Docket: 2015-4074(IT)G

BETWEEN:

ATLANTIC PACKAGING PRODUCTS LTD./
ATLANTIC PRODUITS D’EMBALLAGE LTÉE.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeals heard on June 20, 21 and 22, 2018 at Toronto, Ontario

Before: The Honourable Justice David E. Graham

Appearances:

Counsel for the Appellant:	Louise Summerhill Meghan Cowan Stephanie D’Amico (articling student)
Counsel for the Respondent:	Laurent Bartleman Elizabeth Cunningham (articling student)

JUDGMENT

The appeals of the Appellant’s taxation years ending May 31, 2010, 2011 and 2012 are dismissed.

Costs are awarded to the Respondent. The parties shall have 30 days from the date hereof to reach an agreement on costs, failing which the Respondent shall have a further 30 days to file written submissions on costs and the Appellant shall have yet a further 30 days to file a written response. Any such submissions shall not exceed 10 pages in length. If the parties do not advise the Court that they have

reached an agreement and no submissions are received within the foregoing time limits, costs shall be awarded to the Respondent as set out in the Tariff.

Signed at Ottawa, Canada, this 7th day of September 2018.

"David E. Graham"

Graham J.

Citation: 2018 TCC 183
Date: 20180907
Docket: 2015-4074(IT)G

BETWEEN:

ATLANTIC PACKAGING PRODUCTS LTD./
ATLANTIC PRODUITS D'EMBALLAGE LTÉE.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR JUDGMENT

Graham J.

[1] The Appellant is a paper products manufacturer. In 2009, the Appellant had five divisions. One of those divisions was its tissue division (the "Tissue Division"). The Tissue Division focused on the manufacturing and sale of toilet paper and paper towels. The Appellant was approached by a competitor named Cascades Canada Inc. regarding the sale of the Tissue Division. In August 2009, the Appellant entered into a number of different transactions that were designed to effect the transfer of the Tissue Division to Cascades.

[2] One of the transactions that the Appellant completed was a rollover of certain assets of the Tissue Division to a newly formed corporation named 7228392 Canada Inc. ("722") pursuant to subsection 85(1) of the *Income Tax Act* (the "Act") in exchange for common shares of 722. The Appellant ultimately sold those common shares to Cascades.

[3] When the Appellant filed its tax return for its taxation year ending May 31, 2010, it reported its $29.2 million gain on the sale of the shares of 722 as a capital gain. The Appellant did so in reliance on section 54.2 of the Act. Section 54.2 states that when a taxpayer disposes of property that consists of all or substantially all of the assets used in an active business carried on by that taxpayer to a corporation for consideration that includes shares of the corporation, the shares are deemed to be capital property.

[4] The Minister of National Revenue audited the Appellant and concluded that the Appellant could not rely on section 54.2 to deem the shares of 722 to have been capital property. The Minister came to this conclusion for two reasons. First, the Minister believed that the Tissue Division was not a business in itself but rather was a part of the Appellant's overall paper products business. Second, even if the Tissue Division was a business, the Minister believed that the Appellant did not transfer all or substantially all of the assets used in that business to 722.

[5] As a result of the foregoing, the Minister reassessed the Appellant on the basis that the gain should have been reported on income account. The Minister also issued consequential reassessments of the Appellant's taxation years ending May 31, 2011 and 2012. The Appellant has appealed those reassessments.

A. Issues

[6] The appeals raise the following issues:

(a) Was the Tissue Division a business?

(b) If the Tissue Division was a business, what assets were used in that business?

(c) Which of those business assets were transferred to 722?

(d) Do the transferred assets represent all or substantially all of the assets used in that business?

B. Was the Tissue Division a business?

[7] The Appellant submits that the Tissue Division was a business. The Respondent submits that the Appellant was in the business of manufacturing various paper products (i.e. cardboard, newsprint, toilet paper, paper towels and paper bags) from various types of recycled paper and that the Tissue Division was merely a part of that overall paper products business.

[8] I do not need to decide whether the Tissue Division was a separate business or not because, for the reasons set out below, I find that, even if the Tissue Division was a business, the Appellant did not transfer all or substantially all of the assets used in that business to 722.

[9] That said, I will highlight that, had I had to decide this issue, the inconsistent filing positions taken by the Appellant would have hurt its case. The Appellant had a history of treating its operations as a single business when claiming capital cost allowance.[1] The Appellant continued that single-business approach when determining the cost of the assets that were rolled into 722, yet treated the Tissue Division as a separate business when selling the common shares that the Appellant received from 722 on that rollover. I would have struggled with an outcome that gave the Appellant the benefit of single-business treatment for all of its prior tax years and for the first part of the sale transaction, yet gave it the benefit of separate-business treatment for the second half of that same transaction. Either the Tissue Division was a business or it was not. The Appellant should not have had it both ways.

C. What assets did the Appellant use in the Tissue Division?

[10] The Tissue Division operated from three different locations. Two of those locations were owned by the Appellant and the third location was leased from an affiliated party. Various assets were located at those locations. The Tissue Division also held some general assets not connected to any of the locations. The following discussion breaks down the relevant assets used by the Tissue Division into categories.

Assets relating to the Progress Property

[11] The first location from which the Tissue Division operated was in Scarborough, Ontario (the "Progress Property"). The Progress Property was owned by the Appellant. A large manufacturing plant was located on the property. The Tissue Division operated a tissue mill in part of the plant (the "Progress Mill"). The Progress Mill turned recycled white office paper into very large rolls of tissue. The Appellant's corrugated cardboard division used the balance of the Progress Property to operate a liner mill and a corrugated cardboard mill.

[12] The Tissue Division had a number of assets located at the Progress Property other than the Progress Mill and the Inventory (defined below). I will refer to these other assets as the "Remaining Progress Assets".

Assets relating to the Whitby Property

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[1] The Appellant added all assets of a given class to the same pool regardless of the division to which those assets related.

[13] The Tissue Division's second location was in Whitby, Ontario (the "Whitby Property"). The Whitby Property was owned by the Appellant. A large manufacturing plant was located on the property along with a number of smaller buildings and several clarifying tanks. The Tissue Division operated a second tissue mill in part of the plant (the "Whitby Mill"). Like the Progress Mill, the Whitby Mill turned recycled white office paper into very large rolls of tissue. The Appellant's newsprint division used the balance of the Whitby Property.

[14] The Whitby Mill had a quality control system (the "Quality Control System").

[15] The Tissue Division had a number of assets located at the Whitby Property other than the Whitby Mill, the Quality Control System and the Inventory. I will refer to these other assets as the "Remaining Whitby Assets".

Assets relating to the Converting Property

[16] The Tissue Division's third location was in Scarborough, Ontario (the "Converting Property"). The Converting Property was owned by an affiliated company and was leased to the Appellant. A large manufacturing plant was located on the property. The Tissue Division operated a tissue converting mill in the plant (the "Converting Mill"). The Converting Mill turned the large rolls of tissue produced by the Progress Mill and the Whitby Mill into individual rolls of toilet paper and paper towels. None of the Appellant's other divisions used any part of the Converting Property.

[17] A facial tissue converting machine was also located in the plant (the "Facial Tissue Converting Machine").

[18] The Tissue Division had a number of assets located at the Converting Property other than the Converting Mill, the Facial Tissue Converting Machine and the Inventory. I will refer to these other assets as the "Remaining Converting Assets".

General assets of the Tissue Division

[19] The Tissue Division had inventory consisting of raw materials, large tissue rolls and finished products (the "Inventory").

[20] The Tissue Division also had intellectual property. Some of that intellectual property was sold to Cascades (the "Sold IP"). The balance was retained by the Appellant (the "Excluded IP").

[21] The Tissue Division had other minor assets that it retained (the "Minor Excluded Assets"). The details of those assets are not important.

D. Which of those assets were transferred to 722?

[22] Having determined the Tissue Division's assets, I must next look at which of those assets were transferred to 722. It is important to note that the question is not which assets were transferred to Cascades (directly or indirectly through the sale of the shares of 722). The question is which assets were transferred to 722.

[23] The only assets that were transferred to 722 were the Converting Mill and the Remaining Converting Assets. All of the other assets of the Tissue Division were either sold directly to Cascades, leased to Cascades or retained by the Appellant. The Appellant's leasehold interest in the Converting Property was subleased to Cascades.

[24] The chart at Appendix "A" summarizes what happened to each asset of the Tissue Division.

E. Do the transferred assets represent all or substantially all of the assets used in that business?

[25] It is unclear on the face of section 54.2 how I am to determine whether the assets that the Appellant transferred to 722 represent all or substantially all of the assets of the Tissue Division. Clearly the test does not involve simply counting the number of assets transferred. My initial inclination is to consider the value of the assets but the test makes no specific reference to value. The test in section 54.2 can be contrasted to the definition of "small business corporation" found in subsection 248(1). That definition requires an examination of whether "all or substantially all of the fair market value of the assets" of the corporation meets certain tests. It is clear from this definition that, when Parliament wants to require the use of fair market value in an "all or substantially all" test, it does so explicitly. However, the fact that the test in section 54.2 does not refer to value does not mean that I cannot consider value. It simply indicates that I am not limited to considering value.

[26] The test in section 54.2 does not appear to require that the recipient of the assets be able to carry on the business using the assets acquired. Arguably, a transfer that included an expensive but unnecessary asset and omitted an essential but inexpensive asset would still qualify. An example of a test that focuses on the recipient's ability to carry on the business is found in subsection 167(1) of the *Excise Tax Act*. That test asks whether the recipient of a supply "is acquiring ownership, possession or use of all or substantially all of the property that can reasonably be regarded as being necessary for the recipient to be capable of carrying on the business". In addition to considering whether the recipient will be capable of carrying on the business, this test also considers property that the recipient may have leased from the supplier. Because of these two key differences, I do not find the case law regarding subsection 167(1) helpful.

[27] While there does not appear to be a requirement that the recipient of the assets be able to carry on the business, the inverse is not necessarily true. It is arguable that the test in section 54.2 could be satisfied so long as the recipient had received all of the key assets of the business, regardless of their value. For example, consider a taxi business that has a car worth $5,000, a taxi licence worth $30,000 and $15,000 in credit card receivables, working capital and spare parts. If the operator transferred the car and the licence, it would be arguable that the operator had transferred all or substantially all of the assets used in the business despite the fact that only 70% of the value of the assets had been transferred because the car and the licence are the two most important assets of the business.

[28] Based on all of the foregoing, I find that the test in section 54.2 is intended to be a somewhat flexible test but that there is no reason not to consider the fair market value of the assets when applying the test. As a result, I will first look at the fair market value of the assets transferred and then consider other proposals put forward by the Appellant.

Fair market value

[29] The Appellant valued the assets transferred to 722 at $52,000,000.

[30] The assets that were sold directly to Cascades were sold for $14,329,744. A breakdown of those values is set out in the chart at Appendix "A".

[31] The Whitby Mill was leased to Cascades for one dollar per year. Cascades was given an option to purchase the Whitby Mill. The option was exercisable at

any time. The option purchase price would have been at least $10,000,000.[2] The Appellant submits that I should not place any value on the Whitby Mill because the option purchase price represents nothing more than an offer. I agree that the option purchase price represents the price at which the Appellant is prepared to sell the Whitby Mill. It does not necessarily represent the price at which Cascades would be prepared to buy the Whitby Mill. I acknowledge that, assuming Cascades had the available funds, if it felt the option purchase price was a fair price, it could have simply purchased the Whitby Mill for that price up front. At the same time, the fact that it did not do so may simply have been because, at a lease price of $1 per year, there was little incentive to buy the Whitby Mill before the lease ended. In any event, the fact that Cascades did not simply buy the Whitby Mill or exercise the option is not a reason to place no value at all on the Whitby Mill or to value it based on the $10 in revenue that it was to generate over the term of the lease. In the circumstances, the best evidence that I have of the value of the Whitby Mill is the value that the Appellant was prepared to sell it for, namely a minimum of $10,000,000. Accordingly, that is the value that I will place on it. If the Appellant wanted me to place a different value on the Whitby Mill, it should have provided me with evidence upon which I could do so.

[32] Taking all of the above into account, the assets transferred to 722 would make up only 68% of the total assets of the Tissue Division.[3] While I acknowledge that all or substantially all does not mean 90% and that the specific percentage that meets the test in any given context may vary, I cannot accept that it means something just over two-thirds. Furthermore, the foregoing calculation does not take into account all of the assets of the Tissue Division.

[33] There was no evidence as to the fair market value of the portion of the Progress Property used by the Tissue Division. There was similarly no evidence as to the fair market value of the portion of the Whitby Property used by the Tissue Division. It is, however, clear from the evidence that these assets would have had substantial value. They were sizeable pieces of property with significant improvements on them, most notably, manufacturing plants. Had these assets been

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2 The option purchase price was the greater of $10,000,000 and $20,000,000 less all capital modifications made by Cascades during the term net of all depreciation taken during the term.

3 ($52,000,000 in assets transferred to 722) / ($76,329,744 in total valued assets) = 68.1% where the total valued assets are the Converting Mill, the Remaining Converting Assets, the Inventory, the Facial Tissue Converting Machine, the Quality Control System, the Progress Mill, the Remaining Progress Assets, the Remaining Whitby Assets and the Sold IP.

included in the above calculation, the percentage of fair market value transferred to 722 would have been even lower.

[34] There was also no evidence of the value of the Excluded IP and the Minor Excluded Assets. I accept that the value of these assets was likely relatively small. That said, any value attributed to them would decrease the percentage of the total asset value that the transferred assets represented.

[35] As set out above, the Converting Property was not owned by the Appellant, but rather leased from an affiliated company. The Appellant submits that a leasehold interest is not an asset for the purposes of section 54.2 and thus does not need to be valued. I am not sure that I necessarily agree with the Appellant. It seems to me that a leasehold interest in a property, particularly one that has been custom built for a business, may be an asset within the meaning of section 54.2 and may have significant value. That said, it is not necessary for me to decide the issue so I decline to do so.

[36] Based on the foregoing, I find that, to the extent that the test considers fair market value, the Appellant has not met the test.

Net book value

[37] The Appellant asked me to consider whether the net book value of the assets transferred represented all or substantially all of the assets of the Tissue Division. I disagree with this approach. If I am going to consider the value of the assets, I cannot see why I would examine their net book value rather than their fair market value. Furthermore, the net book value figures provided by the Appellant did not include the net book values of the portions of the Progress Property and the Whitby Property used by the Tissue Division or the net book value of the Whitby Mill and are thus not fair reflections of the value transferred.

Heart of the business

[38] The Appellant argues that all or substantially all of the heart of the business of the Tissue Division was transferred. The Appellant submits that the converting operations were the heart of the Tissue Division. The Appellant says that the converting operations added significant value by converting the large tissue rolls produced by the Progress Mill and the Whitby Mill into individual rolls of toilet paper and paper towels and then selling those products to retailers. The Appellant observes that the Tissue Division could have purchased the large tissue rolls from

third party manufacturers and thus could have carried on the business without the Progress Mill and the Whitby Mill. Since the Converting Mill and the Remaining Converting Assets were the only assets transferred to 722, the Appellant argues that all or substantially all of the heart of the business was transferred.

[39] I accept that this may be a valid way of determining whether all or substantially all of the assets were transferred. However, I disagree with the Appellant's characterization of the Tissue Division. While the converting operations could have functioned without the Progress Mill and the Whitby Mill, the reverse is also true. The Tissue Division could have produced large tissue rolls using the Progress Mill and the Whitby Mill and sold those rolls to third parties. The evidence was that a market for large tissue rolls existed. There was no need for the converting operations. Thus, if there are two parts of the operation that work together and either of them could have worked separately, in order to understand which of those parts, if either, was the heart of the business, I would need to understand their relative value to the Tissue Division.

[40] In support of its argument, the Appellant directed me to calculations that indicated that the converting operations represented a significant percentage of the Tissue Division's sales, gross profit, net profit and earnings before interest, tax, depreciation and amortization. The Appellant submitted that these metrics showed that all or substantially all of the "worth or value of the Tissue Division" was in the converting operations.[4] However, the Appellant's calculations were significantly skewed by the fact that the Appellant ignored intra-division sales. The vast majority of the tissue rolls produced by the Progress Mill and the Whitby Mill were used in the converting operations. By failing to calculate the sales that could have been achieved had those rolls been sold in the open market and the corresponding costs that the converting operations would have had to pay had those rolls been acquired in the open market, the Appellant made the converting operations seem very important and downplayed the contributions of the operations of the Progress Mill and the Whitby Mill.[5] Without these adjustments being made and without some assurance that intra-division costs have been properly allocated, I am not prepared to rely on the Appellant's calculations.

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[4] Appellant's Written Submissions, para. 30.

[5] For example, it appears to me from the figures presented by the Appellant that, when intra-division sales are taken into account, the sales of the converting operation represent 69% of the sales of the Tissue Division rather than the 94% claimed by the Appellant.

[41] The Appellant argued that its position that the converting operations were the heart of the Tissue Division was reinforced by the square footage of those operations and the number of employees involved. I accept that the converting operations required significantly more floor space than the operations of the Progress Mill and the Whitby Mill and that the converting operations employed significantly more people. However, I do not accept that square footage or the number of employees is an appropriate means of measuring the relative importance of various business assets. Bigger is not necessarily better and, as the modern economy aptly demonstrates, the most labour-intensive activities are not necessarily the most valuable.

Conclusion

[42] Based on the evidence before me, the most reliable method of determining whether all or substantially all of the assets of the Tissue Division were transferred is by examining the fair market value of the assets. That analysis indicates that the assets the Appellant transferred to 722 do not represent all or substantially all of the assets used by the Tissue Division.

F. Decision

[43] Based on all of the foregoing, the appeals are dismissed.

G. Costs

[44] Costs are awarded to the Respondent. The parties shall have 30 days from the date hereof to reach an agreement on costs, failing which the Respondent shall have a further 30 days to file written submissions on costs and the Appellant shall have yet a further 30 days to file a written response. Any such submissions shall not exceed 10 pages in length. If the parties do not advise the Court that they have reached an agreement and no submissions are received within the foregoing time limits, costs shall be awarded to the Respondent as set out in the Tariff.

Signed at Ottawa, Canada, this 7th day of September 2018.

"David E. Graham"

Graham J.

Appendix "A"

Asset	Transaction	Fair Market Value
Converting Mill and Remaining Converting Assets	sold to 722	$52,000,000
Inventory	sold to Cascades	$4,937,448
Facial Tissue Converting Machine	sold to Cascades	$100,000
Quality Control System	sold to Cascades	$1,292,296
Progress Mill, Remaining Progress Assets, Remaining Whitby Assets and Sold IP	sold to Cascades	$8,000,000
leasehold interest in the Converting Property	sub-leased to Cascades	unknown
portion of the Progress Property used by the Tissue Division	leased to Cascades	unknown
portion of the Whitby Property used by the Tissue Division	leased to Cascades	unknown
Whitby Mill	leased to Cascades	$10,000,000
Excluded IP	retained by Appellant	unknown
Minor Excluded Assets	retained by Appellant	unknown

CITATION:	2018 TCC 183
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PLACE OF HEARING:	Toronto, Ontario
DATE OF HEARING:	June 20, 21 and 22, 2018
REASONS FOR JUDGMENT BY:	The Honourable Justice David E. Graham
DATE OF JUDGMENT:	September 7, 2018

APPEARANCES:

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