Dockets: 2012-1765(GST)G
2015-2123(GST)G

BETWEEN:

MARINE ATLANTIC INC.,

Appellant,

and

HIS MAJESTY THE KING,

Respondent.

Appeals heard on September 27-29, 2021 at Vancouver, British Columbia, before the Honourable Justice Johanne D'Auray; on October 26, 2021, December 16, 2021, January 11-12, 2022 and January 21, 2022 via Zoom, before the Honourable Justice Johanne D'Auray; and on February 27, 2023 at Vancouver British Columbia, before the Honourable Justice Steven D'Arcy

Appearances:

Counsel for the Appellant:	Kimberley Cook Florence Sauve Chris Canning
Counsel for the Respondent:	Lynn Burch Spencer Landsiedel Selena Sit

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JUDGMENT

In accordance with my Reasons for Judgment:

The appeals from reassessments made under Part IX of the *Excise Tax Act* ("**GST Act**") for the Appellant's reporting periods ending between January 1, 2006 and January 31, 2012 are allowed with costs. The reassessments are referred back to the Minister for reconsideration and reassessment on the basis that, for each reporting period of the Appellant ending between January 1, 2006 and March 31, 2011, the Appellant's input tax credits are to be determined by applying

the Appellant's Final Percentage of 24.52% to the total amount of HST that was paid or payable by the Appellant in the specific period, and for each reporting period of the Appellant ending between April 1, 2011 and January 31, 2012, the Appellant's input tax credits are to be determined by applying the Appellant's Final Percentage of 18.11% to the total amount of HST that was paid or payable by the Appellant in the specific period. Such input tax credits shall be used to calculate the Appellant's net tax for each of the relevant periods and its entitlement to the public service body rebate under section 259 of the GST Act.

The parties have 60 days from the date of this judgment to make written representations with respect to the amount of costs that the Court should award the Appellant. The written submissions shall not exceed 15 pages. If no submissions are received, costs shall be awarded to the Appellant as set out in the Tariff.

Signed at Antigonish, Nova Scotia, this 10th day of July 2023.

"S. D'Arcy"

D'Arcy J.

Citation: 2023TCC95
Date: 20230710
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BETWEEN:

MARINE ATLANTIC INC.,

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REASONS FOR JUDGMENT

D'Arcy J.

[1] The issue in the two appeals before the Court is the Appellant's entitlement to input tax credits with respect to the GST/HST that it paid on goods and services that it acquired in the course of its business of providing a ferry service between Newfoundland and Nova Scotia. The amount at issue in the two appeals is substantial, in excess of $7 million.

[2] In the first appeal (the "**First Appeal**"**)**, the Appellant appeals assessments in respect of its GST/HST reporting periods ending between January 1, 2006 and March 31, 2010. In the second appeal (the "**Second Appeal**"), the Appellant appeals assessments in respect of its GST/HST reporting periods ending between April 1, 2010 and January 31, 2012. The Court heard the two appeals together on common evidence.

[3] My former colleague Justice D'Auray was the presiding judge during the hearing of the evidence and the closing argument. However, she retired from the Court in early 2022, shortly after the conclusion of the hearing.

[4] During a conference call on March 30, 2022, the Chief Justice informed the parties that he would have to assign a new judge to render the judgment in these appeals. He provided the parties with the following two options:

- a new trial with a new judge; or

- a new judge who would render a judgment based upon the trial record.

[5] On the same day, the parties wrote to the Court requesting that it assign a new judge to decide the appeals based on the existing record before the Court.

[6] I was then appointed the presiding judge for these appeals. After a thorough review of the record, including the transcripts of all proceedings, the various written submissions filed by the parties both with respect to argument and procedural issues, and the substantial documentary evidence, I informed the parties that I would require them to appear before the Court to summarize their argument and answer numerous questions. The parties appeared before me on February 27, 2023 (the "**February 2023 Proceedings**").

[7] During the evidentiary portion of the hearing, the Appellant called two witnesses: Mr. Murray Hupman and Mr. Shawn Leamon.

[8] Mr. Hupman, a professional engineer, has been with the Appellant for 22 years. Since April 2019, he has served as the president and CEO of the Appellant. Prior to assuming his current position, he held various other positions with the Appellant, including vice-president of operations and chief information officer.

[9] Mr. Leamon, a CGA/CPA, has served as the vice-president, finance of the Appellant for the last 15 years, including the years at issue in these appeals. He first worked for the Appellant in 1989 as a summer student.

[10] Counsel for the Respondent noted at the commencement of the hearing that she did not intend to call any witnesses. However, she intended to file an affidavit. I will discuss the filing of the affidavit shortly.

[11] Because of issues with respect to the filing of the Respondent's affidavit, the Respondent called Mr. Bryan Roach. Mr. Roach is currently retired but worked for the Canada Revenue Agency (the "**CRA**") between March 1992 and October 2012. He did not participate in the GST audit of the Appellant that resulted in the assessments that are before the Court. However, he did conduct a GST audit of the Appellant in the early 2000s that included an audit of excise tax refunds claimed by the Appellant in respect of fuel for the period ending December 31, 2001. As I will discuss, his testimony related solely to these excise tax refunds, Mr. Roach provided no evidence with respect to the periods at issue.

[12] At the commencement of Mr. Roach's testimony, counsel for the Respondent asked Mr. Roach the following question: "Other than your general recollection of attending at MAI's [the Appellant's] offices and having an interview on the topic of the excise tax refund claims made by MAI for hoteling, do you have any independent recollection of who you talked to, what they told you, or anything of that sort?" Mr. Roach answered, "No, I don't."[1]

[13] Counsel for the Respondent then argued that Mr. Roach's working paper dated November 27, 2002 (which had previously been marked as Exhibit A-3 and which I will refer to as the 2002 excise tax audit working paper) should be accepted by the Court under what she referred to as the "past recollection accorded" concept. The working paper is a document that is barely over a page in length.

[14] Counsel for the Appellant stated that she had no objection to the Court accepting the 2002 excise tax audit working paper.

[15] The Respondent was clearly invoking the *past recollection recorded* doctrine. This doctrine permits witnesses who demonstrate an inability to recall "certain events", to use documents, such as the 2002 excise tax audit working paper, in Court in order to assist them while giving testimony, provided that the following conditions are satisfied:

- The past recollection must have been recorded in some reliable way.
- At the time that the witness made or reviewed the record, his or her memory must have been sufficiently fresh and vivid to be probably accurate.
- The witness must be able now to assert that the record accurately represented his or her knowledge and recollection at the time that he or she reviewed it.
- The original record itself must be used, if it is procurable.[2]

[16] Counsel for the Respondent then put the 2002 excise tax audit working paper in front of Mr. Roach and asked him a number of leading questions with respect to the working paper. On the basis of Mr. Roach's answers to counsel for the Respondent's leading questions (his answers were mainly "Yes, that's correct", "Yes, that's right", "I don't directly recall" and "[Y]es, I think in this case that's

[1] Transcript of proceedings, December 16, 2021, page 99.
[2] *R v. Fliss*, 2002 SCC 16, at paragraph 63.

what I would have been told",) it is clear that the working paper was not being used to refresh Mr. Roach's memory; he had no recollection of the events referred to in his working paper.

[17] As a result, I have treated the 2002 excise tax audit working paper as a record admitted by the Court under the *past recollection recorded* doctrine.

[18] Since the working papers did not refresh Mr. Roach's memory, it is the 2002 excise tax audit working paper, not Mr. Roach's testimony, that is the source of the information before the Court.

[19] The Respondent appears to be relying on the 2002 excise tax audit working paper as evidence of purported discussions between Mr. Roach and a Mr. David Penney, who in 2002 was a staff accountant for the Appellant. This evidence is hearsay evidence. I have given no weight to the references in the 2002 excise tax audit working paper to such discussions, especially since a number of factual conclusions made by Mr. Roach in the working paper were shown by the Appellant's witnesses to be incorrect. If the Respondent wanted evidence before the Court with respect to Mr. Penney's purported comments, he should have called Mr. Penney.

[20] In addition, the 2002 excise tax audit working paper arose with respect to an audit that occurred years before the period at issue and related to excise tax on fuel, not to GST. Such evidence has little or no value in the appeals before the Court.

[21] To the extent that the Appellant's claiming of excise tax refunds with respect to fuel during the periods at issue is relevant, I have relied on the testimony of Mr. Leamon as opposed to a one-page document. Mr. Leamon informed himself of why the Appellant claimed the excise tax refunds during the periods at issue in these appeals and how it calculated the refunds during such periods.

[22] The parties also filed a Partially Agreed Statement of Facts (the "**PASF**") as well as a Joint Book of Documents composed of seven volumes of documents. Although this was not indicated at the time that the books were filed with the Court, the parties stated during the February 2023 Proceedings that they agreed on the admissibility and authenticity of the documents included in the Joint Book of Documents. However, they did not agree on the truthfulness of their contents.

Affidavit Filed by the Respondent

[23] On September 29, 2021, immediately after the Appellant had closed the evidentiary portion of its case, the Respondent attempted to enter an affidavit sworn on September 20, 2021 by Mr. Jonathan Shimizu, a CRA tax appeals case specialist. The affidavit relates to the Appellant's claim for excise tax refunds between January 1, 2006 and January 31, 2012. In the affidavit, Mr. Shimizu provides his opinion of when the *Excise Tax Act* allows for a refund for excise tax paid on fuel and he also discusses how the CRA records information with respect to refund claims. In addition, he refers to the 90 pages of documents attached to the affidavit. These 90 pages include a 10-page Excel spreadsheet that purportedly shows the CRA's recording of refund claims for diesel fuel during the January 1, 2006 to January 31, 2009 period and an 80-page document that purportedly shows the CRA's recording of refund claims for diesel fuel during the February 1, 2009 to January 31, 2012 period.

[24] Counsel for the Respondent stated that she was entering the affidavit pursuant to subsection 335(5) of the GST Act. She stated that if the Crown satisfies the conditions of subsection 335(5) then the Crown may tender the evidence without the necessity of producing a live witness to put that evidence before the Court.[3] In other words, counsel believed that if the conditions of subsection 335(5) are satisfied, the Court must admit the affidavit.

[25] She also stated that with this type of affidavit, no cross-examination of Mr. Shimizu "is required and no opportunity for cross-examination is required".[4] Moreover, she argued that the Respondent's actions did not offend rule 89 of the *Tax Court of Canada Rules (General Procedure)* (the "**General Procedure Rules**").

[26] Rule 89 is relevant because the 90 pages of documents attached to the affidavit were not on the Appellant's list of documents or the Respondent's list of documents, were not provided in answers to undertakings during discovery, and were not even informally given to the Appellant before the Appellant closed the evidentiary portion of its case.

[27] Further, the documents attached to the affidavit were not mentioned in the pleadings, and the Appellant had not waived discovery of the documents.

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[3] Transcript of proceedings, September 29, 2021, page 539.
[4] Transcript of proceedings, September 27, 2021, page 15.

[28] Counsel for the Appellant strenuously objected to the admission of the affidavit and the 90 pages of documents attached to it. Counsel for the Appellant clearly explained the issue with the Respondent's conduct as follows:

> Justice, we're put in a very difficult position here because fundamentally my friend stands up and says, "this is non-controversial evidence" and it couldn't be anything further from the truth. It goes to the basis upon which a significant portion of the appellant's claim rests … And what's particularly galling to me is that the respondent would choose not to provide this evidence to us before now. They swear the affidavit on the 20th, they don't even give it to us on Monday morning, when our clients are here. They carefully wait until we've closed our case and then *voila* here's an affidavit. Won't even speak to what it goes to or what they're relying on it for. And of course that's the whole purpose of the discovery process is for the parties have a chance to consider these things.[5]
>
> …
>
> We can't proceed, Justice, and that's the problem. And why that doesn't work is because we can't rest our case and argue a case when we're not able to ascertain the relevance and significance of the evidence that the Crown at 4:30 on a Wednesday afternoon with argument on Friday suddenly springs on the Court without any justification for why they're springing it now instead of, for example, even if they had provided us with the affidavit when it was commissioned, then we would have had a chance to explore that. But to do it at this time is outrageous candidly.[6]

[29] I agree completely with counsel for the Appellant; this was a blatant attempt at trial by ambush in respect of a key issue in the appeals.

[30] The Respondent's actions defeated the purpose of discovery. As the Supreme Court of Canada noted in *Juman v. Doucette*, "… a proper pre-trial discovery is essential to prevent surprise or 'litigation by ambush', to encourage settlement once the facts are known, and to narrow issues even where settlement proves unachievable."[7]

[31] The main purpose of rule 89 of the Court's General Procedure Rules is to avoid trial by ambush. The rule provides that no document shall be used in evidence by a party unless:

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[5] Transcript of proceedings, September 29, 2021, page 570.
[6] Transcript of proceedings, September 29, 2021, page 573.
[7] 2008 SCC 8, [2008] 1 S.C.R. 157, at paragraph 24.

- a reference to the document appears in the pleadings, or in a party's list of documents or in the affidavit filed with the list of documents;
- it was produced at the examination for discovery; or
- it was produced by a witness who was not under the control of the party.

[32] In the current appeals, none of these conditions were satisfied. As a result, the document was not admissible unless the Respondent obtained the consent of the Appellant or unless the Court directed that the affidavit be admitted.

[33] As I will discuss, eventually the Appellant withdrew its objection to the affidavit and the Court allowed it to be admitted. But this was done at a cost.

[34] Further, the fact that the affidavit was eventually admitted does not change the fact that the Respondent attempted a trial by ambush.

[35] I also have a serious concern with respect to the Respondent's attempt to use an affidavit in appeals such as the ones before the Court, especially when the Respondent, at that point in time, did not intend to call any fact witnesses.

[36] As noted in *Sopinka on the Trial of an Action*,[8] "[T]he general rule is that witnesses are to attend in court to give their evidence orally. Affidavit evidence may be admitted as an exception to prove facts which are not contentious, but will generally not be allowed where the evidence is contentious, or the credibility of the witness is in issue."[9]

[37] In my view, an affidavit has no place in a trial where the facts are in issue, such as the trial before the Court. The Court is a trial court; evidence must come in through witnesses so that this evidence can be tested on cross-examination.

[38] Only in exceptional circumstances will the Court allow affidavit evidence, and even then, this evidence can be admitted only when the facts are not contentious. In my view, affidavit evidence should never be allowed when it is an attempt to circumvent the Court's General Procedure Rules and would lead to a trial by ambush.

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[8] 3rd edition (Toronto: LexisNexis Canada Inc. 2016,) pages 101-102, at paragraph 4.81.

[9] See also *Good Spirit School Division No. 204 v. Christ the Teacher Roman Catholic Separate School Division No. 212*, 2016 SKQB 148, at paragraph 16, and *Mitchell v. Pytel*, 2021 ABQB 403, at paragraphs 12–19.

[39] As counsel for the Appellant noted, and as can be seen from my reasons for judgment, the Appellant's ability to claim input tax credits for GST paid on fuel is a key issue in the appeals before the Court. Further, the Respondent is relying on the Appellant's claims for excise tax refunds to support his argument.

[40] The Respondent's actions in these appeals are consistent with a troubling trend of the Respondent not bringing witnesses to the hearings of taxpayers' appeals and then attempting to enter evidence through affidavits. Recently, the Court has seen this happen frequently in informal proceedings. The Respondent now appears to be attempting to use the same ill-advised approach in general proceedings.

[41] In my view, this conduct must stop. The Court issues judgments based on the evidence before it. If the Respondent wishes to rely on facts that he cannot obtain through cross-examination of the Appellant's witnesses, then he needs to bring witnesses. Considering the vast resources of the CRA, this should not be an issue.

[42] My third concern with the affidavit relates to the Respondent's argument with respect to the application of subsection 335(5) of the GST Act.

[43] Subsection 335(5) provides that an affidavit properly sworn by an officer of the CRA setting out that the officer has charge of the appropriate records and that a document attached to the affidavit is a document or a true copy of a document or a print-out of an electronic document made by or on behalf of the Minister **is evidence of the nature and contents of the document**. For purposes of appeals and applications before this Court, the reference to a document made by or on behalf of the Minister is normally a reference to a document made by the CRA.

[44] The Respondent does not appear to appreciate that subsection 335(5) does not address the truthfulness of the contents of the document. This subsection states that the affidavit is evidence of the nature and contents of the CRA document. In my view, the words "evidence of the nature and contents" refer to the authenticity of the CRA document and the fact that the affidavit evidences what is stated in the CRA document.

[45] For example, the affidavit of Mr. Shimizu is evidence that the attached documents are copies of authentic CRA documents and the documents evidence what is stated in the documents. The documents attached to Mr. Shimzu's affidavit evidence how the CRA recorded the Appellant's refund claims; they are not evidence of the truth ("correctness") of what the documents say.

[46] The Respondent argued that subsection 335(5) allows a document to be presented without cross-examination and that it allows the Minister to file documents without calling a witness.

[47] There is nothing in the wording of subsection 335(5) to support such a position. The subsection simply states that the affidavit is evidence of the nature and contents of the attached CRA document. It does not state that the document is admissible in a hearing or that it can be presented without cross-examination.

[48] These are decisions that are only made by the Court under its jurisdiction to control the processes of the Court.

[49] The Court's decision in *Carcone v. The Queen*[10], ("***Carcone***"), a decision relied on by the Respondent, illustrates the danger of the Respondent's position. The Court's decision in that case was in respect of the applicant's application for an order extending the time within which notices of objection to reassessments may be filed. During the hearing, the Respondent filed an affidavit under subsection 244(9) of the *Income Tax Act*, which is very similar to subsection 335(5) of the GST Act. Subsection 244(9) of the *Income Tax Act* also contains the wording that the affidavit is evidence of the nature and contents of the CRA documents.

[50] Similar to Mr. Shimizu's affidavit, the affidavit in *Carcone* provided evidence with respect to information in the CRA's records. However, in *Carcone*, the CRA person who swore the subsection 244(9) affidavit was called as a witness at the hearing and was cross-examined by counsel for the applicant. This cross-examination showed that the information taken from the CRA's records was incorrect; the information did not, as claimed in the affidavit, reflect information provided by the taxpayer.[11] In short, once the evidence was tested under cross-examination, it was proven to be incorrect. *Carcone* is an example of why, in appeals such as the ones before the Court, untested evidence provided by an affidavit should only be placed before the Court in exceptional circumstances.

[51] My fourth concern with Mr. Shimizu's affidavit is that it contains more than what is permitted under subsection 335(5). Paragraph 4 of the affidavit contains opinion evidence on excise tax law, and paragraphs 5 to 8 contain evidence with respect to the CRA's internal systems.

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[10] 2011 TCC 550.
[11] See *Carcone*, at paragraphs 54 to 60.

[52] In the current appeals, once counsel for the Appellant raised her concerns, Justice D'Auray adjourned the hearing to allow counsel for the Appellant to consult with her client. The Appellant then filed written submissions on October 6, 2021, and the Respondent filed written submissions on October 18, 2021. On October 26, 2021, just before Justice D'Auray was scheduled to issue her decision on the admissibility of the affidavit, the Appellant wrote to the Court stating that the Appellant had agreed to withdraw its objection to the admission of the affidavit and that the Respondent had agreed that the Appellant should be entitled to recall one or both of its witnesses to provide direct examination evidence regarding the matters in the affidavit. The Appellant also agreed to allow cross-examination of its witness.

[53] The affidavit was then accepted by the Court.

[54] Mr. Leamon and Mr. Roach then provided testimony on December 16, 2021 via Zoom. Mr. Leamon was able to provide detailed evidence with respect to the Appellant's claim for excise tax refunds during the periods at issue. As I noted previously, I will rely on Mr. Leamon's evidence to the extent that I need to consider the Appellant's excise tax refunds.

[55] Closing argument was then held on January 11, 12 and 21, 2022 by Zoom.

[56] The Respondent's actions resulted in trial days being thrown away, additional written submissions having to be prepared and filed, and an additional day of testimony by two witnesses. Further, argument was delayed from October 1, 2021 to January 2022. I will deal with the Respondent's actions in my cost award.

Summary of Facts

[57] The Appellant is a federal Crown corporation that provides a constitutionally mandated passenger and commercial marine transportation system between Newfoundland and Nova Scotia.

[58] The constitutionally mandated ferry service is provided between Port aux Basques, Newfoundland and North Sydney, Nova Scotia. The sail takes approximately six to eight hours. The Appellant also operates a seasonal route between Argentia, Newfoundland and North Sydney, Nova Scotia. The seasonal sail takes approximately 16 hours, is not constitutionally mandated and runs between mid-June and late-September.

[59] The Appellant operates terminals in Port aux Basques, Argentia, and North Sydney (the "**Terminals**"). Its head office is located in St. John's, Newfoundland, and it has corporate offices in Port aux Basques, Newfoundland.

[60] During the relevant periods, the Appellant provided its services using a fleet of four vessels (the "**Vessels**"). The Vessels were substantial in size. They were capable of transporting 600 to 700 hundred people and their vehicles. In addition to containing areas for the transportation of vehicles, the ships (other than one ship called the *Atlantic Freighter*[12]), contained areas that were used for such things as passenger cabins, individual passenger seating, restaurants, retail stores, and bars.

[61] At the beginning of 2006, the fleet was composed of vessels named the *Ericson*, the *Caribou*, the *Smallwood* and the *Atlantic Freighter*. By April 2011, the *Caribou*, the *Smallwood* and the *Atlantic Freighter* had been replaced by vessels named the *Atlantic Vision*, the *Blue Puttees* and the *Highlanders* (the "**New Vessels**").[13]

[62] The Appellant imported each of the New Vessels into Canada before placing it in service.

[63] During the relevant periods, the Appellant made both taxable and exempt GST supplies. The various taxable supplies identified by the Appellant are set out at paragraph 11 of the PASF and in Exhibit A-1, Tab 14. The specific taxable supplies identified by the Appellant are as follows:

- the provision of passenger cabins;
- the provision of sleeper dorms;
- the provision of reserved seating (also referred to as day/nighters);
- the sale of items in retail stores (including gift shops and speciality shops);
- the sale of food and beverages in à la carte dining halls;
- the sale of food and beverages in cafeterias;
- the sale of food and beverages in bars;

[12] The *Atlantic Freighter* was much smaller than the other Vessels and was only used to transport commercial vehicles.
[13] PASF, at paragraph 6.

- the provision of kennels;
- the sale of items through vending machines; and
- the provision of amusement machines.

[64] As I will discuss, on the basis of the evidence before the Court, in particular the lack of evidence, it is difficult for the Court to know how the Minister, when assessing the Appellant, calculated the Appellant's input tax credits. However it appears that at the time of the issuance of the assessments for the Appellant's reporting periods ending between January 1, 2006 and March 31, 2010 (the reporting periods covered by the First Appeal), the Minister accepted that the Appellant had made each of the noted taxable supplies. Yet, before confirming the notices of assessment with respect to the reporting periods ending between January 1, 2006 and March 31, 2010, the CRA changed its view and concluded that the supplies of the passenger cabins, sleeper dorms, and reserved seating were exempt supplies.[14] It also took this position when assessing the Appellant's reporting periods that are the subject of the Second Appeal.

[65] On September 17, 2021, shortly before the start of the oral hearing, counsel for the Respondent filed a letter with the Court (the "**Concession Letter**") in which she stated that the Minister had conceded that the supplies of the passenger cabins, sleeper dorms and reserved seating were "areas of taxable activity".

[66] Both parties agree that the Appellant made one exempt supply, the supply of a ferry service. Specifically, the Appellant made the following supply, which section 1 of Part VIII of Schedule V of the GST Act deems to be an exempt supply:

> A supply, other than a zero-related supply, of a service of ferrying by watercraft passengers or property where the principal purpose of the ferrying is to transport motor vehicles and passengers between parts of a road or highway system that are separated by a stretch of water.

[67] The only issue before the Court is the Appellant's entitlement to input tax credits in respect of property and services acquired or imported for consumption, use, or supply in the course of its commercial activities.

[68] Mr. Hupman testified that the operation of each vessel involves an integrated environment. In his words, "everything depends on everything."[15] The interior of

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[14] See Tab 25 of Volume 2 of the Joint Book of Documents, page 56.
[15] Transcript of proceedings, September 27, 2021, page 30.

each of the Appellant's ships was designed based upon the features that the Appellant required in order to provide its services. For example, the number of passenger cabins, crew cabins, restaurants, snack bars, passenger seating areas and vehicle parking areas required by the Appellant, affected the design of a specific vessel.

[69] He noted that one of the most important factors that was taken into account when designing the Vessels was seaworthiness, particularly damage stability and intact stability. The Vessels had to be stable in the water.

[70] Mr. Hupman described each of the taxable supplies made by the Appellant focusing on the nature of the supply and on how a Vessel's physical space and subsystems were used in making the supply.

[71] The most significant generator of revenue from taxable supplies was the passenger cabins. The cabins generated annual revenue of between $4.5 and $4.6 million; however, once the New Vessels entered service, this revenue rose to between $6.1 and $7.3 million.[16]

[72] Mr. Hupman described the cabins as hotel rooms. Each cabin had its own washroom (including a shower), electrical system (to recharge devices), and television. In addition, each cabin has its own HVAC system, meaning that a guest can control the heating and air conditioning for the cabin.

[73] He noted that the cabins took up a great deal of space on the Vessels. For example, the two or three people who occupy a cabin take up as much space as 40 to 50 people sitting in the general seating area.

[74] The cabins also added significant weight to the Vessels. Mr. Hupman noted that this was an important issue from a design perspective. He stated that the more weight you have on a vessel, the bigger the internal systems and engines must be to manage the vessel and propel it.

[75] Since the 100 cabins have 100 showers, sinks and toilets, they also have a significant impact on the ship's water system and sewage treatment facility.

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[16] The revenue for the fiscal period ending March 31, 2007 is significantly lower because the fiscal period is short. The Appellant changed its fiscal year-end in 2007, resulting in a three-month fiscal period ending March 31, 2007. See Transcript of proceedings, September 28, 2021, page 338.

[76] Many staff members are required to service and clean the cabins. Since all of the crewmembers live on the ship for two-week periods, this affects various parts of the ship, particularly the crew cabins.

[77] Catering services were another significant generator of taxable supplies. The Vessels' galley, cafeterias, dining rooms, bars, and snack bars were used to provide the catering services. In most years, these supplies generated revenue of approximately $3 million.

[78] Mr. Hupman noted that the catering services had a significant impact on the design of the Vessels. The catering services required a significant amount of space on the Vessels and relied on numerous subsystems of the Vessels. He provided the following examples:

- The galley used to prepare the food for the various food service outlets took up a significant amount of space. It required marine equipment of a special quality and grade.
- A separate space was required to process and clean the dishes and cutlery to avoid cross-contamination.
- The restaurants, which seat approximately 100 people, took up a great deal of space. In addition, a vessel must provide space to allow for the turnover of customers using the restaurants. Mr. Hupman explained that, while a restaurant had the ability to seat around 100 passengers, there were somewhere between 600 and 700 people on each vessel. A vessel had to provide space to allow, over the six- to eight-hour journey, as many people as possible to use the restaurant. He referred to this as the turnover of customers.
- Significant storage space was required to operate the catering services. Each vessel had cold storage, bulk stores and freezer/cooler storage. These stored the food required to feed thousands of passengers and the crew.
- The area used to provide the catering services utilized a number of what were referred to as technical systems, including:
    - the HVAC systems;
    - the potable water system, which provided drinkable water that was used for both drinking and washing the dishes and cutlery;
    - the sewage treatment facility; and

- a composting area that was required for the physical food waste generated by the catering services.

[79] As a result, the catering services affected the size of the various tanks on the Vessels that were used to store the potable water (the Appellant did not produce water–it was loaded prior to a crossing) and to operate the sewage system. For example, the sewage generated from the catering had a notable impact on the size of the tanks.

[80] Each vessel had to be crewed to support the catering services. As with other crewmembers, these crewmembers were on board the Vessels for two-week periods. As a result, the Vessels required crew cabins for those who provided the catering services.

[81] The day/night seating was another source of taxable supplies. These seats were larger than the normal seating and were contained in a separate space. The Appellant charged a fee for the use of these seats. Annual revenue from these taxable supplies was between $60,000 and $89,000 in the earlier years but climbed to $254,000 once the New Vessels were added to the fleet. Mr. Hupman noted that these seats required more floor space than the general seating. This space consumed heating and air conditioning.

[82] The retail stores were another source of taxable supplies. The stores sold day-to-day amenities, souvenirs and other confection items. Space was required for the stores and for storage of the stores goods. In most of the years under appeal, the retail stores generated between $500,000 and $600,000 of revenue.

[83] Other sources of taxable supplies were the kennels, vending machines and amusement machines. All required space and consumed electricity for lights, heating and air conditioning. The amusement machines, in particular, consumed a significant amount of electricity.

[84] Mr. Hupman testified that 50% of the crew on board a vessel worked directly in the areas that made taxable supplies. Crew cabins were required for each of the crewmembers.

[85] He noted that crew cabins were similar to the passenger cabins and thus had the same impact on the operating systems of the vessel. However, since the crew cabins were the person's "home away from home", the cabins contained a few extra features. These included mini-fridges and a higher electrical outage to allow for the

use of various other appliances and devices. As a result, the electrical load in the crew cabins was higher than the load in the passenger cabins.

[86] Mr. Hupman noted that there were two areas of the ships that the Appellant treated as being used exclusively in the making of the exempt supply of the ferry service. One was the area where passengers parked their cars and trucks. The Appellant referred to this area as the passenger vehicle decks. Passengers were not permitted on the vehicle decks while the vessel was sailing.

[87] Mr. Hupman acknowledged that an argument could be made that the passenger vehicle decks had a strong nexus to the making of taxable supplies. For example, passengers who had booked cabins had to park their cars on the passenger vehicle decks before walking to their cabins. The Appellant believed that treating the passenger vehicle area as an exclusively exempt area supported a fair and reasonable allocation of the Appellant's costs to taxable and exempt supplies. This was a prudent decision.

[88] The second area of the ships that the Appellant treated as being used exclusively in the making of the exempt supply of the ferry service was the general seating area. Any passenger who received the exempt supply of the ferry service was entitled to use the general seating area.

[89] In addition to the areas of the Vessels used exclusively to make exempt supplies and the areas used exclusively to make taxable supplies, the Appellant identified numerous areas that, in Mr. Hupman's words, had a connection to both the making of the taxable supplies and the making of the exempt transportation service. These included all areas of the ships that were not used solely in the making of either taxable supplies or exempt supplies. The Appellant refers to these areas as the common areas.

[90] The common areas, which are summarized in Exhibit A-1 at Tabs 3 to 9, varied from ship to ship depending on the design of the ship. They included corridors, walkways, stairways, public washrooms, the exterior deck (also referred to as the outside seating or open deck space or the exterior walking deck), the galley, galley stores, the hospital room, the bridge, crew cabins, the officers' and crew's mess area, crew laundry, the wheelhouse, the engine room, the auxiliary engine room, the air conditioning room, the pump room, maintenance shops, the sewage

plant, the boiler room, fuel and ballast water tanks, void spaces,[17] the generator compartment, the control room, mooring stations, hydraulic machinery compartments,[18] the stabilizer room, and the fire control room.

The Law

[91] The GST is levied under four separate and distinct divisions of the GST Act, Division II, Division III, Division IV and Division IV.1 of the GST Act. Each of these divisions imposes the tax. For example, a single transaction may be taxed under both Division II and Division III.

[92] Under Division II, the tax is levied on taxable supplies that are *made in Canada*. This is the tax levied on supplies that occur in Canada. Division II tax is levied either at the 5% GST rate or at the higher 13%/15% HST rates. The 5% GST rate applies to goods and services consumed in so-called non-participating provinces (Quebec and all provinces west of Ontario). The 13% HST rate is applied to goods and services consumed in Ontario and the 15% HST rate is applied to goods and services consumed in one of the Atlantic provinces. Ontario and the Atlantic provinces are referred to as the participating provinces.

[93] The Division II tax is collected by the supplier of the good or service.

[94] Under Division III, the tax is levied on all goods imported into Canada, regardless of whether or not the goods are subject to Canadian customs duties. The tax is levied and collected by the Canada Border Services Agency at the time of importation. All commercial importations are taxed at 5%. Non-commercial importations are taxed at either the 5% GST rate or the 13%/15% HST rates, depending on whether the importer is a resident of a non-participating or a participating province.

[95] Under Division IV, the tax is levied on imported services and intangible personal property. The recipient of the imported service or intangible personal property pays the tax on a self-assessing basis directly to the CRA. Generally speaking, a recipient only self-assesses Division IV tax if it imports the service or

[17] Void spaces arose on account of the design of the Vessels. Some were used for ballast to provide a more stable platform for the ship.
[18] These were used to load and unload the Vessels.

intangible personal property for use in activities that do not constitute GST commercial activities.[19]

[96] Division IV.1 is intended to ensure that consumers in a participating province do not avoid the higher HST rate by acquiring goods and services in non-participating provinces. Division IV.1 tax is imposed on goods and services imported into a participating province. Similar to Division IV, Division IV.1 tax is imposed on a self-assessing basis and does not apply if the person is entitled to claim full input tax credits in respect of the imported property or service.

[97] As noted previously, the Appellant made a number of taxable supplies on the ships. Each of these taxable supplies was subject to Division II tax. The Appellant was required to add such tax when calculating, under subsection 225(1), its net tax for a specific reporting period.

[98] When calculating its net tax, the Appellant was entitled to claim input tax credits in respect of tax that it paid under divisions II, III, IV and IV.1.

[99] The evidence before me is that during the relevant periods, the Appellant paid Division II, Division III and Division IV.1 tax. It paid Division II tax on goods and services that it acquired in Canada for consumption, use or supply when operating its ferry service. Division III tax was paid when it imported the New Vessels into Canada, and Division IV.1 tax was paid when it first brought each of the New Vessels into a participating province (either Newfoundland and Labrador or Nova Scotia).[20]

[100] When calculating its net tax under subsection 225(1), a person, such as the Appellant, may claim input tax credits. Subsection 169(1) of the GST Act contains the general rules for the claiming of input tax credits. The applicable portions of subsection 169(1) read as follows:

> Subject to this Part, where a person acquires or imports property or a service or brings it into a participating province and, during a reporting period of the person

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[19] Division IV may also apply to certain supplies of tangible personal property that are subject to the so-called drop-shipment rules.

[20] In its Notice of Appeal, the Appellant refers to the tax that it paid on bringing the New Vessels into Nova Scotia and Newfoundland and Labrador as provincial tax. I am not aware of any provincial tax that would apply in such a situation. As confirmed by counsel for the Appellant during the February 2023 Proceedings, the Appellant meant to refer to the federal GST/HST imposed under Division IV.1 of the GST Act in respect of the New Vessels.

> during which the person is a registrant, tax in respect of the supply, importation or bringing in becomes payable by the person or is paid by the person without having become payable, the amount determined by the following formula is an input tax credit of the person in respect of the property or service for the period
>
> A x B
>
> where
>
> A is the tax in respect of the supply, importation or bringing in, as the case may be, that becomes payable by the person during the reporting period or that is paid by the person during the period without having become payable; and
>
> B is
>
> ...
>
> (c) ... the extent (expressed as a percentage) to which the person acquired or imported the property or service or brought it into the participating province, as the case may be, for consumption, use or supply in the course of commercial activities of the person.

[101] Subsection 169(1) provides for input tax credits for Division II, Division III, Division IV and Division IV.1 tax. The reference in the opening paragraph of subsection 169(1) to a person *acquiring* property or a service and *tax in respect of the supply* being paid or payable is a reference to Division II tax. The reference to a person *importing* property or a service and *tax in respect of the importation* being paid or payable is a reference to Division III or Division IV tax. The reference to a person *bringing a property or a service into a participating province* and *tax in respect of the bringing in* being paid or becoming payable is a reference to Division IV.1 tax.

[102] The Appellant is entitled to claim input tax credits for the Division II, Division III and Division IV.1 tax that it paid to the extent it satisfies the conditions of subsection 169(1) in respect of each acquisition, importation or bringing into a participating province of a good or service. Specifically, the Appellant is entitled to claim an input tax credit for a percentage of the tax that it paid in respect of the acquisition or importation of a specific property or service or in respect of the bringing of a property or service into a participating province. The percentage is based upon the extent that the Appellant acquired or imported the relevant property or service or brought it into a participating province for consumption, use or supply in the course of its *commercial activities*.

[103] As a result of subsection 169(1), a person's ability to claim input tax credits is dependent on its intended or actual use of the property or service in its *commercial*

activities. *Commercial activity* is defined in subsection 123(1). The relevant portion of the definition, for the purposes of these appeals is "(a) a business carried on by the person … except to the extent to which the business involves the making of exempt supplies by the person".

[104] *Business* is defined in subsection 123(1) as follows:

> "business" includes a profession, calling, trade, manufacture or undertaking of any kind whatever, whether the activity or undertaking is engaged in for profit, and any activity engaged in on a regular or continuous basis that involves the supply of property by way of lease, licence or similar arrangement, but does not include an office or employment.

[105] As I noted in *Stewardship Ontario v. The Queen*[21] and *University of Calgary v. The Queen* ("***University of Calgary***")[22] under the GST Act, a person's business is broader than the person's commercial activity. A business includes all of the activities of a person, regardless of whether the activities involve the making of taxable supplies or of exempt supplies. However, a commercial activity only includes the activities of the business that do not involve the making of exempt supplies.

[106] On the basis of the evidence before me, I have concluded that the Appellant carried on a single business, namely the transportation of persons and vehicles by ferry between Nova Scotia and Newfoundland. In the course of this business, the Appellant made both taxable supplies and exempt supplies. As a result, the activities that the Appellant carried out when carrying on its transportation business constituted commercial activities, except to the extent that the business involved the making of exempt supplies.

[107] Since the Appellant made both taxable and exempt supplies, it had to determine, for each acquisition or importation of property or a service, the extent to which it acquired or imported the specific property or service for consumption, use or supply in the course of its commercial activities. It had to make a similar determination for the property (the New Vessels) that it brought into Nova Scotia and Newfoundland and Labrador.

[108] The Appellant had to do this for both the property and services that it used directly in the making of a specific supply and for the property and services that it

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[21] 2018 TCC 59.
[22] 2015 TCC 321.

used indirectly in the making of a specific supply. When determining the extent to which a person may claim input tax credits for property and services used indirectly in the making of a specific supply, one must consider the section 141.01 input tax credit apportionment rules.

[109] I explained in detail the operation of subsections 141.01(2) and (3) at paragraphs 94 to 109 of my reasons for judgment in *University of Calgary* (see Appendix A).

[110] The key point for purposes of the current appeals is that when determining input tax credits for a person, one must attribute all costs that the person incurs in the course of its business to the making of supplies. This includes both direct costs and indirect costs.

[111] Once all of the costs are attributed, then one must determine, for **each** individual direct cost and indirect cost, the extent to which the relevant property or service was acquired, imported or brought into a participating province for consumption, use or supply in the course of the person's commercial activities.

[112] As a result of subsection 141.01(2), property or a service is deemed to have been acquired, imported or brought into a participating province for consumption or use in the course of the person's commercial activities to the extent that the property or service is acquired for the purpose of making taxable supplies for consideration in the course of the person's business.

[113] In most instances, when a GST registrant is making both taxable and exempt supplies, this requires the registrant to develop an allocation method or formula.

[114] In doing so, the registrant must comply with subsection 141.01(5). Paragraph 141.01(5)(a) provides that the methods used by a person in a fiscal year to determine the extent to which properties or services are acquired, imported or brought into a participating province by the person for the purpose of making taxable supplies for consideration or for other purposes must be fair and reasonable and are to be used consistently by the person throughout the year.

[115] Paragraph 141.01(5)(b) sets out an identical rule for actual consumption or use of the properties or services. It provides, in part, that the methods used by a person in a fiscal year to determine the extent to which the consumption or use of properties or services is for the purpose of making taxable supplies for consideration

or for other purposes must be fair and reasonable and are to be used consistently by the person throughout the year.

[116] The issue of what is fair and reasonable was addressed by my colleague Justice Owen in *Sun Life Assurance Company of Canada v. The Queen*.[23] He stated the following with respect to the method proposed by the Appellant, Sun Life Assurance Company of Canada:

> [37] The definition of the word "reasonable" in the *Oxford English Dictionary* (Second Edition) that is in my view most appropriate is A.2.a: "Having sound judgement; sensible, sane. . . . Also, not asking for too much." The use of the word "raisonnables" in the French version of the provision supports this interpretation.
>
> [38] The use of a reasonableness requirement in tax legislation has been considered in other contexts. In *Bailey v. M.N.R.*, [1989] T.C.J. No. 602 (QL), 89 DTC 416, the Court stated (at page 420):
>
> > What is "reasonable" is not the subjective view of either the respondent or appellant but the view of an objective observer with a knowledge of all the pertinent facts: *Canadian Propane Gas & Oil Limited v. M.N.R.*, 73 DTC 5019 per Cattanach J. at 5028.
>
> [39] In *Maege v. The Queen*, 2006 TCC 117, the Court adopted the general approach to determining reasonableness set out in *Tsiantoulas v. Canada*, [1994] T.C.J. No. 984 (QL), where the Court stated at paragraph 11:
>
> > Reasonableness is a question of fact and requires the application of a measure of judgement and common sense.
>
> [40] I can see no reason why the general approach to determining reasonableness in these cases would not also apply to determining whether a particular method is "fair and reasonable". That is to say, what is "fair and reasonable" is a question of fact and requires the application of a measure of judgment and common sense. The determination is not based on the subjective view of either the Appellant or the Respondent but is based on the view of an objective observer with knowledge of all the pertinent facts. It is also important to recognize that the tax authorities cannot simply substitute their approach for that of Sun Life and that there may be more than one method that is fair and reasonable in the circumstances (see *Ville de Magog v. The Queen, supra*).

[117] In my view, this is an accurate statement of the law with respect to the application of the subsection 141.01(5) fair and reasonable test. A GST registrant is

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[23] 2015 TCC 37.

entitled to use any method that is fair and reasonable provided that it complies with the provisions of the GST Act. The CRA cannot simply substitute its method for that of the GST registrant.

[118] The question to be asked is whether the GST registrant's methodology allocates the GST paid on inputs to its taxable supplies (i.e. its commercial activities) in a reasonable manner. When answering this question, one should consider the business activities of the GST registrant, focusing on the particular activities that consume or use the taxable inputs. An allocation method should not distort the financial reality of the commercial activity.[24]

[119] The Federal Court of Appeal in *Magog (City of) v. Canada* stated:

> It is important in this regard to note that the Act does not require the appellant to establish the type of accounting systems that would enable it to separate out each property or service that is consumed or used in the context of its mixed activities. Parliament was aware that such a requirement could result in compliance expenses that would exceed the tax yielded. So it left it to the taxpayer to select an appropriate method, while requiring that the method chosen be "fair and reasonable".[25]

[120] For the same reason, as I noted in *University of Calgary*, a GST registrant should be entitled to determine its input tax credits on the basis of information in its possession without having to resort to hiring expensive third parties, such as valuators or, as I will discuss, engineers to measure spaces on its ships or experts to try to determine what percentage of fuel is consumed to propel a ship and what percentage is consumed to produce electricity, heat or hot water.

[121] Subject to section 141, the percentage determined using the GST registrant's chosen method decides the amount of input tax credits that it is entitled to claim on its GST return. Section 141 contains what is referred to as the *substantially all* test. Subsection 141(1) provides that if substantially all of the consumption or use of property or a service is in the course of the GST registrant's commercial activities, then all the consumption or use of the property or service is deemed to be in the course of commercial activities. Conversely, subsection 141(3) provides that if substantially all of the consumption or use of property or a service is in the course of activities of the GST registrant that are not commercial activities, then all the

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[24] See for example, *British Columbia Ferry Services Inc. v. The Queen*, 2014 TCC 305 ("***B.C. Ferries***"*)* at paragraph 60 and *Bay Ferries Limited, v. The Queen*, 2004 TCC 663 ("***Bay Ferries***"), at paragraph 46.

[25] 2001 FCA 210, at paragraph 17.

consumption or use is deemed to be in the course of non-commercial activities of the GST registrant.[26]

Application of the Law to the Facts

[122] The Appellant made both taxable and exempt supplies during the relevant periods. As a result, it was required to develop an allocation method or formula in order to determine the extent to which each of its individual direct costs and indirect costs was acquired, imported or brought into a participating province for consumption, use or supply in the course of its commercial activities.

[123] Prior to 2006, the Appellant used what is referred to as an output method to calculate its input tax credits. An output method does not attempt to trace an input to the related supply or supplies, but rather looks only at the nature of the revenue earned by the supplier of the goods and services.

[124] Using this method, the Appellant first determined what the percentage of its total revenue was revenue from taxable supplies. It then applied this percentage to the GST that it paid to determine its input tax credits. The percentage was approximately 11% to 12%.[27]

[125] It appears that the CRA accepted this percentage.

[126] In certain situations, the Court has accepted the output method. However, it clearly can lead to distortions since it does not attempt to trace inputs to actual supplies. For example, if the taxable supplies of a GST registrant use fewer taxable inputs than the exempt supplies made by the registrant, the input tax credits will be overstated. This can occur if the taxable supplies have a substantially higher profit margin (incur fewer taxable inputs) or if a significantly higher amount of non-taxable inputs, such as salary and wages, are used to make the taxable supplies. In such a situation, the output method would not reflect the business activities that consume or use the taxable inputs.

[127] Mr. Leamon explained that in 2005, the Appellant was approached by a number of consultants advising it that, as a result of this Court's decision in *Bay Ferries* it should review its method of calculating input tax credits.

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[26] Subsections 141(2) and (4) contain identical rules for intended consumption or use.
[27] Transcript of proceedings, September 28, 2021, pages 340–341.

[128] The Appellant subsequently retained the Deloitte accounting firm and, after discussions with the firm, decided to change its allocation method to a so-called input method, a method that attempts to trace inputs to the related supplies.

[129] When determining a methodology, the Appellant considered the fact that all, or nearly all, of its revenue came from supplies made on the Vessels: the exempt supply of the ferry transportation service and the numerous taxable supplies. Relying on this fact, it decided to allocate all of its inputs to its taxable and exempt supplies using a method that is based on the use that the Appellant made of the space on each vessel.

[130] It grouped areas on the Vessels into three categories:

- areas used in the making of exempt supplies (exempt areas);
- areas used in the making of taxable supplies (taxable areas); and
- areas used in the making of both taxable and exempt supplies (common areas).

[131] Mr. Hupman explained that the Appellant categorized each area of the Vessels by looking at what the area was actually meant to do. If the area was intended to be used solely to generate income from taxable supplies (such as the passenger cabins and restaurants), then it was included in the taxable areas. If the area was intended to be used solely to generate income from exempt supplies (such as the passenger vehicle decks and the general seating area), then it was included in the exempt areas. Finally, if the area had a connection to both the taxable supplies and the exempt supplies, meaning that it was intended to be used directly or indirectly for both, then it was treated as a common area.

[132] It is the Appellant's position that the extent to which it acquired, imported or brought into a participating province property or services for consumption, use, or supply in the course of its commercial activities can be determined by taking the total square metres of all areas of the Vessels that were used exclusively in the making of taxable supplies for consideration and dividing this figure by the total of the square metres of all areas of the Vessels that were used exclusively in the making of taxable supplies for consideration and the square metres of all areas of the Vessels that were used exclusively in the making of exempt supplies.

[133] Originally, the Appellant had used the following formula: the total square metres of the areas of the Vessels used in making taxable supplies divided by the

difference between the total area of the Vessels and the total square meters of the common areas of the Vessels[28]. This calculation leads to the same result as the calculation set out in the previous paragraph, since the total area of the Vessels minus the total square metres of the common areas is equal to the total of the areas used to make the taxable supplies and the areas used to make the exempt supplies. Under the Appellant's final method, there is no need to measure the common areas.

[134] Using this methodology, the Appellant arrived at the following percentages (the **Appellant's Final Percentages or Final Percentages**)[29]:

- Reporting periods ending between January 1, 2006 and March 31, 2011: 24.52%
- Reporting periods ending between April 1, 2011 and January 31, 2012: 18.11%

[135] The percentage was reduced from 24.52% to 18.11% on account of a change in the composition of the Vessels, which occurred when the New Vessels replaced the *Caribou*, the *Smallwood* and the *Atlantic Freighter*.

[136] The Appellant applied the relevant Final Percentage to the total amount of HST that it paid in each reporting period. This included HST that it paid for goods and services consumed or used on the Vessels, in the Terminals and at the Appellant's corporate offices. It also included the Division III and Division IV.1 tax that it paid on the importation of the New Vessels.

[137] By applying the Final Percentages to the total amount of HST paid, including the HST that it paid on goods and services acquired for consumption or use in respect of the operation of the Terminals and the Appellant's corporate offices, the Appellant treated the Terminals and the corporate offices as common areas – namely as areas that were used to support the making of both taxable and exempt supplies on the Vessels. This is the result since the formula used by the Appellant only includes the areas used directly in the making of taxable supplies and directly in the making of exempt supplies on the Vessels. Therefore, any remaining areas, which would include the remaining areas on the Vessels, the corporate offices and the

[28] Tab 2 of Exhibit A-1 refers to "Common" and "Common Excluded". The "Common Excluded" represents areas that were not measured when the Appellant first performed the calculation. Since the "Common Excluded" were not originally included in the total area of the ship, the calculation does not change once they are included in the total and subsequently subtracted from the total.
[29] See Exhibit A-1, Tab 2 and PASF, at paragraph 12.

Terminals, must be areas that the Appellant determined it used to support the making of both taxable and exempt supplies on the Vessels.

[138] Mr. Hupman and Mr. Leamon explained in some detail how the Appellant arrived at its Final Percentages. In 2005, the Appellant met with representatives from Deloitte to agree on the method that the Appellant was to use to determine its entitlement to input tax credits. The Appellant provided Deloitte with detailed cross plans of each of its Vessels. Deloitte reviewed the plans with the Appellant, discussed the various areas on each of the Vessels, and then visited each of the Vessels. During the visits to the Vessels, Deloitte discussed the Vessels' operations with onboard staff.

[139] Using this information, Deloitte and the Appellant calculated the 24.52% that the Appellant used to determine the input tax credits that it claimed when determining its net tax for the reporting periods ending between January 1, 2006 and March 31, 2010.

[140] The Appellant did not use the 24.52% to determine input tax credits that it claimed when determining its net tax for the reporting periods ending between April 1, 2010 and March 31, 2011. Instead, it used 15.57%. This was a percentage mandated by the CRA. The CRA informed the Appellant that if it used the 24.52% instead of the CRA's 15.57%, the CRA would assess the Appellant to reduce its input tax credits to an amount calculated using the 15.57% and impose penalties. Mr. Hupman explained to the Court that even though the Appellant considered that the proper percentage was, and continues to be, the 24.52%, it decided that it had to use the CRA percentage since, as a Crown corporation, it could not take a position that would result in the imposition of penalties.

[141] I am troubled by the CRA's conduct. The CRA should never threaten penalties to force a GST registrant to accept the CRA's allocation method. The law is clear: the CRA cannot simply substitute its approach for that of the Appellant, and there may be more than one method that is fair and reasonable in the circumstances. The Appellant was proposing a methodology that it had developed after a substantial review of its operations. In such a situation, it is inconceivable that the Appellant's conduct met the standard for a gross negligence penalty. It appears that the CRA was using the threat of penalties to force the Appellant into accepting the CRA's 15.57%, the calculation of which was not explained to the Court and not explained to the Appellant.

[142] The Appellant revisited the 24.52% when the New Vessels were brought into service in March 2009 (the *Atlantic Vision*), April 2011 (the *Blue Puttees*), and April 2011 (the *Highlanders*). It retained a naval architect/marine consultant to prepare the necessary cross plans (with measurements) for the New Vessels. The cross plans were required as a result of a number of modifications that the Appellant made to the New Vessels before placing them in service.

[143] The Appellant worked with Deloitte to determine the taxable and exempt areas on the *Atlantic Vision* and made the determinations by itself for the *Blue Puttees* and the *Highlanders*. It arrived at a new percentage of 18.11%. However, it did not calculate its input tax credits using the 18.11%. Instead, it claimed input tax credits for the reporting periods ending between April 1, 2011 and January 31, 2012 using 12%. The 12% was based on "CRA methodology" that the Appellant disagreed with, but similar to the earlier reporting periods, the Appellant decided to use the 12% to avoid being assessed penalties.

[144] As a result of an undertaking provided during discovery in these appeals, the Appellant retained an engineering firm to complete measurements of each of the Vessels and identify all spaces on the Vessels. The engineering firm's measurements resulted in the same 18.11% calculated by the Appellant for the period from April 2011 to January 2012 and in percentages that were within 0.25% of the percentages that have been calculated for the remaining periods. Unfortunately, the Appellant incurred over 1,000 internal labour hours and over $70,000 in costs during this process. This is the very type of expense that a GST registrant should not be required to incur. A GST registrant should be entitled to determine its input tax credits on the basis of information in its possession. It should not be required to retain expensive third parties.

[145] During the hearing, Mr. Hupman took the Court through the detailed cross plans for each vessel, describing each area of the ships and its use.

[146] In summary, it is the Appellant's position that between January 1, 2006 and March 31, 2011, 24.52% of the property and services that it acquired, imported or brought into a participating province were acquired, imported or brought into a participating province for consumption, use or supply in the course of its commercial activities. The percentage is 18.11% for the period from April 1, 2011 to January 31, 2012.

[147] As mentioned previously, the CRA did not agree with the Appellant's calculations. The evidence before me is that the Respondent's position on a

reasonable allocation method has been fluid, changing frequently since the time of the assessments. Some of these changes arose after the Respondent (or the Minister) became aware that some of his factual assumptions were incorrect, while other changes represent a change in the Respondent's position with respect to what he considers is fair and reasonable.

[148] For the Appellant's reporting periods ending between January 1, 2006 and March 31, 2009, the CRA performed separate calculations for input tax credits relating to the HST that the Appellant paid when acquiring fuel and the HST that it paid on all other acquired property and services. When assessing the Appellant, the Minister allowed input tax credits equal to 15.57% of the HST paid by the Appellant on non-fuel inputs. She also allowed input tax credits equal to 12.456% of the HST that the Appellant paid in respect of the fuel that it purchased for use in the Vessels' auxiliary engines. She did not allow any input tax credits for the HST that the Appellant paid when acquiring fuel for use in a Vessels' main engines.

[149] For the Appellant's reporting periods ending between April 1, 2009 and March 31, 2010, the Minister reassessed to allow for input tax credits equal to 17.20% of the HST that the Appellant paid on non-fuel inputs and 13.76% of the HST that the Appellant paid in respect of the fuel that it purchased for use in the Vessels' auxiliary engines. She denied inputs tax credits for the HST that the Appellant paid when acquiring fuel for use in the Vessels' main engines.

[150] The CRA's Appeals Division confirmed these reassessments.

[151] For the Appellant's reporting periods ending between April 1, 2010 and January 31, 2012, which is the subject of the Second Appeal, the Minister, relying on section 141, denied all input tax credits on the basis that substantially all of the use of the property and services acquired by the Appellant during this period were consumed or used in exempt activities. Paragraph 24 of the Respondent's Reply to the Further Amended Notice of Appeal for the Second Appeal (the "**Reply – Second Appea**l") states that the "Minister determined that the average indirect ITC allocation ratio was less than 10% for the period under appeal."

[152] With respect to the reporting periods that are the subject of the First Appeal, the Respondent did not produce a witness to explain how the CRA calculated the 15.57% and 17.20% for the non-fuel inputs or the 12.456% and 13.76% for the fuel inputs for the auxiliary engines. The Appellant noted that it has never been able to determine how the CRA calculated the percentages.

[153] The Respondent's Reply in the First Appeal, the Reply to the Further Amended Notice of Appeal (the "**Reply – First Appeal**"), is only of limited help in determining how the CRA calculated the percentages.

[154] Paragraph 19 of the Reply – First Appeal states that in determining the Appellant's net tax liability for the periods under appeal, the Minister relied on the assumptions listed in that paragraph including the following:

- It was unfair and unreasonable to treat the upgraded accommodations on the Vessels (sleeper dorms, cabins and reserved seating area) as areas used exclusively in taxable activities.
- The provision of upgraded accommodations was part of the single exempt supply of the ferry service of transporting passengers.
- It was fair and reasonable to treat the provision of the upgraded accommodations areas as an exempt supply.[30]

[155] However, these are not the assumptions that the Minister relied on when assessing the Appellant. As counsel for the Respondent confirmed during the February 2023 Proceedings, when assessing the Appellant the Minister assumed that the supply of the upgraded accommodations was a taxable supply.

[156] The assumptions in the Reply – First Appeal reflect assumptions made by the CRA's Appeals Division when considering the Appellant's Notice of Objection. Paragraph 19(hh) of the Reply – First Appeal states that a fair and reasonable application of the Appellant's methodology results in percentages of 7.6% and 8.1%, not the 15.57% and 17.20% used by the Minister when she assessed the Appellant. The 7.6% and 8.1% were determined by the CRA's Appeals Division. However, the CRA Appeals Division confirmed the Minister's assessments, which were based on the 15.57% and 17.20%.

[157] The assumptions listed in paragraph 19 of the Reply – First Appeal appear to be the assumptions made by the CRA's Appeals Division to support 7.6% and 8.1%. They are not the assumptions that support the 15.57% and 17.20% that the Minister used when assessing the Appellant – an assessment that the CRA's Appeals Division confirmed.

[30] Reply to the Further Amended Notice of Appeal for the First Appeal, paragraphs s, t and u.

[158] In summary, the Court was not told how the Minister calculated the 15.57% and 17.20% it used when assessing the Appellant for the periods covered by the First Appeal. However, it appears that when calculating the percentages, the Minister treated the Terminals and corporate headquarters as common areas. I have reached this conclusion since the PASF states that if the terminal areas are treated as exempt, the percentage is between 2.78% and 3.44%.[31] The Respondent accepts that the corporate headquarters is a common area.

[159] Paragraphs 19(ll) to (ww) of the Reply – First Appeal address the 12.456% and 13.76% applied to the HST paid on fuel related to the auxiliary engines. The Reply – First Appeal states that the auxiliary engines were used in both taxable and exempt activities, but that less than 10% of the fuel consumed and used by the main engines was attributable to the provision of taxable services.

[160] As with the percentages related to the non-fuel inputs, the Court was not told by a witness how the Minister calculated the 12.456% and 13.76% she used to determine the input tax credits for the HST that the Appellant paid on the acquisition of fuel for consumption in the auxiliary engines. The Court was also not told what percentage, if any, the Minister calculated for the HST paid on the fuel consumed by the main engines.

[161] The Respondent did not call a witness to explain how the Minister arrived at the conclusion that, during the periods covered by the Second Appeal, the Appellant consumed or used the property and services it acquired less than 10% in its commercial activities. However, unlike the assumptions in the Reply – First Appeal, the assumptions set out at paragraph 28 of the Reply – Second Appeal appear to contain the assumptions that the Minister actually made when assessing the Appellant.

[162] Paragraphs 19(l), 19(n), 19(p) to (ee), and 19(ii) to (uu) of the Reply – Second Appeal set out the following assumptions that the Minister made when assessing for the periods covered by the Second Appeal:

- The Minister assumed that the passenger cabins and day/night seating were part of a single exempt supply of the ferry service of transporting passengers. The Appellant had assumed that both were used to make taxable supplies.

[31] See PASF, at paragraphs 69, 80 and 91.

- The Minister assumed that the Vessels' Common Areas (referred to in the Reply – Second Appeal as "the other areas on the Vessels including the engine rooms, crew and officers' quarters and navigational bridge decks") were in fact not used to make both taxable and exempt supplies, but rather were used exclusively to make exempt supplies.
- The Minister assumed that the outside seating area was part of a single exempt supply of the ferry service of transporting vehicles. The Appellant had treated this area as part of the Vessels' Common Areas.
- The Minister concluded that the input tax credits for HST paid on fuel should be calculated separately from the input tax credits for HST paid for non-fuel property and services. The Minister concluded that the Appellant was not entitled to claim input tax credits for the HST paid on fuel since more than 90% of the fuel consumed and used by the Vessels was attributable to the provision of exempt services. The Appellant did not distinguish between fuel and non-fuel inputs when claiming input tax credits.
- The Minister concluded that the Appellant acquired and imported the New Vessels for use as capital property. The Minister then denied all input tax credits for Division III and Division IV.1 tax paid on the importation of the New Vessels on the basis that the New Vessels were not acquired, imported or brought into a participating province for use primarily in commercial activities. This would be the result under subsection 199(2) if the New Vessels were capital property of the Appellant.

[163] As discussed previously, the Respondent made certain concessions prior to the commencement of the hearing of the appeal.

[164] The first concession was that the passenger cabins and day/night seating were "areas of taxable activity".

[165] The second concession was the Respondent's acceptance that the "infrastructure areas onboard the ferry vessels were common areas, supporting both taxable and exempt activities". During the February 2023 Proceedings, counsel for the Respondent confirmed to the Court that the term *infrastructure*, as used in the Concession Letter, refers, with one exception, to the Vessels' Common Areas

described by the Appellant's witnesses,[32] which are the areas summarized in Exhibit A-1 at Tabs 3 to 9. The exception is the exterior deck.

[166] The Respondent does not accept that the exterior deck, which includes the outside seating, open deck space and exterior walking space, is common space.

[167] The third concession relates to the New Vessels. The Respondent accepts that subsection 199(2) is not applicable with respect to the Division III and Division IV.1 tax paid on the importation of the New Vessels and "as such, 'the fair and reasonable' ITC allocation ratio may be applied to GST/HST paid on importation." It appears that the Respondent's concession is based on the fact that the Appellant leased the New Vessels.

[168] On September 27, 2021, at the commencement of the hearing, counsel for the Respondent made a concession relating to the Appellant's methodology. She noted that the Respondent does not have an issue with the use of the indirect input allocation method per se. The Respondent's concern relates to the Appellant's calculations using the method.[33]

[169] The Respondent's current position with respect to the method chosen by the Appellant is set out at paragraph 124 of his written submissions, as follows:

> … [t]he Minister does not take issue with a methodology based upon an analysis of space used in making both taxable and exempt supplies. The Minister does not say that using an input based area-by-area method utilizing square metre measurements is in and of itself, either unfair or unreasonable. The Minister says that while a measurement-based method may be fair and reasonable, because it was not consistently applied to the totality of MAI's operations, it was not fair and reasonable or consistently applied.

[170] In reply to my questions during the February 2023 Proceedings, counsel for the Respondent noted that the Respondent's concern is with respect to items that were, in counsel's words, "left out of the formula". By items "left out", counsel was referring to the Terminals and the exterior deck, which the Appellant treated as common areas.[34]

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[32] Transcript of proceedings, February 27, 2023, page 17.
[33] Transcript of proceedings, September 27, 2021, page 7.
[34] Transcript of proceedings, February 27, 2023, pages 17–19.

[171] In summary, the parties agree that a methodology based on the Appellant's actual use of space is a fair and reasonable method to determine the extent to which the Appellant acquired property and services, other than fuel, for consumption or use in its commercial activities. Further, the parties agree on the measurements made by the Appellant.

[172] However, it is the Respondent's current position that the Appellant did not apply its measurement-based method in a fair and reasonable or consistent manner. The Respondent also argues that a different methodology should be used for the HST paid on the acquisition of fuel.

[173] In my view, the Appellant's method allocates the HST paid on its taxable inputs to its commercial activities in a fair and reasonable manner.

[174] The Appellant carries on a substantial business involving the making of numerous supplies, the vast majority of which occur on the Vessels.[35] As is normally the situation, the determination of the extent to which it acquired individual property or services for use in the course of its commercial activities will never be exact.

[175] As I noted in *University of Calgary*, the question is not whether the Appellant's methodology determines the exact extent to which the Appellant acquired property or services for consumption or use in the course of its commercial activities or whether one of the Respondent's methodologies is better than the Appellant's methodology. The question is whether the Appellant's methodology provides a fair and reasonable estimate of the extent to which the Appellant acquired individual property or services for consumption or use in the course of its commercial activities.

[176] As discussed previously, the Appellant's method is based on the total square metres of all areas of the Vessels that were used exclusively in the making of taxable supplies for consideration, the total square metres for all areas of the Vessels that were used exclusively in the making of exempt supplies, and the total amount of HST that the Appellant paid in a specific period on the acquisition of property and services that were consumed or used in all areas of its operations, including operations that were carried out on land.

[177] Its methodology, particularly the inclusion of all HST paid during the relevant periods, treated the areas of its operations that were not used exclusively to make

[35] Transcript of proceedings, September 28, 2021, page 339.

taxable supplies or exempt supplies as areas that contributed to the making of both taxable and exempt supplies, the so-called common areas. On the basis of the evidence before me, this is a reasonable assumption. The operation of each vessel involves an integrated environment. In Mr. Hupman's words, everything depends on everything. In such an environment, the common areas facilitate and support all supplies made on the Vessels. As I will discuss, I have reached a similar conclusion with respect to the common areas located on land in Nova Scotia and Newfoundland.

[178] During the periods at issue, the Appellant operated seven vessels with a combined area of 111,083 square metres.[36] It conducted a detailed review of each area on the Vessels, which included measuring all of these areas. Although not required once it concluded that the terminal areas were common space, it also measured all of the individual areas that comprise the Terminals, which are situated on approximately 257,000 square meters of land, and provided the Court with a detailed description of the use of each of the individual areas of the Terminals.

[179] In my view, a methodology that is based on the actual use of the space used to carry on an integrated business such as the one carried on by the Appellant and that involves a detailed review of all areas of its operations is a fair and reasonable method for the Appellant to use to determine the extent to which it acquired property and services for use in its commercial activities.

[180] The Appellant generates 95% of its revenue on the Vessels, meaning that it makes most of its supplies on the Vessels. Therefore, a method based on the space on the Vessels that was used exclusively to make taxable supplies and the space that was used exclusively to make exempt supplies reflects the Appellant's business activities and does not distort the financial reality of the Appellant's commercial activities.

[181] The Respondent raised the concern that the Appellant applied its Final Percentage to all the HST that it paid during the relevant periods, even the HST that related to tax paid on property and services consumed solely in the making of taxable supplies or exempt supplies. The Respondent did not provide any evidence of such property or services.

[182] On the basis of the evidence before me, the only significant inputs that I can identify that may have been consumed or used exclusively in the making of a specific supply, are some of the property and services that were consumed in the making of

[36] See Exhibit A-1, Tab 2.

the taxable supplies of the passenger cabins and the catering services. It is not clear from the evidence before the Court why, if such inputs did in fact exist, the Appellant did not separate the HST paid on such inputs from the tax paid on other inputs. Regardless, the separation of HST paid on such inputs would have increased the Appellant's input tax credits since it would have been entitled to claim input tax credits for 100% of such tax.

[183] As previously noted, the Respondent argues that because the Appellant did not apply its methodology consistently to the totality of the Appellant's operations this method was not fair or reasonable or consistently applied. Counsel for the Respondent argued that the Appellant left items out, specifically the terminal areas and the exterior deck area. The Respondent's argument is misplaced. The Appellant, when applying its methodology, did not leave any items out and did in fact apply its methodology to the totality of its operations. It treated the terminal areas and the exterior deck area as common areas.

[184] Given that the Appellant decided that these areas were common areas, then the size of such areas does not factor into the calculation of the percentages for the relevant periods. The percentages are based solely on the areas used exclusively in the making of taxable supplies and exempt supplies.

[185] The issue is not whether the Appellant left the items out; the issue is whether the Appellant properly treated the spaces as common areas. As I will discuss, the Respondent's position is that a substantial portion of the Terminals should have been treated as areas used substantially for the making of exempt supplies. The Respondent also argues that the Appellant used the exterior deck area substantially for the purpose of making exempt supplies.

[186] It is important to recognize that because of the Respondent's position with respect to fuel, he is proposing that the Court use a different methodology than the one used by the Appellant. Specifically, as I will discuss, he is asking the Court to use the methodology proposed by the Appellant only if it results in a percentage below 10%. If it results in a percentage of 10% or higher, he is asking the Court to use the Appellant's methodology only with respect to the HST paid for non-fuel inputs. For HST paid on fuel inputs, the Respondent is asking the Court to try to determine the amount of fuel that the Appellant consumed to propel the Vessels and the amount that it consumed to supply electricity, heat and hot water.

[187] I will now address the Respondent's arguments with respect to the Terminals, the exterior deck area, and fuel.

The Terminals

[188] As discussed previously, under the Appellant's methodology, the Terminals are part of the common areas. The Appellant's methodology is based solely on the areas of the Vessels that are used exclusively to make taxable supplies and the areas that are used exclusively to make exempt supplies. As a result, when using the Appellant's methodology to determine a percentage, the size of the common areas (areas that contribute to the making of both taxable and exempt supplies) is irrelevant. The Appellant argues that this includes the Vessels' common areas, all areas of the Terminals and the areas of the Appellant's corporate offices.

[189] If one accepts that the Terminals and corporate offices were common areas, then as discussed previously, the various areas of the Appellant's three Terminals and its corporate offices do not affect the percentages determined under its methodology.

[190] In the Appellant's view, the Terminals only exist to support the operations of the Vessels; the Terminals provide the infrastructure required to support all operations of the Vessels, both exempt and taxable.

[191] The Respondent's position has changed significantly since the Minister issued her assessments. In counsel for the Respondent's words, the Minister ignored the Terminals when assessing the Appellant. This is not correct. For the periods covered by the First Appeal, the Minister assessed the Appellant by using the Appellant's methodology to calculate the percentages of 15.57% and 17.20% and then applied these percentages to all of the GST paid by the Appellant on non-fuel inputs, which would include the GST paid on costs incurred in respect of the Terminals. As a result, the Minister, when assessing the Appellant, treated the Terminals as common areas.

[192] During the February 2023 Proceedings, counsel for the Respondent noted that the Terminals did not factor into these appeals as an issue until the Respondent filed her replies.

[193] In her replies, the Respondent pleads additional facts with respect to the Terminals that he intended to rely on at the hearing of the appeals. One of these additional facts is that the ferry terminals, terminal parking and boarding areas were part of the single exempt supply of the ferry service of transporting motor and passenger vehicles. It appears to me that these additional facts are only referring to a portion of the space occupied by the Terminals, namely, to the areas that

passengers use when boarding the Vessels, and not to the areas in the Terminals used to service the Vessels, such as the warehouses, stevedore buildings, maintenance buildings, and fuel depot.

[194] However, paragraphs 43 to 61 and paragraphs 138 to 139 of the Respondent's written submissions make it clear that when referring to the Terminals, the Respondent is now referring to all of the space occupied by the Terminals. The Respondent's final position is summarized at paragraph 161 of his written submissions as follows:

> … On a proper determination, substantially all of the Terminal expenses are direct inputs to MAI's [the Appellant's] exempt supply of transporting people, cars and commercial freight. As such, when the Terminal areas are properly accounted for as exempt, a fair and reasonable method based on square metre measurement results in a Ratio that is less than 10% such that no ITCs are available. That Ratio applies across the board, including to expenses incurred for fuel.

[195] At paragraph 126 of her written submissions, the Respondent argues that the Appellant did not consider the different areas within the Terminals, but merely assumed them to be wholly "common" without any analysis of that proposition. He argues that as a result, the Appellant's methodology was not consistently applied.

[196] Prior to the February 2023 Proceedings, I instructed the parties that they were not to introduce new arguments. During the proceedings, counsel for the Respondent raised an argument that was different from an argument set out in her written submissions.

[197] As I just noted, at paragraph 161 of her written submissions, the Respondent states that when the Terminals are properly accounted for, the Appellant is not entitled to any input tax credits. However, during the February 2023 Proceedings, in response to my query of whether it was fair and reasonable for the Appellant to be denied all input tax credits, counsel for the Respondent argued that it is not certain that the Appellant would be denied all input tax credits. She returned to the Respondent's position contained in the Reply, namely that only a portion of the terminal areas was used exclusively to make exempt supplies.[37] It is not clear to me if counsel for the Respondent made this argument in her original oral submissions. Regardless, my reasons indirectly address this argument by my factual finding that

[37] Transcript of proceedings, February 27, 2023, page 105.

the Appellant's application of its methodology in a way that treated the Terminals as common areas was fair and reasonable.

The Court's Finding With Respect to the Terminals

[198] The Appellant's methodology assumes that the Appellant used the Terminals indirectly to make both taxable and exempt supplies on the Vessels.

[199] Mr. Hupman and Mr. Leamon explained, in some detail, the purpose and use of the various components of the Terminals.

[200] As noted previously, the Appellant has year-round terminals in Port aux Basques, Newfoundland and North Sydney, Nova Scotia. It has a seasonal terminal in Argentia, Newfoundland.

[201] The Appellant does not own any of the Terminals. The Terminals are owned by the Canadian government. Mr. Hupman testified that the Appellant was the custodian of the Terminals. It does not pay any rent to the federal government.

[202] Mr. Hupman explained the use of the various areas of the Terminals. Tab 12 of Exhibit A-1 sets out each of the specific areas referred to by Mr. Hupman and each area's size. As discussed previously, the Appellant did not measure the areas of the Terminals when calculating its percentages. It only measured the areas after it filed its appeals, in satisfaction of an undertaking given during discovery in these appeals.

[203] The terminals in Port aux Basques and North Sydney are large. The Port aux Basques terminal is situated on 121,660 square metres of land, while the North Sydney terminal is situated on 100,423 square metres of land. The Argentia terminal is much smaller, using only 36,037 metres of land.

[204] Each of the Terminals has a terminal building. In Port aux Basques and North Sydney, the terminal buildings comprise a small portion of the total area of the Terminals: 1.2% in Port aux Basques (1,527 square metres) and 1% in North Sydney (912 square meters). The seasonal terminal building in Argentia accounts for 4% of the total terminal (1,588 square metres).

[205] The terminal buildings have facilities for the passengers, including washrooms, waiting rooms, seasonal information kiosks occupied by employees of

either Newfoundland or Nova Scotia, gift shops and cafeterias. Third parties, who pay rent to the Appellant, operate the gift shops and cafeterias.

[206] Mr. Hupman explained the use of the other structures on the terminal land as follows:

- The terminal in North Sydney has a maintenance building (1,249 square metres), while the terminal in Port aux Basques has a maintenance and warehouse building (2,164 square metres). The maintenance buildings supported the operation of the Terminals. The warehouse stored the various items that were consumed on the Vessels on a daily basis. Mr. Hupman noted that this included such things as cleaning supplies, materials, beer, liquor and food (basically, any item that was required on the Vessels on a regular basis).
- A tank farm (7,738 square metres), used to fuel the Vessels, is located at the Port aux Basques terminal. It is composed of fuel tanks that store the necessary fuel and the facilities required to transfer the fuel to the Vessels. It is protected from spillage by a berm area. The area also has a pumphouse (221 square metres), which is used to provide fuel to vehicles used in dock operations.
- The terminal in North Sydney has a storage area (2,624 square metres) that is used to store equipment needed for the loading/unloading process.
- The terminal in North Sydney has an administration building (1,526 square metres). The administrative staff use this building to support the operations of the Vessels.
- The Port aux Basques terminal has a small life raft shop (656 square metres) that maintains the Appellant's marine evacuation system.
- Each of the Terminals has a stevedore building (367 square metres in Port aux Basques, 251 square metres in North Sydney and 801 square meters in Argentia); these buildings are used to manage the loading and unloading of the Vessels.
- Each of the Terminals has a ticket booth (445 square metres in Port aux Basques, 280 square metres in North Sydney and 132 square metres in Argentia). Passengers obtain their tickets or cabin keys at the ticket booths. North Sydney also has a small security booth (113 square metres), which secures access to the facilities. Passengers

may or may not go through a security screening. Typically, approximately 3% of the passengers/vehicles are chosen on a random basis for screening.

- Each of the Terminals has a dock and a traffic ramps area. The docks use 10,130 square metres of the measured space at the Port aux Basques terminal, 20,530 square metres of the measured space at the North Sydney terminal and 2,318 square metres at the Argentia terminal. The Vessels were secured at the docks to allow passengers and vehicles to be loaded and offloaded. The traffic ramps use 1,742 square metres of the measured space at the Port aux Basques terminal and 5,429 square metres at the North Sydney terminal. The traffic ramps are the means by which the Appellant connects the Vessels to the docks.

[207] The measured areas at the Terminals included the following three areas, which did not contain any physical structures:

- The area of each terminal that contained green spaces, roadways and access ways. These areas comprised over 50% of the measured area at the Port aux Basques and Argentia terminals and approximately 45% of the measured areas at the North Sydney terminal; these areas measured 64,884 square metres in Port aux Basques, 45,424 square metres in North Sydney and 20,076 square metres in Argentia.
- The marshalling area for live traffic and drop trailers. These areas accounted for 25,557 square metres in Port aux Basques, 19,445 square metres in North Sydney and 8,785 square metres in Argentia. This is where the vehicles stopped before driving onto the Vessels. The marshalling area for live traffic was for both passenger vehicles and commercial tractor-trailers. The marshalling area for drop trailers was where customers left the drop trailers.
- The visitor and staff parking areas. These areas take up 6,229 square metres in Port aux Basques, 2,640 square metres in North Sydney and 2,303 square metres in Argentia.

[208] Mr. Hupman stated that the purpose of the Appellant's operations at the Terminals was to provide support for the Vessels. He noted that the operations on the Vessels accounted for nearly all of the Appellant's revenue and a good portion of its expenses. Mr. Hupman's testimony was supported by the testimony of

Mr. Leamon, who stated that 95% of the Appellant's total revenue arose from the operation of the Vessels.[38]

[209] Using the numbers provided in the Appellant's financial statements, Mr. Leamon gave a breakdown of where the Appellant incurred the majority of the expenses in respect of which it claimed input tax credits. Mr. Leamon provided the following evidence regarding the HST paid in respect of the acquisition of fuel; expenses incurred for materials, supplies and services; and expenses incurred for repairs and maintenance:

- 98% of fuel purchases related to the Vessels and the remaining 2% related to the Terminals;
- 90% of expenses for repairs and maintenance related to the Vessels and the remaining 10% related to the Terminals; and
- 57% of expenses for materials, supplies and services related to the Vessels, 26% related to the corporate headquarters and the remaining 17% related to the Terminals.[39]

[210] Tab B of the appendices to the Appellant's argument correctly summarizes Mr. Leamon's testimony. It shows that the evidence before the Court is that 86.54% of the noted expenses in respect of which the Appellant claimed input tax credits were incurred in respect of the Vessels, 7.59% were incurred in respect of the Terminals and 5.87% were incurred in respect of the Appellant's head office.

[211] In the Appellant's view, everything it owns and everything it does is geared towards delivering the taxable and exempt services provided on board the Vessels. This includes the operations at the Terminals and at the Appellant's corporate offices.

[212] I agree with the Appellant.

[213] Section 141.01 requires the Appellant to attribute all costs that it incurred in the course of its business of transporting persons and vehicles by ferry between Nova Scotia and Newfoundland to the making of supplies.

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[38] Transcript of proceedings, September 28, 2021, page 339.

[39] Transcript of proceedings, September 28, 2021, pages 360 to 371. Mr. Leamon also noted that 100% of the GST/HST paid on the importation of the New Vessels related to the Vessels.

[214] With the exception of renting concession space in the Terminals, the Appellant made no supplies at the Terminals. The exempt supply of the ferry service and the various taxable supplies made on the Vessels comprise nearly all of the supplies made by the Appellant. The Appellant made all of these supplies on the Vessels.

[215] As a result, the Appellant was required to allocate all of the costs incurred within the Terminals to the supplies made on the Vessels.[40] Neither the Appellant nor the Respondent identified any goods or services that were purchased for use or consumption within the Terminals that could be directly traced to a specific supply made on the Vessels. All of the goods or services were consumed or used indirectly in the making of the supplies on the Vessels.

[216] The question before the Court is whether these costs were, as the Appellant argues, incurred indirectly in the course of making both taxable and exempt supplies, or whether all of the costs were, as the Respondent argues, incurred indirectly in the course of making the exempt supply of the ferry service.

[217] In my view, the evidence before the Court leads to the conclusion that the indirect costs incurred at the Terminals supported all supplies made on the Vessels, both the taxable and the exempt supplies. The costs are similar to the so-called infrastructure costs incurred on the Vessels.

[218] For example, the warehouse stored items consumed on the Vessels; the tank farm supplied the fuel consumed on the Vessels, fuel that was consumed in the making of both taxable and exempt supplies and the administration building housed staff who supported the operation of the Vessels.

[219] No supplies, taxable or exempt, would be made on the Vessels unless the passengers were able to board the Vessels. Therefore, the docks, traffic ramps, terminal buildings, and ticket booths all supported both the taxable and exempt supplies made on the Vessels in the same way that the corridors, hallways and other general areas on the Vessels allowed the passengers to enter the ship and access the general seating area, the upgraded seating area, the cabins, the restaurants and the bars. The Respondent has conceded that the corridors and hallways and other general

[40] I acknowledge that goods or services may have been purchased for use in leasing the concession space, but I have assumed that the HST paid on such goods and services was immaterial considering the relatively small size of the concession areas.

areas of the Vessels were used indirectly in the making of both taxable and exempt supplies.

[220] The Respondent is asking the Court to treat the total area of the Terminals as space used exclusively in the making of exempt supplies. Such a conclusion would result in the Appellant not being entitled to claim any input tax credits. In addition to that conclusion not being supported by the evidence, it would lead to an unreasonable result.

[221] The Terminals make up between 70% and 83% of the total of the areas of the Vessels and the Terminals. However, only 7.59% of the funds that the Appellant spent on expenses during the relevant periods related to expenses incurred in respect of the Terminals. The Respondent's position would result in the denial of input tax credits based solely on the relatively large size of the Terminals' areas even though such areas consumed or used less than 10% (by value) of the inputs that the Appellant consumed or used in the making of supplies.

[222] Therefore, the Respondent's position is unreasonable since it does not reflect the business activities of the Appellant, particularly the activities of the Appellant that consumed or used the taxable inputs.

[223] Regardless, I have concluded, on the basis of the evidence before the Court, that, as assumed by the Minister when assessing the Appellant, all of the areas of the Terminals were common areas for purposes of the Appellant's methodology.

Outside Deck/Seating Area

[224] The Appellant treated the outside deck/seating area as common space. The Appellant views it as being similar to the interior corridors and hallways: support for all passengers who are on the Vessels, including those in cabins and the premium seats.

[225] Counsel for the Respondent acknowledged that the treatment of the outside deck/seating area has a minimal impact on the percentage determined under the Appellant's methodology. She argues that since the outside deck/seating area contains places where passengers may sit, it should be treated in the same manner as the regular seating that exists inside the Vessels–in other words, as an area that is used exclusively to make an exempt supply.

[226] I do not agree.

[227] The outside deck contains space where the passengers may go for fresh air or to view the ocean or ports. Mr. Hupman noted that the outside area is closed in adverse conditions, such as rough seas, snow or ice.

[228] The outside deck has some benches where passengers may sit. Mr. Hupman explained that these benches are not included when determining a vessel's passenger capacity. He explained that one of the items that is used to determine a vessel's passenger capacity is available seating. This is based on the interior seating only; the outside benches are not included in this calculation.

[229] The Appellant provided the Court with photographs showing the outside seating and the interior seating.[41] These photographs illustrate that the outside seats are plastic benches. They are not the cushioned seats that can be found in the interior general sitting area. The general seating and day/night seating are comfortable seats similar to seats one may find on an airplane or train. The outside seats are similar to benches one may find in an outdoor park.

[230] In my view, the outside deck, which includes areas where the benches are located is part of the infrastructure of the Vessels in the same way that the interior hallways and corridors are part of the infrastructure of the ships; areas that the Respondent has conceded should be treated as common areas.

Fuel

[231] The Vessels' main engines, auxiliary engines and boilers consume fuel. The main engines are engaged when the Vessels are moving. They are used to propel the Vessels and produce electricity, heat and hot water. The main engines are not engaged when the Vessels are dockside. The auxiliary engines are only engaged when the Vessels are alongside the dock. They are not used to propel the Vessels. When the Vessels are sailing between Terminals, the auxiliary engines are turned off.

[232] The Appellant's witnesses testified that the taxable operations had a significant impact on the fuel consumed on the Vessels because of their consumption of electricity and hot water, the need to heat and cool the spaces that were used to make the taxable supplies, and the need to increase the size of the main engine on

[41] See Exhibit A-1, Tab 13, pages 2, 3, 17, and 25 for interior seating. See Exhibit AR-1, Volume 7, Tab 75, pages 16 and 19 and Tab 77, page 2 for outside seating.

account of the weight added to the Vessels as a result of the additional space and equipment required to make the taxable supplies.

[233] When the Vessels were sailing the main engines generated the electricity consumed on the Vessels by turning shaft alternators. The auxiliary engines generated the electricity when the Vessels were docked. Emergency generators also generated electricity; however, they were used infrequently.

[234] The electricity was used in the various areas of the Vessels, powering such things as light fixtures, appliances, machines and air conditioners. Since the main engines and the auxiliary engines generated the electricity, fuel was consumed when producing the electricity.

[235] The main engines also generated the heat that was used when the Vessels were sailing. Mr. Hupman explained that, when running, the main engines generate a great deal of hot air. The Vessels have an exhaust system that contains a technology called economizers, which operates as a heat-capture system. The captured heat is redistributed throughout the Vessels.

[236] The second source of heat was the Vessels' fuel-fired boilers. They were used to generate heat when the Vessels were docked and the main engines were turned off.

[237] When the Vessels were sailing, the main engines provided the hot water used by the Vessels. In addition to capturing heat, the economizer system captured hot water. When the Vessels were docked, the hot water was provided by the fuel-fired boilers.

[238] It is clear from the evidence before me that the operations carried out on the Vessels to make the taxable supplies consumed a significant amount of electricity, heat and hot water.

[239] The approximately 100 passenger cabins on the Vessels consumed a significant amount of electricity, heat and hot water. The cabins were basically hotel rooms, with electricity required to power lights, televisions, air conditioners, small appliances and whatever devices the passengers brought into the rooms to use or recharge. Each passenger cabin had its own washroom with a shower, which consumed a good deal of hot water. Each cabin also had its own HVAC system, meaning that a guest could control the heating and air conditioning in the cabin.

[240] Mr. Hupman testified that 50% of the crew on board a vessel worked directly in the areas that made taxable supplies. Crew cabins were required for each of the crewmembers.

[241] He noted that crew cabins were similar to the passenger cabins and thus had the same impact on the operating systems of the Vessels, particularly with respect to the consumption of electricity, heat and hot water. However, since the crew cabins were the person's home away from home, the cabins contained a few extra features. These included mini-fridges and a higher electrical outage to allow for the use of various other appliances and devices. As a result, the electrical load in the crew cabins was higher than the load in the passenger cabins.

[242] The taxable supplies made by the various catering services also consumed a significant amount of electricity, heat and hot water. Mr. Hupman testified that heating, ventilation and air-conditioning systems must be designed around the catering services.

[243] The catering supplies were made through the Vessels' dining rooms, cafeterias, bars and snack bars when providing food and drinks to 600 to 700 passengers during the six- to eight-hour journey between Port aux Basques and North Sydney and the 16 hour journey between Argentia and North Sydney. All of the areas where the passengers consumed food and drink were heated and had air conditioning.

[244] The kitchen/galley supported the dining, drinking and eating areas.

[245] Mr. Hupman testified that the kitchen/galley consumed a large amount of electricity. All of the equipment that is in the kitchen/galley runs on electricity. The electricity load on ovens and heaters was very high. The kitchen/galley also consumed a significant amount of hot water. Further, a galley becomes very hot in the summer and thus consumes a considerable amount of cold air from the air conditioners.

[246] He noted that the catering services require a great deal of storage space, including cold storage areas and freezer/cooler storage areas for food. All of these areas consume electricity and, with the exception of the freezer/cooler area, heat.

[247] Mr. Hupman noted that the heating and air conditioning is distributed throughout the Vessels, as is the lighting. It other words, fuel is used to produce heat, cold air and lighting that is consumed in the other areas of the ships that were used

exclusively to make taxable supplies, such as the reserved seating, retail stores, kennels, and arcade areas.

[248] Similarly, the heat and electricity produced by the engines was consumed in all of the common areas of the Vessels. These areas supported the making of both taxable supplies and exempt supplies.

[249] In summary, fuel was consumed by the main and auxiliary engines when the engines produced heat, electricity and hot water that was consumed or used directly or indirectly in the making of taxable supplies. The impact on the electrical load was clearly significant.

[250] The taxable operations also affected the fuel consumption on account of the size of the area required to provide the operations. Mr. Hupman explained this as follows:

> … The smaller the boat, the smaller the motor, the less fuel you're going to burn. Once you start working on taxable operations and taxable services, you start to make a lot more space requirements, it's going to be a much larger vessel, it's going to be a heavier vessel, it's going to require a larger engine and therefore it's going to require more fuel. So there's a direct nexus between the cost of the fuel to the cost of operating the taxable operations on board.[42]

[251] The evidence before the Court supports his comments. The fact that the cabins, restaurants, galleys and arcades consumed a significant amount of electricity, heat and hot water meant that the Vessels required larger engines to produce these resources, resulting in heavier Vessels.

[252] Mr. Hupman noted that the cabins take up a great deal of space that needs to be lit, heated and cooled. Normally, two or three people occupy this space. If the same area was used for general seating, 40 to 50 people could be accommodated. Further, in Mr. Hupman's words, the cabins added a significant amount of weight to the ship. The additional weight was a major design concern. He noted that the more weight that is added by the cabins, the bigger that the systems, including the engines, must be in order to manage the cabins and to propel the Vessels.

[253] The catering services also added considerable weight to the Vessels. In addition to the significant area occupied by the eating areas and the galley, the

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[42] Transcript of proceedings, September 27, 2021, page 81.

catering services were supported by a number of storage areas that also took up a good deal of space. This includes the areas occupied by cold storage, freezer/cooler storage and bulk stores.

[254] Mr. Hupman noted that it is not possible to directly measure the amount of fuel consumed in the making of taxable supplies and the amount consumed in the making of exempt supplies. In response to the question "[I]s it possible to measure … the consumption of fuel that results from the taxable operations on the vessel?", Mr. Hupman stated the following:

> No, it isn't. It's not possible to break that down and measure the individual pieces that would go to the different taxable operations. You've got one engine or two engines and those engines are basically providing supply to a multitude of outlets. And in this case the main engines would also be providing propulsion. So there's no way to actually determine how you would actually figure out what goes specifically to a certain outlet. That is not a possibility.
>
> You need heat or you need power, you turn the engine on and the engine burns fuel. And if it's not moving, it's still burning the fuel. You still need the engine going to actually provide the service. So it's -- no, there's no way to calculate that.[43]

[255] I accept Mr. Hupman's testimony on this point. Both he and Mr. Leamon were consistent on this point, including when tested on cross-examination.

[256] Since it is not possible to directly measure the amount of fuel consumed in the making of taxable or exempt supplies, the Appellant must use an allocation method.

[257] It is the Appellant's position that since the main engines of the Vessels were used to propel the Vessels and to generate electricity, heat and hot water, they were used in both taxable and exempt activities. Therefore, the fuel consumed by the main engines was acquired, in part, for consumption or use in the course of the Appellant's commercial activities. The Appellant also argues that the fuel consumed by the auxiliary engines was also acquired, in part, for consumption or use in the course of its commercial activities. This is the result since the auxiliary engines provided electricity, heat and hot water when the Vessels were dockside.

[258] The Appellant argues that the cost of the fuel should be treated in the same manner as the other direct and indirect costs incurred by the Appellant: it should be allocated to taxable supplies using the Appellant's methodology.

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[43] Transcript of proceedings, September 27, 2021, page 84.

[259] Similar to his position with respect to other issues, the Respondent's position with respect to fuel has changed over time.

[260] As discussed previously, the Minister, when assessing the Appellant for the reporting periods covered by the First Appeal, allowed input tax credits equal to 12.456% and 13.76% of the HST that the Appellant paid in respect of fuel purchased for use in the Vessels' auxiliary engines during its reporting periods ending between January 1, 2006 and March 31, 2009 and April 1, 2009 and March 31, 2010, respectively. She did not allow any input tax credits for HST paid on fuel purchased during these periods for use in the Vessels' main engines.

[261] She did not allow any input tax credits in respect of the HST paid on fuel that the Appellant acquired during the periods covered by the Second Appeal.

[262] The Respondent now argues that the Minister made a mistake when allowing any input tax credits in respect of the fuel purchased by the Appellant. He argues that all fuel consumed and used by the Appellant was a direct cost of, and was attributable to, its exempt supply of the ferry transportation service. In the Respondent's view, the fuel did not contribute to the Appellant's commercial activities.[44]

[263] The Respondent raises the following additional arguments in support of his current position that the Appellant is not entitled to claim input tax credits for the HST that it incurred when acquiring fuel:

- He argues that if the percentage determined by the Appellant's methodology is below 10%, then the Appellant cannot claim input tax credits on any of its inputs, including fuel.
- However, if the percentage determined by the Appellant's methodology exceeds 9%, the Respondent argues that the percentage should not be applied to the fuel inputs. The input tax credits with respect to the HST paid on the acquisition of the fuel should be calculated separately from the input tax credits on all other indirect expenses. He argues that regardless of the percentage determined under the Appellant's methodology, the Appellant is not entitled to claim any input tax credits in respect of the HST that it paid on the acquisition of fuel.

[44] Respondent's Written Submissions, at paragraph 227.

- He also argues that the Appellant has led no evidence to rebut the Minister's assumption that more than 90% of the fuel consumed by the engines on the Appellant's Vessels was for the provision of exempt supplies. As a result, subsection 141(3) deems that all of the fuel used on the Vessels was for the provision of exempt supplies. As part of this argument, the Respondent argues that the Appellant was responsible for the erroneous assumptions made by the CRA with respect to the fuel consumed by the Appellant.
- He also argues that judicial comity should apply since the same issue of fuel input tax credits was decided in *B.C. Ferries*.

[264] It is clear from the evidence before the Court that, contrary to the Respondent's position, the Appellant used the fuel directly and indirectly in the making of both taxable and exempt supplies. There is no evidence before the Court to support the Respondent's position that the fuel was only used in the making of exempt supplies.

[265] Since it is impossible to determine the actual amount of fuel that was consumed by the engines to propel the Vessels and the actual amount of fuel that was consumed to produce electricity, heat and hot water, an allocation method must be used to make such a determination.

[266] Having found that the Appellant's methodology is a fair and reasonable method to allocate direct and indirect costs between taxable and exempt supplies, I see no reason why it should not be used for all costs incurred by the Appellant, including fuel.

[267] The evidence before me is that, as a result of the Vessels' main and auxiliary engines producing electricity, heat and hot water and as a result of the increase in the size of the Vessels and their engines because of the taxable operations, a substantial amount of fuel was consumed as an indirect cost of making the taxable supplies on the Vessels.

[268] Specifically, fuel was consumed to produce the electricity, heat and hot water consumed in the areas of the Vessels that were used to make taxable supplies. These areas were used by 600 to 700 passengers over a six- to eight-hour journey (16 hours for the seasonal route between North Sydney and Argentia). The passengers used the electricity, heat and hot water directly and indirectly when using the seating, enjoying their cabins, eating and showering.

[269] There is no perfect allocation method available to determine how much fuel was actually consumed as an indirect input in the making of the taxable supplies. The evidence is that it is impossible to separately measure the fuel that was consumed by the engines to propel the Vessels and the fuel that was consumed by the engines to produce electricity, heat and hot water. This is not uncommon when dealing with indirect costs. It is the reason that most GST registrants must develop an allocation method.

[270] As noted previously, the Appellant's allocation method, which is based on the use of the various areas of the Vessels, is a fair and reasonable method to estimate the use made of the various inputs consumed or used by the Appellant during the relevant periods. The Appellant has chosen to use this method for both direct and indirect costs. There is no reason why it should not be used for fuel, which is a substantial indirect input in the making of taxable supplies, especially since the evidence indicates that there is a direct correlation between the areas of the Vessels used to made taxable supplies and the amount of fuel consumed to produce electricity, heat and hot water.

[271] The Respondent did not adduce any relevant evidence to counter the Appellant's evidence. He relies solely on the assumptions made in his replies, assumptions that been destroyed by the Appellant, his cross-examination of the Appellant's witnesses and an excise tax audit that occurred four years before the periods at issue. I will discuss each of these points shortly.

[272] Counsel for the Respondent suggested that an expert might be able to determine the actual amount of fuel that was consumed by the engines to propel the Vessels and the actual amount of fuel that was consumed to produce electricity, heat and hot water. This is speculation and would have caused the Appellant to incur substantial costs. In my view, if the Respondent considers that an expert could make that determination, then he should have retained such an expert and provided this person's report to the Court.

[273] The Respondent's argument that if the percentage determined by the Appellant is below 10%, then the Appellant cannot claim input tax credits on any of its inputs, including fuel, is moot since the percentage is above 10%.

[274] Further, his argument that if the percentage is 10% or higher, it should not be applied to fuel breaches paragraph 141.01(5)(b) since that would mean that the methodology is not being used consistently. The Appellant's methodology would

only be applied if it produced the result desired by the Respondent. If it did not produce the desired result, then another method would be used.

[275] It is not clear to me what allocation method the Respondent proposes to use if the fuel is dealt with separately from all other direct or indirect costs. The Respondent did not put any evidence before the Court with respect to an alternative allocation method for fuel, other than assuming that no input tax credit is allowed for HST paid on the fuel purchases. Regardless, the law is clear: the CRA cannot simply substitute its method for that of the Appellant. The Appellant is entitled to use any method that is fair and reasonable provided that it complies with the provisions of the GST Act. I have already found that the Appellant's methodology is fair and reasonable and complies with the GST Act.

[276] I do not agree with counsel for the Respondent's argument that the Appellant has led no evidence to rebut the Minister's assumption that more than 90% of the fuel consumed by the engines on the Appellant's Vessels was for the provision of exempt supplies. In my view, the Appellant's evidence destroyed the assumption.

[277] Indeed, I have found, on the basis of the evidence before me, that less than 90% of the fuel was consumed by the engines of the Appellant's Vessels for the provision of exempt supplies.

[278] The Respondent's Reply – First Appeal notes at paragraphs 19(ll) to (ww) twelve assumptions that the Minister made with respect to fuel when determining the Appellant's net tax. Four of these assumptions refer to the 12.456% and 13.76% used to determine input tax credits for HST paid on fuel consumed by the auxiliary engines. The remaining eight assumptions relate to the Minister's denial of input tax credits for HST paid on the fuel consumed by the main engines. These assumptions are:

> ll) the Vessels each had a separate auxiliary generator used to produce heat and electricity and to operate the Vessels;
>
> mm) the auxiliary generators operated separately from the main engines used for propulsion of the Vessels;
>
> nn) the main engines on the Vessels consumed and used a different fuel than the auxiliary generators;
>
> …

ss) fuel consumed for propulsion was directly related to the exempt ferry service of transporting motor vehicles and passengers;

tt) less than 10% of the fuel consumed and used by the main engines was attributable to the provision of taxable services;

uu) more than 90% of the fuel consumed and used by the main engines was attributable to the provision of exempt services;

vv) it was not fair and reasonable to not remove the tax on the fuel consumed and used by the main engines from the tax base prior to applying the indirect allocation ratio to calculate the indirect ITCs; and

ww) it was fair and reasonable to remove the tax on the fuel consumed and used by the main engines from the tax base prior to applying the indirect allocation ratio to calculate the indirect ITCs.

[279] The same eight assumptions were made in the Reply – Second Appeal, except that the words in tt) and uu) "used by the main engines" were replaced with the words "used by the Vessels" and the words in vv) and ww) "consumed and used by the main engines" were deleted. As a result, these assumptions applied to both the main engines and the auxiliary engines, meaning, that for the periods covered by the Second Appeal, the Minister assessed on the basis that no input tax credits were allowed for fuel regardless of whether the fuel was consumed in the main engines or the auxiliary engines.

[280] First, I note that assumptions vv) and ww) are not assumptions of fact; they are assumptions of mixed fact and law. They are in fact argument.

[281] Assumptions ll) and mm) state that the main engines were only used to propel the Vessels and that the auxiliary engines were used to produce the electricity and heat and to "operate the Vessels". The Appellant's evidence destroyed each of these assumptions.

[282] As discussed, the main engines propelled the Vessels and generated the electricity and heat. They also generated hot water. The auxiliary engines were not used when the main engines were engaged; they were only used when the Vessels were dockside.

[283] The Minister's assumption that more than 90% of the fuel consumed and used by the main engines was attributable to the provision of exempt supplies is a factual conclusion that is based on the false assumptions that the main engines were only used to propel the Vessels and that the auxiliary engines produced the electricity and heat when the Vessels were sailing. In my view, by demolishing the assumptions that the main engines were only used to propel the Vessels and that the electricity and heat were provided by the auxiliary engines, the Appellant also demolished the factual conclusion based on these assumptions that more than 90% of the fuel consumed and used by the main engines was attributable to the provision of exempt supplies.

[284] In addition, I find that the Appellant's factual evidence with respect to the consumption of electricity, heat and hot water on the Vessels also demolished the Minister's factual assumption.

[285] The Respondent spent a great deal of time arguing about the cause of the Minister's false assumption that the main engines on the Vessels consumed and used a different fuel than the auxiliary generators. I fail to see how the type of fuel used in the engines has any relevance when determining the use made of the main engines and the auxiliary engines. It appears that this issue was only relevant when the Respondent assumed that the auxiliary engines provided all of the electricity, heat and hot water; this assumption has been destroyed by the Appellant.

[286] With respect to the issue of judicial comity, I would first note that judicial comity relates to questions of law. The question of the extent to which the Appellant acquired the fuel for consumption or use in the course of its commercial activities is a question of fact. The facts in the *B.C. Ferries* appeal are substantially different from the facts in the appeals before the Court. Further, in the *B.C. Ferries* appeal, the appellant made two admissions that Justice Campbell relied on when deciding that the appellant was not entitled to input tax credits in respect of the fuel. The first was an admission made in the agreed statement of facts filed in that appeal that substantially all of the fuel that was consumed was for propulsion. The second was an admission made by the appellant that it was unable to prove, on a balance of probabilities, that over 10% of the fuel was consumed directly in the provision of the vessel's commercial activities.

[287] The Appellant made no such admissions in the current appeals that are before the Court. In fact, the Appellant's witnesses explained in some detail why they are of the opinion that over 10% of the fuel was consumed directly or indirectly in the provision of the Vessels' commercial activities.

[288] I have also considered the evidence given by Mr. Leamon with respect to the Appellant's excise tax refunds. In my view, the method used by the Appellant to calculate refunds of excise tax paid on fuel is irrelevant for purposes of determining the Appellant's net tax under the GST Act. Further, Mr. Leamon's testimony with respect to the fuel tax refunds did not in anyway contradict either his own or Mr. Hupman's testimony with respect to the Appellant's consumption or use of fuel in the course of its commercial activities.

Other Concessions

[289] Immediately prior to the February 2023 Proceedings, the parties each made a concession. The concessions were made in a letter to the Court dated February 24, 2023 that was signed by both parties.

[290] The Respondent informed the Court that he was not pursuing an argument that he had made in his written submissions that the Appellant's revised input tax credit claims are statute-barred.

[291] The Appellant informed the Court that it was not pursuing the argument that the Minister is statute-barred from adjusting the Appellant's entitlement to the public service body rebate under section 259 of the GST Act in the event that the Court finds for the Appellant in respect of the input tax credit claims.

Conclusion

[292] For the foregoing reasons, the appeals are allowed with costs. The reassessments are referred back to the Minister for reconsideration and reassessment on the basis that, for each reporting period of the Appellant ending between January 1, 2006 and March 31, 2011, the Appellant's input tax credits are to be determined by applying the Appellant's Final Percentage of 24.52% to the total amount of HST that was paid or payable by the Appellant in the specific period, and for each reporting period of the Appellant ending between April 1, 2011 and January 31, 2012, the Appellant's input tax credits are to be determined by applying the Appellant's Final Percentage of 18.11% to the total amount of HST that was paid or payable by the Appellant in the specific period. Such input tax credits shall be used to calculate the Appellant's net tax for each of the relevant periods and its entitlement to the public service body rebate under section 259 of the GST Act.

[293] The parties have 60 days from the date of this judgment to make written representations with respect to the amount of costs that the Court should award the

Appellant. The written submissions shall not exceed 15 pages. If no submissions are received, costs shall be awarded to the Appellant as set out in the Tariff.

Signed at Antigonish, Nova Scotia, this 10th day of July 2023.

"S. D'Arcy"

D'Arcy J.

Appendix A

University of Calgary v. The Queen, 2015 TCC 321
Paragraphs 94-109 (footnotes included)

[94] The application of subsection 169(1) to tax paid on property or services acquired by a registrant in the course of its business for consumption or use directly in the making of a specific supply is relatively straightforward. For example, if the registrant acquires the property or service only for consumption or use directly in the making of a taxable supply, then the property is consumed or used in the course of the registrant's commercial activity and the registrant is entitled to claim a full input tax credit for the tax paid on the acquisition of the property or service. Alternatively, no input tax credit is available if the registrant acquires the property or service solely for consumption or use directly in the making of exempt supplies.

[95] The application of subsection 169(1) to "indirect costs", that is, property and services that are not used directly in the making of a taxable or an exempt supply, is not as straightforward. When making a determination in this regard, one must consider the section 141.01 input tax credit apportionment rules.

[96] Indirect costs include such things as administrative costs, overhead costs, and costs incurred in respect of common areas in or around a building. For example, in most instances, the payroll department of a corporation that makes both taxable and exempt supplies will not be involved directly in the making of any supplies by the corporation.

[97] The expenses of the payroll department are incurred in the course of the registrant's business. All of the registrant's business constitutes its commercial activity, except to the extent to which the business involves the making of exempt supplies. It can be argued that, since the payroll department is not involved directly in the making of exempt supplies, it is not involved in the portion of the registrant's business that makes the exempt supplies. If this argument were accepted, then all of the payroll department's activities would be considered to have occurred in the course of the registrant's commercial activity. Such an interpretation would allow a registrant who makes both taxable and exempt supplies to claim full input tax credits for indirect costs such as costs incurred by its payroll department.

[98] Parliament addressed this issue when it added section 141.01 in 1994, retroactive to the introduction of the GST. Subsections 141.01(2) and 141.01(3) clarify that, when determining input tax credits for a registrant involved in both

taxable and exempt activities, one must attribute all costs of the registrant to the making of supplies.

[99] Subsection 141.01(2) sets out a deeming rule that applies on the acquisition of property or a service.[59] The subsection reads as follows:

> Where a person acquires or imports property or a service or brings it into a participating province for consumption or use in the course of an endeavour of the person, the person shall, for the purposes of this Part, be deemed to have acquired or imported the property or service or brought it into the province, as the case may be,
>
> *(a)* for consumption or use in the course of commercial activities of the person, to the extent that the property or service is acquired, imported or brought into the province by the person for the purpose of making taxable supplies for consideration in the course of that endeavour; and
>
> *(b)* for consumption or use otherwise than in the course of commercial activities of the person, to the extent that the property or service is acquired, imported or brought into the province by the person
>
> (i) for the purpose of making supplies in the course of that endeavour that are not taxable supplies made for consideration, or
>
> (ii) for a purpose other than the making of supplies in the course of that endeavour.

[100] Endeavour of a person is defined in subsection 141.01(1) as meaning a business of the person, an adventure or concern in the nature of trade of the person, or the making of a supply of real property of the person.

[101] For example, the endeavour of a person carrying on a single business is all of the activities of the business, including the making of taxable supplies and the making of exempt supplies.

[102] Subsection 141.01(2) applies to property or a service acquired[60] by the person for consumption or use in the course of the business. Pursuant to paragraph 141.01(2)*(a)*, the person is deemed, for the purposes of the Act, to have acquired the property or service for consumption or use in the course of commercial activities of the person to the extent that the property or service is acquired by the person for the purpose of making taxable supplies for consideration in the course of the business.

[103] Alternatively, under subparagraph 141.01(2)*(b)*(i), the person is deemed to have acquired the property or service for consumption or use otherwise than in the course of commercial activities of the person to the extent that the property or service is acquired by the person for the purpose of making supplies in the course of the business that are not taxable supplies made for consideration. Normally, this would be exempt supplies and taxable supplies made for no consideration or nominal consideration.[61]

[104] In addition, under subparagraph 141.01(2)*(b)*(ii), the person is deemed to have acquired the property or service for consumption or use otherwise than in the course of commercial activities of the person to the extent that the property or service is acquired by the person for a purpose other than the making of supplies in the course of the business. This provision applies where a person incurs expenses that do not relate to the person's business. Normally, such expenses are personal expenses of the owner of the business or a person related to the owner.

[105] Subsection 141.01(2) looks at the person's purpose when acquiring the property or service, in other words, the person's intended consumption or use of the property or service. In particular, it looks to see if the intention was to use the property or service in the making of taxable supplies for consideration, the making of exempt supplies or the making of a combination of such supplies.[62] The person is only entitled to claim an input tax credit for tax paid on the property or service to the extent that the person's intention was to use the property or service in the making of taxable supplies for consideration.

[106] In my view, if a corporation incurs an expense in the course of its business (endeavour), then the expense will always be incurred for the purpose of making one or more supplies. The purpose of the business is to earn revenue, i.e., to make supplies. Therefore, the result of subsection 141.01(2) is that all costs incurred by a person in the course of the person's business must be traced to a specific supply or multiple supplies in respect of which the costs were incurred.

[107] This is a relatively easy exercise for property or services that can be traced directly to the making of a taxable or an exempt supply. The challenge is to trace indirect costs to the various related supplies.

[108] My view is consistent with the Department of Finance's February 1994 technical notes, which explain the purpose of section 141.01 with respect to indirect costs as follows:

> Many types of properties and services used in the operation of a business are not directly used in the making of supplies. These may be referred to as "indirect inputs". Examples include items of overhead and inputs used in the operation of "support" functions of a business such as a personnel department or an internal audit department. The personnel, management, administrative and other support functions of a business **are part of what is involved in the making of supplies since these functions are undertaken in order for the business to achieve the ultimate end or purpose of making supplies**. . . .
>
> New section 141.01 is added only to reinforce this concept that the ultimate purpose of making supplies of some kind involves all aspects of the business. **The section, in effect, requires an attribution of all costs to the making of supplies.** . . .
> [Emphasis added.]

[109] Subsection 141.01(3) contains identical rules, except that it applies to the actual consumption or use of the property or service rather than the intended consumption or use of the property or service on its acquisition. This subsection is relevant when applying provisions of the GST Act that look at the actual use or consumption of property or a service in a specific period, such as the section 206 change-in-use rules.

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[59] It also applies on the importation of property or a service.

[60] The subsection also applies to property or services imported into Canada and property or services brought into a participating province.

[61] Under subsection 141.01(4) property or services acquired for the purpose of making a taxable supply for no consideration or nominal consideration may be deemed to have been acquired for the purpose of making a taxable supply for consideration.

[62] In addition to taxable supplies for consideration and exempt supplies, the person may make taxable supplies for no consideration or nominal consideration. Generally speaking, under subsection 141.01(4), such supplies are re-characterized as either taxable supplies for consideration or exempt supplies.

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APPEARANCES:

Counsel for the Appellant:	Kimberley Cook Florence Sauve Chris Canning
Counsel for the Respondent:	Lynn Burch Spencer Landsiedel Selena Sit

COUNSEL OF RECORD:

For the Appellant:

Name:	Kimberley Cook Florence Sauve Chris Canning
Firm:	Thorsteinssons LLP Vancouver, British Columbia

For the Respondent:	Shalene Curtis-Micallef Deputy Attorney General of Canada Ottawa, Canada