fees are said not to represent the cost of acquiring a specific asset but rather represent the cost to plan and watch over the implementation of the reorganization. It is submitted that the acquisition cost of the shares in the Luxemburg entity must be limited to the direct cost of their acquisition. There was a subscription price in relation to that acquisition and it was paid separate and apart from the consulting fees. Further, the consulting fees continued to be incurred after the subscription for the shares in the Luxemburg entity.

[42] It is further submitted that the consulting fees were not incurred with a view to bringing into existence an advantage for the enduring benefit of PCS.

[43] Appellant's counsel argued that a tax benefit (which is the advantage sought by the reorganization) is not by its very nature an enduring benefit. Both the change in the U.S. withholding rate imposed by the U.S. on payments from Finance LLC and the later changes in the withholding rates on payments from the U.S. to Luxemburg, evidence the stroke of a pen absence of any enduring benefit that might be attributed to a tax benefit.

[44] Further, Appellant's counsel cites the minority opinion of Locke J. in *British Columbia Electric Railway Company Limited v. The Minister of National Revenue*:[11]

> 72. Furthermore, in the minority opinion of Locke, J. in *BC Electric Railway* (concurring however in the result with the majority opinion written by Abbott, J.) the SCC referred to another decision in *Anglo-Persian Oil*, which suggests that an "enduring benefit" is not one that, for some time, relieves you of an income payment:

[11] [1958] S.C.R. 133.

> 20 In *Anglo-Persian Oil Company v. Dale* (1931), 16 T.C. 253, Rowlatt J., referring to the word "enduring" in the passage from Lord Cave's judgment, said (p. 262) that quite clearly he was speaking of a benefit which endures in the way that fixed capital endures, not a benefit that endures in the sense that for a good number of years it relieves you of a revenue payment. (…) (Emphasis added by the Appellant.)

[45] Another reason that it cannot be found, as a matter of fact, that there was an enduring benefit to the reorganization is that it was known that any tax benefit from the Luxemburg structure would be temporary at best. In such circumstances, it is argued that it cannot be found that the subject expenses were incurred with a view of bringing into existence an advantage for the enduring benefit of PCS.

[46] In the alternative, the Appellant argues that if I find that the consulting fees were incurred on account of capital, then they are eligible capital expenditures of PCS.

[47] The definition of "eligible capital expenditures" at subsection 14(5) of the *Act* requires:

a) an amount incurred, in respect of a business, for the purpose of gaining or producing income from the business;

b) that the amount be incurred on account of capital; and

c) that none of the exclusions in that definition apply to the amount.

[48] The Appellant submits that the first requirement is met based on this Court's decision in *BJ Services*. The second requirement would be met on the basis of my making that finding. Lastly, it is submitted that none of the exclusions to the definition of eligible capital expenditures apply to the consulting fees.

The Respondent's Submissions

[49] Counsel for the Respondent asserted, in effect, that I should look at the planning steps separately and the multi-faceted objectives they each sought to implement. The subject expenses should be seen as having been incurred to facilitate these distinct objectives. On that basis, none of the individual transactions

in the series can be found to be for the purpose of gaining or producing income for PCS.

[50] It is submitted that only the acquisition of shares of the Luxemburg entity was a transaction entered into for the purpose of producing dividend income for PCS. However, it is argued that it should be clear that most of the steps and transactions undertaken by PCS's foreign subsidiaries, if viewed independently, were not undertaken to acquire shares of the Luxemburg entity. Accordingly, the consulting fees cannot be found to have been incurred to earn income from these shares. They were incurred for other purposes inherent in each of those separate transactions.

[51] The Respondent asserts then that the purpose test must be applied in respect of each of the transactions even though the overall purpose of the series of transactions was to maximize the cashflow, through the group, back to PCS. For example, some expenses were incurred to ensure that the entity that received the interest payments on the Notes would only be subject to a minimal local income tax. Other expenses were incurred to minimize capital taxes in both Ireland and Luxemburg. It would not be helpful, in my view, to go through each step of the reorganization, as did Respondent's counsel, and reiterate counsel's position that the particular purpose of that particular step was this or that, as opposed to being for the purpose of producing income for PCS. His point is made without going through that exercise.

[52] Reliance is placed on *Singleton v. M.N.R.*[12] where Major J. of the Supreme Court of Canada noted at paragraph 34 as follows:

> … it is an error to treat this as one simultaneous transaction. In order to give effect to the legal relationships, the transactions must be viewed independently. When viewed that way, on either version of the facts (i.e. regardless of the sequence), what the respondent did in this case was use the borrowed funds for the purpose of refinancing his partnership capital account with debt. This is the legal transaction to which the Court must give effect. (Emphasis added by the Respondent.)

[53] Relying, as did the Appellant, on the almost identical language in paragraph 20(1)(*c*) to that in paragraph 18(1)(*a*), Respondent's counsel also referred to an

[12] 2001 DTC 5533 (SCC).

observation of Rothstein J.A. writing for the Federal Court of Appeal in *Singleton* as follows:[13]

> In the context of the *Income Tax Act* in which the phrase "series of transactions" appears 41 times, its absence from paragraph 20(1)(*c*) implies that there is no legislative intent to import the series test into that paragraph or, in other words, to link a series of individual transactions as if they were one transaction …

[54] Similarly, reliance is placed on Rothstein J.A.'s finding in *Novopharm* where he again confirmed at paragraph 12 that these provisions do not contemplate treating individual transactions as part of a series but rather each must be viewed independently.

[55] Since the consulting fees were incurred for different immediate purposes in respect of each of the steps taken, their deductibility must be governed accordingly.

[56] Considering the paragraph 18(1)(*a*) requirement in the context of the subject expenses being incurred to earn income from a business, the Respondent relies more on the construction of the provision that would match the expenditure to income from a particular business. Benefits, even cashflow benefits, that arise from expenditures unrelated to the particular business of PCS cannot be said to have been incurred for the purpose of earning income from that particular business. Respondent's counsel cites *Royal Trust Co. v. Minister of National Revenue*[14] at paragraph 33 as follows:

> The essential limitation in the exception expressed in [Section 18(1)(a)] is that the outlay or expense should have been made by the taxpayer "<u>for the purpose</u>" of gaining or producing income "<u>from the business</u>". It is the purpose of the outlay or expense that is emphasized but <u>the purpose must be</u> that of gaining or producing income "<u>from the business</u>" in which the taxpayer is engaged. … (Emphasis added by the Respondent.)

[57] Based on admitted facts and the evidence presented at the hearing, it is asserted that the business of PCS during its 1997 and 1998 taxation years was solely the mining, processing and sale of potash. The consulting fees did not relate

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[13] 99 DTC 5362 (FCA), para. 28.

[14] 57 DTC 1055 (Ex. C.R.).

in any way to these businesses and, accordingly, do not meet the "from *the* business" test in paragraph 18(1)(*a*).

[58] It is further argued that seeking to deduct on income account expenses associated with all the various steps involved in the reorganization ignores the separate legal existence of the various foreign subsidiaries. It is submitted that if the separate corporate existence of PCS and its foreign subsidiaries are respected, then the consulting fees incurred by PCS to enable its foreign subsidiaries to move the Notes from the U.S. to Luxemburg are expenses of the respective foreign subsidiaries because it was each foreign subsidiary that actually implemented each successive step for its own account. On this basis, it is submitted that the consulting fees that affected the relocation of the Notes, even though incurred by PCS are, nonetheless, expenses of the foreign subsidiaries whose existence PCS chose to have the benefit of in the course of the Notes being relocated. As to the principal benefactor of that relocation, it is asserted that it could be the Luxemburg entity. The subject transactions did, after all, create an income earning capacity for the Luxemburg entity. From that perspective the consulting fees can be said to have been incurred for the purpose of enabling the Luxemburg entity to earn income, not PCS. In *R. v. MerBan Capital Corp.*[15] the Court noted that "A payment made to allow a subsidiary to earn income is a payment made in respect *of another taxpayer's business*"[16] and as such does not meet the requirements of paragraph 18(1)(*a*), at least with respect to the gaining or producing income from the business requirement.

[59] Having created the Luxemburg entity to earn the interest income, PCS's benefit is indirect, at best. That is, it is argued that even if the business of PCS benefited from the reorganization, it was an indirect benefit in respect of which costs to achieve it, would not be deductible. Respondent's counsel relied on *Canada Safeway Ltd. v. Minister of National Revenue*[17] where the Supreme Court of Canada denied the claim to an interest deduction of a parent company to finance the acquisition of its subsidiary. The parent company, a retail grocer, argued the acquisition of the shares of the subsidiary enabled it to control the business of the subsidiary and do so in a manner that would benefit the parent in terms of increasing the parent's business income.

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[15] 89 DTC 5404 (FCA).

[16] *MerBan* at para. 34.

[17] 57 DTC 1239 (SCC).

[60] In that case, Rand J. warned of a slippery slope that would be created if a parent company, like PCS, is allowed to deduct an expense simply because there is an indirect benefit to the business income-earning capacity of the parent company through share ownership. Rand J. noted:[18]

> What the contention comes to is that the subsidiary becomes a mere agent or alter ego of the [parent] company; that its acts are those of the [parent] company; and that by acting as shareholder or director the [parent] company is acting in its own immediate right in matters of which the agency subsidiary performs the motions. But the two corporate bodies are assumed to be totally disparate in themselves and their activities, with the [parent] company exercising its voting power not in the course of its own business but as a shareholder only. That distinction in capacity cannot be obliterated by a vague sense of exercise of power by the [parent] company through its stock ownership as an instrument immediately used in its business. If the subsidiary is not merely an agent, the exercise of voting power must, on the argument made, be taken to be in the course of the [parent] company's business; but that exercise is as a shareholder or director of the subsidiary and I cannot view it as an act in the [parent] company's business. In the circumstances before us, the interposition of a new and distinct capacity as shareholder breaks the continuity of the company's act as being in its own business; the act of voting is in respect of an act relating to the business of the subsidiary. No doubt there is in fact a causal connection between the purchase of the stock and the benefits ultimately received; but the statutory language cannot be extended to such a remote consequence; it could be carried to any length in a chain of subsidiaries; and to say that such a thing was envisaged by the ordinary expression used in the statute is to speculate and not interpret. (Emphasis added by the Respondent.)

[61] It is submitted that Rand J.'s caution is particularly important in the context of multinational conglomerates where there are several layers of subsidiaries resident around the world. Respondent's counsel asks, for example, whether legal fees incurred to restructure one of the subsidiaries in the group such as the nitrogen company so as to maximize its earning capacity would be deductible to PCS on income account because of the possible eventual flow of dividends to PCS from the profits of this operating company. It is submitted that accepting such a proposition would render paragraph 18(1)(*a*) nearly meaningless by removing the distinction between the business and property source of income and add in the phrase "*directly or indirectly for the purpose of gaining or producing income from the business*".

[18] *Canada Safeway* at para. 11.

[62] It is submitted that this point was made clear in *Neonex International Ltd. v. R.*[19] where the capital nature of legal fees associated with a failed share acquisition was emphasized. In that case, the corporate taxpayer was in the business of making and selling advertising signage and was a parent company of a conglomerate with over 50 subsidiaries. The taxpayer was denied the deduction of legal fees it incurred in its failed take-over bid of another corporation. In the trial court decision, which was upheld on this issue by the Federal Court of Appeal, Marceau J. noted:[20]

> … I don't see how buying shares, not in order to sell at a profit but with the view to holding and owning same, can be said to be a business within the meaning of that word in the *Income Tax Act*. As Martland, J said in *Irrigation Industries Ltd* v *Minister of National Revenue*, [1962] C.T.C. 215 at 221, 62 D.T.C. 1131 at 1133, shares "constitute something the purchase of which is, in itself, an investment". The plaintiff was in the business of making and selling signs, and it was also in the business of supplying funds and management services to its subsidiaries. But the acquisition itself of the shares of those subsidiaries which were to keep carrying on their own businesses, can only be regarded as a pure investment. … the legal expenses here in question … were outlays associated with an "investment transaction", they were made in connection with the acquisition of a capital asset. They were, therefore, expenditures on capital account.

[63] The submission of the Respondent essentially concludes that the consulting fees were capital outlays which could be recognized under the *Act* as part of the adjusted cost base of PCS's shares of the various subsidiaries involved in the series of transactions. Since there was no basis for allocating the cost amongst all of the subsidiaries whose shares in the series of transactions had been disposed of then, in effect, the expenses could not be recognized at all.

[64] It is argued that if I accept that the purpose of every step of the reorganization was for the purpose of earning income from the shares in the Luxemburg entity, then I must still disallow the subject expenses as being capital in nature. The shares are capital in nature. Any enhanced value to PCS from the expenditure would be reflected by such asset.

[65] Further, Respondent's counsel noted that PCS, in taking advantage of the rollover provisions of the *Act* in subsection 85.1(3) in respect of the disposition of

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[19] 77 DTC 5321 (FCTD) (*Neonex*).

[20] *Neonex* at paras. 23 and 24, upheld on this issue 78 DTC 6339 (FCA).

shares of a foreign affiliate, accepted the characterization of the transfer of its shares of Finance LLC and other entities as capital transactions. It was submitted that PCS cannot characterize these transactions as capital in order to obtain one benefit under the *Act* and then re-characterize them as being on current account for another purpose of the *Act* in advancing its appeal.

[66] Respondent's counsel also cites *Rona v. R.*[21] where the Court held as follows:

> … If the professional fees involve current transactions, they are income expenditures. If the fees involve the expansion of the business structure, they are capital outlays. For example, if fees are paid for negotiations with respect to a marketing campaign, they are income expenses. However, if fees are paid in order to acquire a competitor, they are capital outlays. What needed to be determined first is the nature of the transactions conducted by Rona in order to characterize the nature of the professional services required for these. Here, the professional services were retained for transactions in which franchised stores, or "corporate" stores to be constructed or already owned by competitors were to be acquired. The purpose of these services was to confer on Rona an advantage [TRANSLATION] "for the lasting benefit of [its] business". (Emphasis added by the Respondent.)

[67] As well, it was emphasized that the purpose of paragraphs (18)(1)(*a*) and 18(1)(*b*) is to distinguish those expenditures that are attributable to producing income in the year from a business or property source from those that have a benefit to the income producing process for more than one year. In *British Columbia Electric Railway Co. v. Minister of National Revenue*, Abbott J. summarized the purpose of the provisions as follows:[22]

> The principle underlying such a distinction is, of course, that since for tax purposes income is determined on an annual basis, an income expense is one incurred to earn the income of the particular year in which it is made and should be allowed as a deduction from gross income in that year. Most capital outlays on the other hand may be amortized or written off over a period of years. …

[68] With respect to the consulting fees being entitled to eligible capital expenditure treatment, the Respondent asserts that any claim to such entitlement is not warranted under the provisions of the *Act*. It is submitted that none of the consulting fees constitute eligible capital property of PCS because none of them

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[21] 2003 DTC 264 (T.C.C.) at para. 45.

[22] 58 DTC 1022 (SCC) at para. 37.

were incurred for the purpose of gaining or producing income from PCS's business within the meaning of the definition of such property in subsection 14(5) of the *Act*. The reasons for asserting that none of the consulting fees were incurred for that purpose are the same as that relied on in respect of the submissions on paragraph 18(1)(*a*).

[69] Respondent's counsel also acknowledged in argument the possibility that there might be another avenue to argue the deductibility of the consulting fees. He acknowledged that it was the Canada Revenue Agency's ("CRA") position that custodial costs incurred by a parent company in a multinational group to manage and protect its investment in the subsidiaries might be deductible provided they are incurred for the sole benefit of the parent company.[23] He argued, however, that the evidence confirmed that the consulting fees were not in the nature of custodial costs.

[70] I note, here, that each of the parties made submissions in reply to the submissions of the other. I have not found it helpful to reiterate those further submissions in these Reasons.

Analysis

[71] While appreciating that the authorities have suggested that the analysis of paragraphs 18(1)(*a*) and (*b*) of the *Act* should proceed in that order, in the context of the instant case, I do not find that to be a particularly useful approach. If the subject expenses are capital in nature no deduction will be allowed under paragraph 18(1)(*a*) regardless where an analysis of that paragraph will lead.

[72] Consideration of the deduction limitation in paragraph 18(1)(*b*) in this case will, in my view, lead to a conclusion that the subject expenses are capital in nature. That, in turn, will lead to an analysis of section 14 and a determination of the question as to whether the subject expenses are eligible capital expenditures.

[73] Still, addressing the purpose of incurring the subject expenses needs to be examined for two reasons. First, to determine what it is that has been acquired. It is ultimately the nature of that which is acquired that will determine the nature of the subject expenses. Second, the analysis of section 14 will require a finding of the

[23] CRA – Information Circular – International Transfer Pricing, p. 25; OECD, Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, pp. 207 and 208.

purpose for incurring it. Accordingly, I will proceed with my analysis under the following headings:

a) The overall or end result purpose of the transactions vs. viewing each transaction in the series independently;

b) Capital outlays;

c) The Capital Asset Acquired;

d) Eligible Capital Expenditures; and

e) Conclusion.

a) The overall or end result purpose of the transactions vs. viewing each transaction in the series independently

[74] It is fair to say, based on the evidence, that the consulting fees were incurred to advise and ultimately assist in implementing a plan whereby the cashflow from the Notes could, at least for a time, be repatriated or made available to PCS in the most tax efficient manner. That was the purpose of incurring the subject expenses. The plan required that PCS purchase the shares of a new company, the Luxemburg entity that was to acquire the Notes. That simplistic "end result" overview identifies a *tangible* property acquired to which the subject expenses can reasonably attach. Alternatively, it identifies an "end result" intangible structure to which the subject expenses can reasonably attach. If either such attachment is in fact appropriate, then, it must be recognized that the purpose of incurring the subject expenses should be determined by the overall or end result of the series of transactions entered into.

[75] The Respondent argues, in effect, that the subject expenses attach to the various transactions in the series and that the authorities preclude an analysis that looks to the final result in determining the purpose of incurring the expenditure.

[76] I do not agree with the Respondent's position. The structure and share purchase in this case were only of value if the result was tax effective. That is, it was only of value if the after tax cashflow from the Luxemburg entity was enhanced relative to that obtained through the investment in Finance LLC. This required that the down stream income producing asset (the Notes) be acquired by the target company (the Luxemburg entity) in such a way as would permit this

result. The tax effectiveness of the share purchase was essential to proceeding. For the share purchase to be tax effective, a variety of taxes, such as capital tax on the target company, had to be avoided or minimized and a routing of the asset needed to be carefully planned. The vendor of the asset might have little interest in that structure except to ensure it was tax effective for it and provided the cost of the plan itself was *not* passed on to it. The plan, the structure, was designed entirely for the ultimate benefit of the purchaser of the shares in the Luxemburg entity as a means to access a tax effective cashflow. That is who properly bears the cost of the plan. The consulting fees must attach to that which it ultimately acquired: the share in the Luxemburg entity or the organization holding structure that gave PCS what it paid its consultants to deliver.

[77] In coming to this conclusion, I have not lost sight of the fact that the Luxemburg entity has, in becoming the direct owner of the Notes, benefited from the plan. However, the purpose for incurring the fee was not that. It is the purpose of the party that properly bears the expense for its account that drives the analysis of its nature. Further, there is nothing sinister in acknowledging that the Luxemburg entity was not brought into existence to benefit from the ownership of the Notes. As I will note later in these Reasons, I have no reason to believe that the fiduciary governors of the foreign entities involved in the plan, including the Luxemburg entity, acted contrary to their legal understanding of the purposes and objects of their respective entities. The Luxemburg entity existed to provide PCS with funds derived from the Notes.

[78] Adding that the former owner of the targeted asset, Finance LLC, is a subsidiary of PCS brings in an additional consideration. The pre-tax income stream from the targeted asset derives from an income interest already indirectly held by PCS through Finance LLC. Re-acquiring that interest indirectly in a different form on a tax effective basis in Canada by a share for share exchange, or series of exchanges, on a rollover basis, again only benefits PCS, the indirect purchaser. Again then, the plan, the structure, is ultimately entirely for the benefit of the purchaser of the shares in the Luxemburg entity. Allocations to other entities, as suggested by the Respondent, would not be appropriate in this case.

[79] I note here, as well, that the plan as a whole leaves Finance LLC, and two other companies created as part of the plan, with nothing – they have volunteered or been forced by their respective shareholders, to commit suicide. That is neither troublesome nor consequential, in my view. Shareholders have the power to cause that and more importantly, it underlines that the consulting fees were really of no value to them.

[80] That said, my inclination is that the separate entities argument, and the argument that the overall purpose of a series of transactions cannot displace the legal significance of each transaction viewed independently, are misconceived in this case.

[81] With respect to the separate entities issue, I noted earlier that the *raison d'être* of the intermediary entities did not inherently put them in a conflict of interest position with PCS. I do not mean to suggest that the absence of a conflict of interest stems from there being no minority shareholders or because the corporate veil must be pierced. I say this because it is not unlawful for entities to come into existence for limited purposes and limited times. While I was not shown any constating documents or been guided by any foreign law experts, I have no reason to believe that the fiduciary governors of these foreign entities acted contrary to their legal understanding of the purposes and objects of their respective entities. This is not to suggest that any were the mere agents of another entity. No such assertion was made by the parties. That said, I do not find recognizing a full allocation of the consulting fees to PCS as in any way violating the separate entities doctrine. Every entity paid its own costs relating to every step in the reorganization.

[82] In coming to this conclusion, it is questionable whether or not I am turning a blind eye to the principles set down in *Singleton* and *Novopharm* in respect of interest expenses. There is also the question of whether coming to that conclusion would be turning a blind eye to the authorities that rely on the language in each of paragraphs 12(1)(*c*) and 18(1)(*a*) as saying that the purpose test in both should be applied in the same manner. It must be understood, however, that for tax purposes interest expenses on a loan transaction are not fixed by that particular initiating transaction. When the interest obligation is incurred, the authorities treat the purpose of the loan as open-ended. That is, it is not an expense necessarily incurred for any particular purpose or result until a second transaction occurs which, in turn, on a strict application of the *Act*, dictates the purpose for incurring the expense as actually demonstrated by that second transaction. There is a necessary sequence involving a critical or pivotal second transaction. It is the direct use of the proceeds of the loan that is strictly considered in the case of interest expenses.

[83] A professional fee paid for a reorganization of a holding, particularized from start to finish before being undertaken, has no critical or pivotal second transaction that the *Act* focuses on. Without that focus, isolating transactions in a series so as to ignore the end, predetermined, result as the purpose of the expenditure in this case makes little sense, in my view. This is not a novel view in the context of

determining the nature of an expenditure related to a corporate reorganization as illustrated by the authorities reviewed under the next heading of these Reasons.

[84] Further, I am not dissuaded from that view by the decision in *Novopharm*. Consulting fees in that case were treated under section 18(1)(*a*) as having been paid to earn income on the same basis as the interest expense which was to look at the direct, initial, use of the loan proceeds and ignore the ultimate purpose of the loan and consulting fees. That conclusion, however, cannot be taken as dispositive of the case at bar. The consulting fees in *Novapharm* were tied to the loan. The purpose test as it applied to one had to apply to the other. They were inseparable. That has no similarity to the case at bar.

[85] As well, even if I were to agree that the intermediary transactions must be viewed independently, I would attribute little or no value to an apportionment made to anything other than the cost of the shares in the Luxemburg entity or the plan created and orchestrated to ensure holding those shares would be tax-effective. If the expenses incurred by PCS for its own benefit must attach to intermediary steps, they should only attach to those steps that actually involved PCS in a transaction. If it received shares in a BVI company then arguably a portion of the consulting fees could be attributed to those shares. If it received shares in an Irish company then arguably a portion of the consulting fees could be attributed to those shares. However, the apportionment, if any, would be negligible. While it is true that the shares of intermediaries that hold the Notes will have value, and will have a cost base (that might end up in the cost of the shares in the Luxemburg entity under the Canadian rollover rules), does not mean that the professional fees incurred by PCS must be apportioned on the basis of those values. One has nothing to do with the other. Indeed, all such expenses have only, and necessarily, been incurred as part of a plan to bring the shares in the Luxemburg entity into existence in an effective manner in order to maximize PCS's access to funds derived from the Notes. There is no other reason to incur them and as such the subject expenses in respect of the independent transactions, as stand alone, isolated, independent transactions, would have little or no value to PCS. As well, as noted, they have no value to these other entities.

[86] As such, I have little difficulty in finding that 100% of the consulting fees must be attributed to either the tangible assets it acquired (the shares of the Luxemburg entity) or the intangible structure conceived and orchestrated to enable a more effective cashflow. These two alternatives reflect the purpose for incurring the subject expense and confirm what was acquired for the purposes of determining the nature of the subject expense.

b) Capital outlays

[87] Whether the consulting fees were paid as part of the cost of the shares of the Luxemburg entity or for the plan to reconstruct a pipeline through which down stream interest income could be moved will not change their capital nature. Either way, the reorganization was a worthwhile project. It was known to have a limited life, but it is a capital project nonetheless. All the transactions engaged in by PCS were capital in nature. The fees associated with those capital transactions must then be recognized as incurred on account of capital.

[88] The Appellant argues that the consulting fees were incurred to repair an existing structure. Repairs are on-going recurrent expenses that may well have enduring benefits but are, nonetheless, required in the normal course of business and must be recognized as current expenses. An analogy might be drawn to repairs to rental properties where the cost of a new roof would generally be accepted as a current expense since the repair was not so substantial as to constitute replacement of the asset. The repair did not add value, it maintained value; it maintained the cashflow.[24] However, the scenario in this case is different. What existed prior to the reorganization was an external pipeline feeding the coffers of PCS. PCS paid the planning and design costs to rebuild a new and entirely different pipeline. In such a case the repair analogy fails to recognize the coming into existence of an entirely new structure. This calls on a different line of authorities which hold that the costs of such reconstruction are capital in nature.[25]

[89] As well, this is not a case such as in *Pantorama Industries Inc. v. R.*[26] where monies were paid each year to ensure an existing structure could continue to be exploited profitably. In the case at bar, an entirely new structure was constructed.

[90] In any event, the Appellant's argument that the subject expenses were made for the purpose of earning income from its business brings with it the need to recognize that the new structure allowed for that. Costs associated with new income earning structures are capital in nature. An early authority for the capital

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[24] See for example *Gold Bar Developments Ltd. v. R.*, 87 DTC 5152 (FCTD).

[25] See for example *Shabro Investments Ltd. v. R.*, 79 DTC 5104 (FCA) where a structural change to a building was found to effectively bring a different building into existence.

[26] 2005 FCA 135.

nature of expenditures on a reorganization is found in *Canada Starch Company Limited v. Minister of National Revenue*[27] where Jackett J. found that generally speaking:

> (a) … an expenditure for the acquisition or creation of a business entity, structure or organization, for the earning of profit, or for an addition to such an entity, structure or organization, is an expenditure on account of capital, and
>
> (b) on the other hand, an expenditure in the process of operation of a profit-making entity, structure or organization is an expenditure on revenue account.

[91] This description of an expenditure on capital account is particularly helpful in that by including organizational structures it goes beyond traditional metaphors that depict capital in more tangible terms such as a tree which yields fruit. Further, in *Bergeron c. R.*[28] Justice Archambault at paragraphs 36 and 37 discusses the theory of the tree as a capital metaphor and with authority refers more broadly to capital being a productive source yielding a recurring gain. The two concepts merge so as to underline that a productive source from which recurrent income, gains or benefits can be derived, which are capital, would include an organizational structure and any reorganization of it. That cannot preclude structures that involve any variety of subsidiary entities, foreign or domestic.

[92] Another and recent example referring to the capital nature of an outlay made in the course of a corporate reorganization is found in *Imperial Tobacco Canada Ltd. v. R.*[29] where Bowie J. agreeing with the Crown found that an outlay made in the course of a corporate reorganization to achieve an assurance that some end goal will be completed or achieved in a manner that will have value, will be on capital account. At paragraph 12, Justice Bowie stated that “The real question in each case is "what was the expenditure calculated to effect from a practical and business point of view?"”. Consideration of the ultimate effect of the expenditure is then of paramount importance. He relied on the Federal Court of Appeal decision in *Kaiser Petroleum Ltd. v. R.*[30] where expenditures incurred to reshape the capital structure of

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[27] 68 DTC 5320 at 5323. An earlier authority can be found in *Sun Newspapers Ltd. v. Federal Commissioner of Taxation,* (1938) 61 CLR 337 at 359.

[28] DTC 1265 TCC.

[29] 2010 TCC 648 (T.C.C.) at paras. 11 and 12.

[30] 90 DTC 6603 (FCA); reversing 90 DTC 6034 (FCTD). Justice Bowie in his *Imperial Tobacco Canada* decision distinguished an earlier decision in *Imperial Tobacco Canada Ltd. v. R.*, 2007

the taxpayer's organization were found to be capital in nature. In that reorganization, which offered an inducement to employees to relinquish stock options, the plan was not undertaken to discharge obligations to employees which might have been on income account, but rather the dominant aspect of it, and I would add the desired resulting aspect of it, was to reshape the capital structure of the company. Monies paid out to employees pursuant to the reorganization were accordingly on capital account.

[93] The consulting fees in the case at bar were all about the reorganization of a downstream structure; it was a restructuring of it. Fees relating to it were incurred on capital account whether attributed to the acquisition of shares in a new entity by an exchange of capital assets or to the creation of the plan. Either approach dictates a finding that the expenditures were on capital account given what they were intended to accomplish from a practical and business point of view.

[94] The Appellant's reliance on authorities such as *BJ Services* and *International Colin* do not, in my view, support its position that those authorities have opened the door to a different finding in the case at bar.

[95] As I understand it, the Crown's position in *BJ Services* was that the expenses sought to be deducted were incurred for the benefit of the shareholders and not to earn income from its business. The discussion of those expenses being on current or capital account was required under paragraph 18(1)(*b*) only as a second step after finding that there was a sufficient link between the expenses and the taxpayer's revenue to warrant a finding that they were incurred for the purpose of earning income from a business. The reasons for finding that the expenses were not capital in nature are set out by Justice Campbell at paragraph 45 as follows:

> … No capital asset was acquired, no capital asset was preserved, and no enduring benefit was obtained in incurring these expenditures. The expenses did not relate to any prior or subsequent year. …

[96] That is not the case in the instant appeal. The subject expenses were incurred in respect of a tangible capital asset and/or an intangible holding structure. They gave rise to a benefit to the party that incurred the expense. It was a benefit that endured for a sufficient period to relate to future years.

TCC 636 on the basis that in his later case, as in *Kaiser Petroleum*, the dominant consideration was to reshape the capital structure.

[97] While the Appellant's alternative argument accepts the subject expenses as having been made on account of capital, its principal argument was that they had no enduring benefit and, accordingly, they should not be treated on capital account. It was argued that structural changes to achieve a tax advantage are by their nature of an uncertain life and should not be viewed as affording any enduring benefit.

[98] The enduring nature of a capital expenditure is a characteristic recognizing that its benefit is not consumed in the year it is incurred. The benefit of some expenditures dissipate immediately; their short life is known with some certainty by their nature. Their benefit will be consumed entirely in the accounting period in which their cost is incurred and as a result, the expenditures tend to be recurring on a regular basis. They are deductible on income account. In the case at bar, the benefit of the reorganized corporate structure had a known life. The U.S.-Luxemburg treaty changes that ended the tax advantage of the reorganization were known when the reorganization was first undertaken. It had a known useful life of some three years. The reorganization was planned and the subject expenses were incurred on the basis of achieving a benefit that PCS knew would endure beyond the accounting periods in which they were incurred. Even though the life of that intangible asset was predictably as short as the life of the Appellant's investment in the Luxemburg entity, both are capital in nature. That the benefit was relatively short lived does not affect its fundamental character as capital.[31]

[99] In *International Colin,* once again the Court found that the taxpayer that incurred the expense acquired nothing. No capital asset was acquired, no capital asset was preserved, and no enduring benefit came into existence.[32] The expense was for professional advice that led to a merger whereby *its* shareholders acquired new shares. The company acquired nothing. Further, the premise of the respondent's case was not that the expenses were on capital account but that they were aimed at increasing share values for its shareholders and had nothing to do with the company's income earning activities. Associate Chief Justice Bowman (as he then was) taking a practical approach took the view that the expenses incurred

[31] For example, the life of a depreciable capital asset might be short but that will not change its character as capital. Class 16 assets (leased vehicles) can claim declining balance capital cost allowance of 40% per year. In three years, the cost of such capital assets will be expensed by in excess of 78% of their original cost. A prescribed shorter useful life will not change its character as capital. An envisioned short life of a non-depreciable capital asset such as shares, or a corporate structure, would similarly not change its character as capital.

[32] *International Colin* at para. 48.

were intended to improve the appellant's income which was equated to being laid out to earn income from the appellant's business.[33]

[100] Of importance perhaps in dealing with *International Colin* and that line of cases is the observation at the end of paragraph 49 that the Court's function is to decide the case bearing in mind the business exigencies that necessitated the payment and the commercial objective that it was designed to achieve. That, however, to my mind, speaks more to paragraph 18(1)(*a*) than it does to paragraph 18(1)(*b*). The subject expense are in my view, fundamentally, capital in nature.

c) The Capital Asset Acquired

[101] Distinguishing *BJ Services* and *International Colin* on the basis of there being something of value acquired by PCS in the instant case requires a determination as to what that something of value is. In this regard, I tend to concur with the Appellant that the something acquired was the intangible plan or structure conceived by the professional advisors in consideration of the consulting fees paid to them by PCS.

[102] Returning to my simplistic overview of the reorganization, I have said that it is fair to say, based on the evidence, that the consulting fees were incurred to advise and assist in the purchase of shares of a new company that was to acquire an asset of considerable value. The asset was the Notes and the shares were shares in the Luxemburg entity. That simplistic overview identified the only tangible property acquired to which the subject expenses can reasonably attach. However, that ignores the paramount focus of the task assigned to the professional advisers that were paid the consulting fees. That focus was not the tangible capital asset that PCS ultimately acquired – it was the intangible survey of the landscape of an international network of corporate finance and taxation intended to give rise to, and ultimately did give rise to, a plan of reorganization that satisfied the objectives of PCS.

[103] There is too much here that is not related to the mere acquisition of the shares of the Luxemburg entity to treat the consulting fees as a cost of those shares. It is the plan that achieved a tax efficient result that had value. Indeed, the subject expenses were not ultimately about increasing income from the shares, it was about avoiding a U.S. tax imposed on it that was impairing its operational requirements.

d) Eligible Capital Expenditures

[33] *International Colin* at para. 47.

[104] In considering the question of whether the subject expenses are eligible capital expenditures, I am required, at least, to provide an overview of how section 14 and paragraph 20(1)(*b*) work in the context of the present case. I will set out the relevant portions of the *Act* in Schedule B to these Reasons as they read at the relevant times. My short form overview, however, is as follows:

> The taxpayer seeks a deduction under paragraph 20(1)(b) which allows a declining balance deduction claim "in respect of a business" of up to 7% of its cumulative eligible capital. To obtain such a deduction in respect of the subject expenses, it must then have them included as part of its cumulative eligible capital. Cumulative eligible capital is defined in subsection 14(5) to be a function of the total of eligible capital expenditures "in respect of a business". Eligible capital expenditures "in respect of a business" are defined in subsection 14(5) to mean an outlay on account of capital incurred <u>for the purpose of earning income from the business</u>. (Emphasis added.)
>
> I might refer to this as the "deduction side" of eligible capital regime. The "income side" of the regime concerns the reduction of cumulative eligible capital and the recapture of the deductions claimed and the triggering of any gain when an eligible capital property is disposed of. It is interesting to note, however, that there is no requirement that an eligible capital property, or any particular type of capital asset, be acquired to have an outlay regarded as an eligible capital expenditure. That is, while the income side of section 14 seeks to identify a particular type of property, that has no impact on the framing of the deduction side of section 14 and paragraph 20(1)(b).[34]
>
> Put another way, the scheme of these provisions on the income side contemplates intangibles that are capable of disposition at a price, such as goodwill. This can be seen as follows: eligible capital property defined in sections 248 and 54 means any property of the taxpayer proceeds of disposition of which will be an eligible capital amount "in respect of a business" of the taxpayer. Eligible capital amount is defined in section 248 and subsection 14(1) as the amount that is "E" in the formulation of the taxpayer's cumulative eligible capital. "E" is the amount which, as a result of a disposition, the taxpayer is entitled to receive "in respect of the business" carried on by the taxpayer where the consideration paid by the taxpayer "therefore" was an eligible capital expenditure. In simpler language then, if you can ascribe proceeds to something sold in respect of a business and the consideration paid to acquire that something was an eligible capital expenditure, then those proceeds reduce the cumulative expenditure pool and can potentially

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[34] Subsection 14(3) addresses the case of the acquisition of an eligible capital property where a non arm's length vendor has disposed of such a property. While this identifies the acquisition of a particular type of property, namely one capable of disposition, such focus has a limited application and purpose.

> give rise to recapture and a gain under subsection 14(1). That no eligible capital property even comes into existence at the time of the expenditure and that the intangible benefit acquired is not capable of disposition, has no bearing on whether an expenditure is an eligible capital expenditure.

[105] The intangible tax planned pipeline in the case at bar is not something like goodwill. There is nothing about it that is capable of being sold or disposed of for identifiable proceeds. The intellectual property right to the plan is not even asserted to be owned by the Appellant. The subject expenses were made for the use of the plan. If it is an eligible capital expenditure it will be afforded a 7% declining balance deduction without the income component of section 14 ever coming into play. In a sense it is, as in the case of a current expense, being recognized as extinguished at the end of its prescribed useful life.[35]

[106] All that said, the question to be determined is whether the subject expenses were eligible capital expenditures "in respect of a business" defined in subsection 14(5) to mean an outlay on account of capital incurred *for the purpose of earning income from the business*.

[107] Initially, I found it quite troubling to accept that cases like *Boulangerie St-Augustine*, *BJ Services* and *International Colin* went so far as to say that an expenditure to save tax was one incurred for the purpose of earning income.[36] Tax savings do not enhance income. In the case at bar the dividend "income" received by PCS from downstream operations was not reduced by the withholding tax sought to be reduced. Cashflows, available dollars to spend on debt service and on operations, were reduced but not "income". My concern over this did not seem to be shared by the Respondent. Indeed, Respondent's counsel not only did not raise that aspect of the purpose test in the subject provisions but did not pursue the point even after I tried, on more than one occasion, to lead him there. In such circumstances, it is not the tendency of this Court to take a harder stand than that taken by the Respondent or its client, the CRA, if that stand, consistently applied,

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[35] That its useful life is prescribed to be longer than its actual useful life is of no concern. Prescribed amortization periods inevitably will not match actual useful lives.

[36] There have been many articles written on this trilogy of cases that have taken a more expansive view of the deductibility of business expenditures. Such articles include "Updating the Trilogy: The Courts Confirm a More Practical Approach to Paragraph 18(1)(*b*) of the *Income Tax Act*" by David Spiro & Sheldon Vanderkooy, *(2005) Corporate Finance*, Vol. XIII, No. 1, 1274 and "Now that I Have Paid You … Are Your Fees Deductible? The Tax Treatment of Transaction Costs – Part I and II" by Ted Citrome & Carrie D'Elia, (2004) IX (4) Business Vehicles 466.

reflects a tolerant practice that is not contrary to the terms of the *Act* as applied by the authorities. Further, while I was not given any authorities that went this far, it strikes me that tax planning expenditures are normal recurring costs of maintaining one's operations in a position to earn income.[37] The link is there, albeit indirect. From a pragmatic business point of view, ignoring that reality would be to ignore the dictates of cases like *BJ Services* even though there is no express suggestion in them that the reference in paragraph 18(1)(*a*) to "income" includes a reference to after tax cashflow.[38]

[108] From a pragmatic business point of view the subject expenses did satisfy a cashflow need integral to the conduct of PCS's business. Practically speaking tax planning costs are incurred in the ordinary course of business and expenses so incurred should not so readily be divorced from its income earning activities. Once the expenditure is divorced from the specific investment that gave rise to the income, in this case the shares in the Luxemburg entity, it must attach to the business that benefited from it. PCS's business was enhanced by being part of a global market in fertilizers. While mining and marketing potash is its business, potash does not exist in a vacuum. It is a component of fertilizer – its value and marketability as a nutrient is interdependent with phosphate and nitrogen. Investing in other entities with a view to being a leading player in this aspect of its *own* business cannot be divorced from its own income earning activity. While that may not make the direct investment in shares a business expense, expenditures incurred to improve the efficiency of the investment to enable better exploitation of its own business by

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[37] One possible authority is *Suncor Inc. v. R.*, 1995 CarswellNat 1015, 90 F.T.R. 22 (Federal Court of Canada -- Trial Division). In his reasons in that case, Joyal J. at paragraph 38 notes that tax should be considered an element of cost "like production costs, processes, equipment, rates of extraction, rates of productivity, levels of training and the like." *Suncor* was an excise tax case not an income tax case and the observation is likely *obiter dicta*, as well. While the decision was affirmed by the Federal Court of Appeal, there is no endorsement of the comment by that higher court. As well, although the case has been cited on more than one occasion, no reference has ever been made to the point made by Joyal J. in respect of taxes being part of the cost of production. Further, that an excise tax might well fall into a production category, does not necessarily suggest that an income tax would. On the other hand, in the context of the trilogy of cases referred to above, Joyal J.'s comments add fuel to the idea that tax planning expenses are, practically speaking, part of the cost incurred to earn income.

[38] I embrace this with some reservation. In *Ludco*, for example, the trial judge found that the interest expense was not deductible pursuant to paragraph 18(1)(*a*) as it was aimed at saving tax, not earning income. In overturning the trial judge's decision in that case, there is no suggestion by the Federal Court of Appeal that that conclusion would be wrong had the tax saving, in fact, been the relevant purpose of the loan under scrutiny. That is to say, the question deserves more attention in a case where this issue is actually raised by one of the parties.

increasing its debt service capability and increasing its funding of Canadian operations are expenditures incurred for the purpose of earning income from its business. That the expenditure was capital in nature by virtue of paragraph 18(1)(*b*) does not change that finding.

[109] While, but for paragraph 18(1)(*b*) that finding may well apply to paragraph 18(1)(*a*), it is all the more appropriate that it apply in the context of section 14. The context of that section appears to me to put even less emphasis on the directness of the link between the expenditure and business revenue stream *per se.*

[110] Recalling that the requirement in section 14 is that an eligible capital expenditure be "in respect of a business". In my view, that informs the construction of the purpose test in that definition. That is, the language used in the context of section 14, which gives rise to a deduction to paragraph 20(1)(*b*), is not identical to the language used in paragraph 18(1)(*a*). If, as described in cases like *Boulangerie St-Augustine*, *BJ Services* and *International Colin* an indirect link of an expenditure to the business of the taxpayer is sufficient in the context of paragraph 18(1)(*a*) then it is all the more appropriate to acknowledge the sufficiency of indirect links in the case of identifying eligible capital expenditures.

[111] For comparison purposes, consider the following provisions:

> 20(1) Deductions permitted in computing income from business or property -- Notwithstanding paragraphs 18(1)(*a*), (*b*) and (*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 such part of the following amounts as may reasonably be regarded as applicable thereto
>
> …
>
> (b) cumulative eligible capital amount -- such amount as the taxpayer may claim in <u>respect of a business</u>, not exceeding 7% of the taxpayer's cumulative eligible capital <u>in respect of the business</u> at the end of the year; (Emphasis added.)
>
> …
>
> 14.(4) "Eligible Capital Expenditure" of a taxpayer <u>in respect of a business</u> means the portion of any outlay or expense made or incurred by the taxpayer, as a result of a transaction occurring after 1971, on account of capital for the purpose of gaining or producing income from the business, other than … (Emphasis added.)
>
> …
>
> 18.(1) In computing the income of a taxpayer from a business or property no deduction shall be made <u>in respect of</u> (Emphasis added.)

General limitation

(*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;

[112] The purpose *limitation* in section 18 is potentially *broadened* by applying the phrase "in respect of" to an outlay or expense. On the other hand, that the purpose limitation in respect of eligible capital expenditures is potentially narrowed by the repeated references their being those that exist "in respect of a business". The words "in respect of" are, as expressed by the Supreme Court of Canada, words of the widest possible scope. "They import such meanings as "in relation to", "with reference to" or "in connection with". The phrase "in respect of" is probably the widest of any expression intended to convey some connection between two related subject matters."[39] While one cannot go so far as to say that the *Act* expressly states that an eligible capital expenditure is one made in respect of a business, the context of those provisions is sufficiently different, in my view, as to warrant more latitude to indirect connections between an expenditure and income from a business than might be the case in respect of the application of paragraph 18(1)(*a*). Expenditures, made in the course of business on intangibles that have insufficient substance to be eligible capital property might more often than not only have an indirect connection to business earnings but the scheme of the *Act* cannot, in my view, be taken so narrowly as to create a "nothing" out of expenses such as the consulting fees here. That is what the Respondent advocates in this case. It is not an acceptable position, in my view. The deduction for cumulative eligible capital amounts in paragraph 20(1)(*b*) has to be taken as sufficiently permissive in cases of expenditures such as this which are incurred to enhance the economic and financial viability of one's business.

(e) Conclusion

[39] *Nowegijick v. R.*, [1983] 1 S.C.R. 29 at p. 39.

[113] All that remains to be said is that for the reasons set out above, the appeals are allowed, with costs, on the basis that the consulting fees were eligible capital expenditures of the Appellant in the years incurred.

Signed at Winnipeg, Manitoba this 20th day of April 2011.

"J.E. Hershfield"

Hershfield J.

SCHEDULE A

A-1

2005-1631(IT)G AND 2005-1760(IT)G
IN THE TAX COURT OF CANADA

IN RE: The *Income Tax Act*

BETWEEN:

POTASH CORPORATION OF SASKATCHEWAN INC.,

Appellant,

- and -

HER MAJESTY THE QUEEN,

Respondent.

PARTIAL AGREED STATEMENT OF FACTS

The parties hereto, by their solicitors, admit the following facts, provided that the parties may adduce further and other evidence not inconsistent with this Partial Agreed Statement of Facts

A. BASIC FACTS

1. The Appellant, Potash Corporation of Saskatchewan Inc. ("**PCS**"), is a corporation formed under the *Canada Business Corporations Act* and has its principal place of business at 500-122 1st Avenue South, in the city of Saskatoon, Province of Saskatchewan, S7K 7G3.

2. Throughout *inter alia* the 1997 and 1998 taxation years (the "**Relevant Period**"), the shares of PCS were listed on the TSX and on the NYSE.

3. In the Relevant Period, PCS owned and operated in Canada six potash mines (five in Saskatchewan and one in New Brunswick) and owned an interest in a seventh mine in Saskatchewan, operated by International Mineral and Chemical (Canada) Global Limited under a long-term arrangement.

4. PCS sold the potash it mined to a wholly-owned Canadian subsidiary, PCS Sales (Canada) Inc., which marketed and resold it in Canada, and marketed and resold potash from PCS's New Brunswick mine for export in the Relevant Period.

5. PCS Sales (U.S.A.) Inc., an indirect U.S. subsidiary of PCS, also purchased potash from PCS and marketed, resold and distributed it primarily to the U.S. market in the Relevant Period.

6. PCS also sold potash during the Relevant Period to Canpotex Limited, a potash marketing, sales and export company, controlled in equal voting rights by three Saskatchewan potash producers, that included PCS, which in turn resold it in markets outside North America.

7. The PCS group of companies ("Potash Group") is an integrated fertilizer and related industrial and feed products enterprise, encompassing the production of potash, phosphates and nitrogen the three primary plant nutrients.

8. During the Relevant Period, PCS owned indirectly subsidiaries resident in the U.S., Trinidad, Cayman Island, Mexico, and the United Kingdom, some of which had operations that included the mining of phosphates, the manufacture and sale of solid and liquid phosphates fertilizers as well the production of nitrogen fertilizers and nitrogen chemicals such as ammonia. PCS also indirectly owned full range U.S retail companies, operating under the name of Florida Favorite Fertilizer.

9. For both of its 1997 and 1998 fiscal year, the PCS Group reported consolidated net sales of approximately U.S. $2.3 billion.

10. In its non-consolidated statement of income and retained earnings for 1997 and 1998 filed with its income tax returns for those years, PCS reported sales of approximately $663 million in 1997 and $807 million in 1998.

11. The sales reported by PCS in 1997 and 1998 were derived from a single product, potash and the sale thereof to PCS Sales (Canada) Inc., PCS Sales (U.S.A.) Inc. and Canpotex Limited.

B. INITIAL FINANCING STRUCTURE

12. In 1995, PCS established PCS Finance LLC ("PCS Finance"), a U.S. subsidiary registered in Delaware, and subscribed for 80 units of PCS Finance at a purchase price of US$160,000,000. In that year, PCS invested a total of $584,000,000 in PCS Finance.

13. 6090430 Saskatchewan Ltd. ("609"), a Canadian holding company wholly-owned by PCS, subscribed in 1995 for 20 units of PCS Finance at a purchase price of US$40,000,000. In that year, 609 invested a total of $146,000,000 in PCS Finance.

14. From the inception of PCS Finance in 1995 to its liquidation in 1997, PCS and 609 held 80% and 20% of the units of PCS Finance, respectively.

15. The sole purpose of PCS Finance throughout its existence was to provide financing to certain indirect U.S. subsidiaries of PCS.

16. In 1995, PCS Finance entered into a US$530 million loan arrangement with PCS Phosphate Company, Inc., a U.S. subsidiary registered in Delaware indirectly wholly owned by PCS and 609 and which became Phosphate Holding Company, Inc. ("Phosphate Holding"), in order to allow Phosphate Holding to finance certain acquisitions in 1995.

17. In 1995, PCS Finance loaned Phosphate Holding an additional US$200 million by cancelling the US$530 million loan arrangement with Phosphate Holding and replacing same with a US$730 million loan arrangement with Phosphate Holding.

18. In 1997, PCS Finance also entered into a US$950 million loan arrangement with PCS Nitrogen, Inc. ("Nitrogen") a U.S. subsidiary registered in Delaware indirectly wholly-owned by PCS and 609, in order to allow Nitrogen to finance certain acquisitions in 1997.

(collectively, the loans described in paragraphs 16, 17, and 18 being the "**Loans**")

19. At no time did PCS Finance have a lender-borrower relationship with PCS.

20. The only assets held by PCS Finance were the Loans receivable from Phosphate Holding and Nitrogen.

21. The sole source of income for PCS Finance was interest earned on the Loans receivable from Phosphate Holding and Nitrogen.

22. In 1995, PCS Finance reported net income of US$53,234,787 and made no distributions to PCS and 609.

23. In 1996, PCS Finance reported net income of US$86,625,384 and made total distributions of US$186,087,215 of which US$148,869,772 was distributed to PCS (representing its 80% interest) and US$37,217,443 was distributed to 609 (representing its 20% interest).

24. The distribution of income by PCS Finance to PCS and 609 was subject to U.S. withholding tax at the reduced rate of 10%.

25. This reduction in the withholding tax rate was as a result of the treaty benefit afforded under the *Canada-US. Income Tax Convention.*

26. Of the US$148,869,772 distributed to PCS in 1996, US$108,869,770 represented income subject to a 10% U.S. withholding tax of US$10,886,977. The difference between US$148,869,772 and US$108,869,770 being US$40,000,000 represented a return of capital to PCS.

27. Of the US$37,217,443 distributed to 609 in 1996, US$27,217,440 represented income subject to a 10% U.S. withholding tax of $2,721,744. The difference between US$37,217,443 and US$27,217,440 being US$10,000,000 represented a return of capital to 609.

28. In 1997, PCS Finance reported net income of US$170,258,970 and made total distributions of US$254,244,754 of which US$203,395,803 was distributed to PCS (representing its 80% interest) and US$50,848,951 was distributed to 609 (representing its 20% interest).

29. Of the US$203,395,803 distributed to PCS in 1997, US$79,395,803 represented income subject to a 10% U.S. withholding tax of $7,939,582. The difference between US$203,395,803 and US$79,395,803 being US$124,000,000 represented a return of capital to PCS.

30. Of the US$50,848,950 distributed to 609 in 1997, US$19,848,950 represented income subject to a 10% U.S withholding tax of US$1,984,895. The difference between US$50,848,950 and US$19,848,950 being US$31,000,000 represented a return of capital to 609.

31. In filing its income tax returns for 1996, PCS reported total dividend income of $182,433,894 composed of $148,925,627 received from PCS Finance and $33,508,267 received from 609.

32. In filing its income tax returns for 1997, PCS reported total dividend income of $134,702,622 composed of $109,961,324 received from PCS Finance and $24,741,298 received from 609.

C. THE 1997 AMENDMENTS TO THE U.S. *INTERNAL REVENUE CODE*

33. In August 1997, the U.S. amended section 894 of the *Internal Revenue Code* to deny treaty reductions in withholding tax on income derived by non-resident persons through a "flow through" entity for U.S. tax purposes. PCS Finance was such an entity.

34. The changes to the *Internal Revenue Code* increased the rate of withholding tax payable by PCS and 609 on income distributions made by PCS Finance to 30% from 10%.

D. THE REORGANIZATION

35. As a result of the changes to U.S. tax law, PCS and 609 requested that the Board of Members-Managers of PCS Finance consider their request to transfer their interests in PCS Finance to a Luxembourg corporation.

36. PCS Finance resolved to restructure its existing financing structure and replace it with a new finance structure operated by a company resident in Luxembourg.

(i) SUMMARY OF THE REORGANIZATION

37. PCS Finance agreed to the transfer of the interests of PCS and 609 and the assets of PCS Finance through companies resident in the British Virgin Islands and Ireland, with the Loans being ultimately held by PCS Luxembourg Finance S.à r.l. ("**PCS Luxembourg**") (such transfers, including all details of the steps described herein, are together referred to as the "**Reorganization**").

38. The Reorganization was implemented in three phases over a period of three months:

 (a) In the first phase, the Loans were transferred from PCS Finance, first to a newly formed British Virgin Islands corporation (being PCS BVI Finance Limited), and then to a newly formed Irish corporation (being PCS Ireland Finance Limited, formerly Sarmento Limited). In addition, PCS and 609 formed PCS Luxembourg, having an Irish branch office. This first phase was initiated on or about December 14, 1997 and was completed on or about December 19, 1997.

 (b) As part of the second phase, the Loans remained in PCS Ireland Finance Limited at a reduced rate of interest for a period of three months (without, however, affecting the overall annual yield).

(c) The last phase consisted in the transfer of the Loans from PCS Ireland Finance Limited to the Irish branch of PCS Luxembourg. This third phase was initiated on or about March 23, 1998 and was completed on or about March 31, 1998.

(ii) THE REORGANIZATION IN DETAIL

39. The detailed steps of the Reorganization are as follows:

(a) Phase I

(i) Amendment of the Loans – The Loans were amended, reducing the rate of interest payable from December 14, 1997 to March 31, 1998 while, however, leaving the overall annual yield of the Loans intact. This time period of reduced interest coincided with the three month holding period in PCS Ireland Finance Limited (described in Phase II).

(ii) Creation of PCS Luxembourg and its Irish branch – PCS and 609 together subscribed for all of the shares of PCS Luxembourg on an 80% / 20% basis for an aggregate amount of US$175,000. Immediately thereafter, PCS Luxembourg created an Irish branch office and opened bank accounts at Citibank Ireland and Bank of Ireland with the subscription proceeds. The Irish branch office of PCS Luxembourg made a loan to Nitrogen in the amount of US$50,000. The creation of PCS Luxembourg, its Irish branch, and the making of the loan were concluded before December 31, 1997 and before the coming into force of amendments to the then applicable U.S.-Ireland Income Tax Convention.

(iii) Transfer of interests in PCS Finance to PCS BVI Finance Limited – PCS and 609 transferred their membership interests in PCS Finance to a British Virgin Islands corporation, PCS BVI Finance Limited, in exchange for all the common shares of PCS BVI Finance Limited. The interests in PCS Finance were transferred to PCS BVI Finance Limited to reduce the overall amount of Irish capital tax that would otherwise result on a direct

transfer to PCS Ireland Finance Limited. The common shares of PCS BVI Finance Limited were reorganized into two classes of shares, preferred shares and common shares, by way of reduction in the par value of the common shares (by an amount equal to the cost base in such common shares) in consideration for the issuance of preferred shares for the latter amount.

(iv) Transfer of the shares of PCS BVI Finance Limited to PCS Ireland Finance Limited – PCS and 609 transferred the common shares of PCS BVI Finance Limited to PCS Ireland Finance Limited on December 19, 1997 in return for all the shares of PCS Ireland Finance Limited and contributed to the capital of the preferred shares of PCS BVI Finance Limited.

(v) Liquidation of PCS BVI Finance Limited – PCS BVI Finance Limited was liquidated into PCS Ireland Finance Limited, thus transferring the membership interests in PCS Finance to PCS Ireland Finance Limited.

(vi) Liquidation of PCS Finance – PCS Finance was liquidated into PCS Ireland Finance Limited, thus transferring the Loans to PCS Ireland Finance Limited.

(b) *Phase II*

(vii) Holding of the Loans in PCS Ireland Finance Limited – The Loans were held by PCS Ireland Finance Limited from December 19, 1997 to March 23, 1998. During this period, a reduced rate of interest accrued on the Loans (though none was paid). To minimize the capital tax due on the ultimate transfer to PCS Luxembourg, PCS Ireland Finance Limited was required to hold the Loans for a period of three months.

C.N.

(c) *Phase III*

(viii) Transfer of the shares of PCS Ireland Finance Limited to PCS Luxembourg – PCS and 609 transferred their shares of PCS Ireland Finance Limited to PCS Luxembourg.

(ix) Appointment of new directors of PCS Ireland Finance Limited – The existing Irish directors of PCS Ireland Finance Limited were replaced by Luxembourg resident directors. In addition, certain amendments were made to the Articles of Association of PCS Ireland Finance Limited and it made a loan in the amount of US$50,000 to Nitrogen. These steps resulted in moving the residence of PCS Ireland Finance Limited from Ireland to Luxembourg.

(x) PCS Ireland Finance Limited was liquidated into PCS Luxembourg – PCS Ireland Finance Limited was liquidated, thus transferring the Loans to PCS Luxembourg.

(xi) Transfer of the Loans to an Irish branch of PCS Luxembourg – PCS Luxembourg then transferred the Loans to its Irish branch.

(iii) **POST-REORGANIZATION**

40. With the establishment of PCS Luxembourg, no U.S. withholding tax was payable on payments of interest on the Loans by Nitrogen and Phosphate Holding to PCS Luxembourg, per the U.S. – Luxembourg Income Tax Convention.

41. With the establishment of PCS Luxembourg, 5% of the interest income earned by PCS Luxembourg was subject to Luxembourg income tax up to a maximum tax of US$2,000,000. This is in contrast to the tax treatment that was applicable to PCS Finance, namely that none of its income was subject to U.S. taxation on profits; instead, the distribution of such income of PCS Finance to PCS and 609 was subject to U.S. withholding tax.

C.N.

42. With the establishment of PCS Luxembourg, PCS and 609 were entitled to a 5% preferential rate of withholding tax on dividends paid by PCS Luxembourg under the *Canada-Luxembourg Income Tax Convention*.

43. From its incorporation in 1997 to its windup in 2001, PCS Luxembourg paid no dividends to its shareholders, PCS and 609.

44. In the financial records and tax filings of PCS Luxembourg for the period 1997 to 2001, it recorded the following:

Year End	Profit/(Loss)
December 31, 1997	(US$10,681)
March 29, 1998	(US$48,676)
March 29, 1999	US$186,425,019
March 29, 2000	US$146,382,537
December 31, 2000	US$48,433,476
December 18, 2001	US$4,345,077

45. In each of the 1998, 1999, 2000 and 2001 taxation years of PCS, PCS Luxembourg made non-interest bearing loans to PCS. The outstanding balance of these loans was $593,475,392 at the end of PCS's 1998 taxation year, $1,326,466,642 at the end of its 1999 taxation year, $1,858,376,442 at the end of its 2000 taxation year, and $3,017,426,211 at the end of its 2001 taxation year.

46. PCS Luxembourg reported no interest income on the loans made to PCS in this period, in its financial records and income tax filing in Luxembourg for 1998, 1999, 2000 and 2001.

47. PCS reported no interest expense paid or payable to PCS Luxembourg in its financial records or income tax returns for 1998, 1999, 2000 and 2001.

C.A.

E. The US-Luxembourg Income Tax Convention Amendments

48. On April 3, 1996, changes to the U.S. – Luxembourg Income Tax Convention were signed (the "Changes").

49. Prior to the coming into force of such Changes, following the Reorganization, no U.S. withholding tax was payable on payments of interest by Nitrogen and Phosphate Holding to PCS Luxembourg.

50. Upon the coming into force of such Changes, PCS Luxembourg was no longer able to claim benefits under the U.S. – Luxembourg Income Tax Convention, thus resulting in a 30% withholding tax on payments of interest by Nitrogen and Phosphate Holding to PCS Luxembourg.

51. Such Changes came into force on January 1, 2001.

52. While PCS was aware of these Changes at the time the decision was made to implement the Reorganization, it did not affect that decision.

F. The Consulting Fees

53. In order to plan and implement the Reorganization, PCS engaged legal counsel and accountants and incurred fees in respect thereof.

54. In its financial records for 1997, PCS reported legal and accounting expenses including the amount of $297,864 in General Ledger account 8525, a profit and loss account. PCS also reported the legal fees of $4,262 in account 3766, a balance sheet account called "Deferred LLC costs."

55. In its financial records for 1998, PCS reported legal and accounting expenses of $1,950,390 in account 3766, a balance sheet account called "Deferred LLC costs."

C.A.

G. THE REASSESSMENTS

56. In filing its T2 Income Tax Return for the 1997 and 1998 taxation years, PCS claimed $297,864 and nil, respectively, in legal and accounting fees in relation to the restructuring of PCS Finance.

57. The Minister of National Revenue (the "Minister") initially assessed PCS's tax liability for the 1997 and 1998 taxation years, as filed, by Notices of Assessment dated October 29, 1998 and August 18, 1999, respectively.

58. On March 26, 2001, PCS requested that the Minister make adjustments to its tax liability for 1997 and 1998, seeking to deduct the amounts of $4,262 and $1,950,390, respectively, in relation to legal and accounting fees in relation to the Reorganization.

(iv) 1997 TAXATION YEAR

59. By Notice of Reassessment dated February 28, 2002, the Minister reassessed PCS's tax liability for the 1997 taxation year, and in so doing, *inter alia*, disallowed the deduction of $297,864 on the basis of paragraph 18(1)(a) of the *Income Tax Act* (the "Act"). The Minister also denied the requested deduction of $4,262 on this same basis.

60. By Notice of Objection dated May 24, 2002, PCS objected to the Minister's reassessment.

61. The Minister issued Notices of Reassessment dated June 20, 2002 and August 11, 2004 in respect of PCS's 1997 taxation year which made no adjustments to the disallowed legal and accounting fees or the denied deduction requested by PCS. PCS objected to the respective reassessments by Notices of Objection dated September 16, 2002 and October 8, 2004.

62. On February 25, 2005, the Minister confirmed PCS's reassessment of tax on the basis of 18(1)(a), 18(1)(b) and on the basis that such expenses did not constitute "eligible capital expenditures" of PCS under subsection 14(5) of the *Act*. On February 28, 2006, the

C.A.

Minister issued a new reassessment in respect of PCS's 1997 taxation year, but maintained the disallowed and denied deduction of legal and accounting fees.

(v) 1998 TAXATION YEAR

63. By Notice of Reassessment dated June 25, 2002, the Minister reassessed PCS's tax liability in the 1998 taxation year, and in so doing, *inter alia*, denied the requested deduction of $1,950,390 on the basis of paragraph 18(1)(a) of Act.

64. By Notice of Objection dated September 23, 2002, PCS objected, *inter alia*, to the Minister's denied deduction of $1,950,390.

65. The Minister issued a Notice of Reassessment dated August 18, 2004 in respect of PCS's 1998 taxation year and made no adjustments to the denied deduction. PCS objected to this reassessment by Notice of Objection dated October 8, 2004.

66. On March 2, 2005, the Minister confirmed PCS's reassessment of tax on the basis of 18(1)(a), 18(1)(b) and on the basis that such expenses did not constitute "eligible capital expenditures" of PCS under subsection 14(5) of the *Act*. On February 28, 2006, the Minister issued a new reassessment in respect of PCS's 1998 taxation year, but maintained the denied claim to legal and accounting fees.

H. AGREED UPON QUANTUM OF CONSULTING FEES AT ISSUE IN THESE APPEALS

67. The parties agree that the total amounts at issue in the present appeals are as follows:

TAXATION YEAR	CONSULTING FEES AT ISSUE
1997	$157,695.39
1998	$1,753,654.88

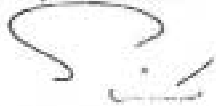
C.A.

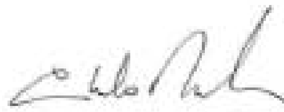
68. Of the total amounts at issue, the parties are now in agreement that PCS incurred legal and accounting fees in respect of the Reorganization in the 1997 and 1998 taxation years in the following amounts:

TAXATION YEAR	CONSULTING FEES INCURRED IN RESPECT OF THE REORGANIZATION
1997	$97,070.57
1998	$1,687,694.57

AGREED to by the parties to be part of the facts of their dispute, as represented by their respective counsel.

Date: September 24, 2010





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SCHEDULE B

SECTION 14

Inclusion in income from business

14.(1) Where, at the end of a taxation year, the total of all amounts each of which is an amount determined, in respect of a business of a taxpayer, for E in the definition "cumulative eligible capital" in subsection 14(5) (in this section referred to as an "eligible capital amount") or for F in that definition exceeds the total of all amounts determined for A to D in that definition in respect of the business (which excess is in this subsection referred to as "the excess"),

14.(1)(a) in the case of a taxpayer (other than

(i) a corporation,

(ii) a partnership all the members of which were

(A) corporations,

(B) partnerships all the members of which were corporations, or

(C) partnerships described in this subparagraph, or

(iii) a partnership that was not a Canadian partnership throughout the year)

who was resident in Canada throughout the year,

(iv) the amount, if any, that is the lesser of

(A) the excess, and

(B) the amount determined for F in the definition "cumulative eligible capital" in subsection 14(5) at the end of the year in respect of the business

shall be included in computing the taxpayer's income from that business for the year, and

(v) there shall be included in computing the taxpayer's income from the business for the year the amount determined by the formula

A - B - C - D

where

A is the excess,

B is the amount determined for F in the definition "cumulative eligible capital" in subsection 14(5) at the end of the year in respect of the business,

C is 1/2 of the amount determined for Q in the definition "cumulative eligible capital" in subsection 14(5) at the end of the year in respect of the business, and

D is such amount as the taxpayer claims, not exceeding the taxpayer's exempt gains balance in respect of the business for the year

14.(1)(b) in any other case, the amount, if any, by which the excess exceeds 1/2 of the amount determined for Q in the definition "cumulative eligible capital" in subsection 14(5) in respect of the business shall be included in computing the taxpayer's income from that business for that year.

Deemed taxable capital gain

14.(1.1) For the purposes of section 110.6 and of paragraph 3(b) as it applies for the purposes of that section, an amount included under subparagraph 14(1)(a)(v) in computing a taxpayer's income for a particular taxation year from a business is deemed to be a taxable capital gain of the taxpayer for the year from the disposition in the year of qualified farm property to the extent of the lesser of

14.(1.1)(a) the amount included under subparagraph 14(1)(a)(v) in computing the taxpayer's income for the particular year from the business, and

14.(1.1)(b) the amount determined by the formula

A - B

where

A is 3/4 of the amount determined in respect of the taxpayer for the particular year equal to the amount, if any, by which

(i) the total of all amounts each of which is the taxpayer's proceeds from a disposition in the particular year or a preceding taxation year that began after 1987 of an eligible capital property in respect of the business that, at the time of disposition, was a qualified farm property (as defined in subsection 110.6(1)) of the taxpayer

exceeds

(ii) the total of all amounts each of which is

(A) an eligible capital expenditure of the taxpayer in respect of the business that was made or incurred in respect of a qualified farm property disposed of by the taxpayer in the particular year or a preceding taxation year that began after 1987, or

(B) an outlay or expense of the taxpayer that was not deductible in computing the taxpayer's income and was made or incurred for the purpose of making a disposition referred to in subparagraph 14(1.1)(b)(i), and

B is the total of all amounts each of which is

(i) that portion of an amount deemed by subparagraph 14(1)(a)(v) (as it applied in respect of the business to fiscal periods that began after 1987 and ended before February 23, 1994) to be a taxable capital gain of the taxpayer that can reasonably be attributed to a disposition of a qualified farm property of the taxpayer, or

(ii) an amount deemed by this section to be a taxable capital gain of the taxpayer for a taxation year preceding the particular year from the disposition of qualified farm property of the taxpayer.

Amount deemed payable

14.(2) Where any amount is, by any provision of this Act, deemed to be a taxpayer's proceeds of disposition of any property disposed of by the taxpayer at any time, for the purposes of this section, that amount shall be deemed to have become payable to the taxpayer at that time.

Acquisition of eligible capital property

14.(3) Notwithstanding any other provision of this Act, where at any time a person or partnership (in this subsection referred to as the " taxpayer") has, directly or indirectly, in any manner whatever, acquired an eligible capital property in respect of a business from a person or partnership with whom the taxpayer did not deal at arm's length (in this subsection referred to as the "transferor") and the property was an eligible capital property of the transferor (other than property acquired by the taxpayer as a consequence of the death of the transferor), the eligible capital expenditure of the taxpayer in respect of the business shall, in respect of that acquisition, be deemed to be equal to 4/3 of the amount, if any, by which

14.(3)(a) the amount determined for E in the definition "cumulative eligible capital" in subsection 14(5) in respect of the disposition of the property by the transferor

exceeds

14.(3)(b) the total of all amounts that can reasonably be considered to have been claimed as deductions under section 110.6 by any person with whom the taxpayer was not dealing at arm's length in respect of the disposition of the property by the transferor, or any other disposition of the property before that time,

except that, where the taxpayer disposes of the property after that time, the amount of the eligible capital expenditure deemed by this subsection to be made by the taxpayer in respect of the property shall be determined at any time after the disposition as if the amount determined under paragraph 14(3)(b) in respect thereof were the lesser of

14.(3)(c) the amount otherwise so determined, and

14.(3)(d) the amount, if any, by which

(i) the amount determined under paragraph 14(3)(a) in respect of the disposition of the property by the transferor

exceeds

(ii) the amount determined for E in the definition "cumulative eligible capital" in subsection 14(5) in respect of the disposition of the property by the taxpayer.

References to "taxation year" or "year"

14.(4) Where a taxpayer is an individual and the taxpayer's income for a taxation year includes income from a business the

fiscal period of which does not coincide with the calendar year, for greater certainty a reference in this section to a "taxation year" or "year" shall be read as a reference to a "fiscal period" or "period".

Definitions

14.(5) In this section,

"adjustment time" "moment du rajustement"

"adjustment time" of a taxpayer in respect of a business is

(a) in the case of a corporation formed as a result of an amalgamation occurring after June 30, 1988, the time immediately before the amalgamation,

(b) in the case of any other corporation, the time immediately after the commencement of its first taxation year commencing after June 30, 1988, and

(c) for any other taxpayer, the time immediately after the commencement of the taxpayer's first fiscal period commencing after 1987 in respect of the business;

"cumulative eligible capital" "montant cumulatif des immobilisations admissibles"

"cumulative eligible capital" of a taxpayer at any time in respect of a business of the taxpayer means the amount determined by the formula

$$(A + B + C + D + D.1) - (E + F)$$

where

A is 3/4 of the total of all eligible capital expenditures in respect of the business made or incurred by the taxpayer before that time and after the taxpayer's adjustment time,

B is the total of

(a) all amounts each of which is the amount that would have been included under subparagraph 14(1)(a)(v) in computing the taxpayer's income from the business for a taxation year that ended before that time and after February 22, 1994 if the amount determined for D in that subparagraph for the year were nil,

(b) all amounts included under paragraph 14(1)(b) in computing the taxpayer's income from the business for taxation years that ended before that time and after the taxpayer's adjustment time, and

(c) all taxable capital gains included, because of the application of subparagraph 14(1)(a)(v) to the taxpayer in respect of the business, in computing the taxpayer's income for taxation years that began before February 23, 1994,

C is 3/2 of the amount, if any, of the taxpayer's cumulative eligible capital in respect of the business at the taxpayer's adjustment time,

D is the amount, if any, by which

(a) the total of all amounts deducted under paragraph 20(1)(b) in computing the taxpayer's income from the business for taxation years ending before the taxpayer's adjustment time

exceeds

(b) the total of all amounts included under subsection 14(1) in computing the taxpayer's income from the business for taxation years ending before the taxpayer's adjustment time,

D.1 is, where the amount determined by B exceeds zero, 1/2 of the amount determined for Q in respect of the business

E is the total of all amounts each of which is 3/4 of the amount, if any, by which

(a) an amount which, as a result of a disposition occurring after the taxpayer's adjustment time and before that time, the taxpayer has or may become entitled to receive, in respect of the business carried on or formerly carried on by the taxpayer where the consideration given by the taxpayer therefor was such that, if any payment had been made by the taxpayer after 1971 for that consideration, the payment would have been an eligible capital expenditure of the taxpayer in respect of the business

exceeds

(b) all outlays and expenses to the extent that they were not otherwise deductible in computing the taxpayer's income and were made or incurred by the taxpayer for the purpose of giving that consideration, and

F is the amount determined by the formula

$$(P + P.1 + Q) - R$$

where

P is the total of all amounts deducted under paragraph 20(1)(b) in computing the taxpayer's income from the business for taxation years ending before

that time and after the taxpayer's adjustment time,

P.1 is the total of all amounts each of which is an amount by which the cumulative eligible capital of the taxpayer in respect of the business is required to be reduced at or before that time because of subsection 80(7);

Q is the amount, if any, by which

(a) the total of all amounts deducted under paragraph 20(1)(b) in computing the taxpayer's income from the business for taxation years ending before the taxpayer's adjustment time

exceeds

(b) the total of all amounts included under subsection 14(1) in computing the taxpayer's income for taxation years ending before the taxpayer's adjustment time, and

R is the total of all amounts included under subparagraph 14(1)(a)(iv) in computing the taxpayer's income from the business for taxation years ending before that time and after the taxpayer's adjustment time;

"eligible capital expenditure" "dépense capital admissible"

"eligible capital expenditure" of a taxpayer in respect of a business means the portion of any outlay or expense made or incurred by the taxpayer, as a result of a transaction occurring after 1971, on account of capital for the purpose of gaining or producing income from the business, other than any such outlay or expense

(a) in respect of which any amount is or would be, but for any provision of this Act limiting the quantum of any deduction, deductible (otherwise than under paragraph 20(1)(b)) in computing the taxpayer's income from the business, or in respect of which any amount is, by virtue of any provision of this Act other than paragraph 18(1)(b), not deductible in computing that income,

(b) made or incurred for the purpose of gaining or producing income that is exempt income, or

(c) that is the cost of, or any part of the cost of,

(i) tangible property of the taxpayer,

(ii) intangible property that is depreciable property of the taxpayer,

(iii) property in respect of which any deduction (otherwise than under paragraph 20(1)(b)) is permitted in computing the taxpayer's income from the

business or would be so permitted if the taxpayer's income from the business were sufficient for the purpose, or

(iv) an interest in, or right to acquire, any property described in any of subparagraphs 14(5) "eligible capital expenditure" (c)(i) to 14(5) "eligible capital expenditure" (c)(iii)

but, for greater certainty and without restricting the generality of the foregoing, does not include any portion of

(d) any amount paid or payable to any creditor of the taxpayer as, on account or in lieu of payment of any debt or as or on account of the redemption, cancellation or purchase of any bond or debenture,

(e) where the taxpayer is a corporation, any amount paid or payable to a person as a shareholder of the corporation, or

(f) any amount that is the cost of, or any part of the cost of,

(i) an interest in a trust,

(ii) an interest in a partnership,

(iii) a share, bond, debenture, mortgage, note, bill or other similar property, or

(iv) an interest in, or right to acquire, any property described in any of subparagraphs (f)(i) to (iii).

"exempt gains balance" "solde des gains exonérés"

"exempt gains balance" of an individual in respect of a business of the individual for a taxation year means the amount determined by the formula

A - B

where

A is the lesser of

(a) the amount by which

(i) the amount that would have been the individual's taxable capital gain determined under paragraph 110.6(19)(b) in respect of the business if

(A) the amount designated in an election under subsection 110.6(19) in respect of the business were equal to the fair market value at the end of February 22, 1994 of all the

eligible capital property owned by the elector at that time in respect of the business, and

(B) this Act were read without reference to subsection 110.6(20)

exceeds

(ii) the amount determined by the formula

0.75(C - 1.1D)

where

C is the amount designated in the election that was made under subsection 110.6(19) in respect of the business, and

D is the fair market value at the end of February 22, 1994 of the property referred to in clause 14(5) "exempt gains balance" (a)(i)(A), and

(b) the individual's taxable capital gain determined under paragraph 110.6(19)(b) in respect of the business, and

B is the total of all amounts each of which is the amount determined for D in subparagraph 14(1)(a)(v) in respect of the business for a preceding taxation year.

Exchange of property
14.(6) ...

Replacement property
14.(7) ...

Deemed residence in Canada
14.(8) ...

Effect of election under subsection 110.6(19)
14.(9) ...

Deemed eligible capital expenditure
14.(10) ...

Receipt of public assistance
14.(11) ...

Loss on certain transfers
14.(12) ...

Deemed identical property
14.(13) ...

PARAGRAPH 20(1)(b)

Deductions permitted in computing income from business or property

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 such part of the following amounts as may reasonably be regarded as applicable thereto

...

Cumulative eligible capital amount

(b) such amount as the taxpayer may claim in respect of a business, not exceeding 7% of the taxpayer's cumulative eligible capital in respect of the business at the end of the year;

SECTION 248

Definitions

248(1) In this Act,

...

"eligible capital amount"

"eligible capital amount" has the meaning assigned by subsection 14(1);

"eligible capital expenditure"

"eligible capital expenditure" has the meaning assigned by subsection 14(5);

"eligible capital property"

"eligible capital property" has the meaning assigned by section 54;

SECTION 54

Definitions

54. In this subdivision,

...

"eligible capital property"

"eligible capital property" of a taxpayer means any property, a part of the consideration for the disposition of which would, if the taxpayer disposed of the property, be an eligible capital amount in respect of a business;

CITATION:	2011 TCC 213
COURT FILE NOS.:	2005-1631(IT)G; 2005-1760(IT)G
STYLE OF CAUSE:	POTASH CORPORATION OF SASKATCHEWAN INC. AND HER MAJESTY THE QUEEN
PLACE OF HEARING:	Saskatoon, Saskatchewan
DATE OF HEARING:	September 30 and October 1, 2010
REASONS FOR JUDGMENT BY:	The Honourable Justice J.E. Hershfield
DATE OF JUDGMENT:	April 20, 2011

APPEARANCES:

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Counsel for the Respondent:	Ifeanyi Nwachukwu Ryan Hall

COUNSEL OF RECORD:

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