Federal Court  Cour fédérale

Date: 20201126

Docket: T-901-19

Citation: 2020 FC 1014

Ottawa, Ontario, November 26, 2020

PRESENT: Madam Justice Walker

BETWEEN:

BANK OF MONTREAL

Applicant

and

ATTORNEY GENERAL OF CANADA

Respondent

AMENDED PUBLIC JUDGMENT AND REASONS
(Confidential Judgment and Reasons issued on October 29, 2020)

[1] This application centres on the method of computation of input tax credits (ITCs) to be used by the Bank of Montreal (the Bank or BMO) in the calculation of its net Goods and Services Tax (GST)/Harmonized Sales Tax (HST) owing for its November 1, 2017 - October 31, 2018 fiscal year (FY 2018). The Bank applied to the Minister of National Revenue (Minister) to use a particular allocation method to compute its ITCs for FY 2018 pursuant to subsection 141.02(18) of the *Excise Tax Act*, RSC 1985, c E-15 (*ETA*). The Minister denied the Bank's application in a letter dated April 30, 2019 (Decision) and the Bank requests the Court's review of the Decision.

[2] The Bank argues that the Minister exceeded the scope of her authority in denying its FY 2018 application (2018 Application). BMO also argues that the Decision was either incorrect or unreasonable principally because the Minister erred in (1) departing from her authorization of the same or a similar ITC computation method for the Bank's prior fiscal years; and (2) her substantive rationale for the denial. The Respondent submits that the Decision was within the Minister's authority to approve the Bank's proposed computation method under section 141.02 of the *ETA* and that the Decision was reasonable. The Respondent states that the Minister's conclusions regarding the distortion of BMO's ITC claim resulting from the proposed method were fully explained in the Decision and supported by the evidence in the record.

[3] For the reasons that follow, the Bank's application for judicial review of the Decision is dismissed. Very briefly, I have found that:

(1) The standard for the Court's review of the Decision is reasonableness;

(2) The Minister's denial of the Bank's 2018 Application falls within the scope of her authority pursuant to subsection 141.02(20) of the ETA; and

(3) The Decision was reasonable. The Minister provided reasons for her denial in accordance with subsection 141.02(22) and those reasons were justified in light of the evidence in the record, the statutory scheme governing her approval authority in the ETA, and the parties' submissions.

[4] By way of preliminary matter and with the consent of the parties, the style of cause in this matter is amended to reflect the proper respondent, the Attorney General of Canada, in accordance with Rule 303(3) of the *Federal Courts Rules*, SOR/98-106 (*Rules*).

[5] Certain commercially sensitive evidence filed in this Application is subject to a Confidentiality Order dated November 14, 2019. A confidential Judgment was sent to the parties on October 29, 2020 to allow them to propose any redactions required for the public issuance of the Judgment. The Bank proposed redactions on November 18, 2020. I have reviewed the redactions proposed. I am satisfied that they appropriately balance the interest of protecting confidential information and the public interest in open and accessible court proceedings.

I. **Introduction**

[6] ITCs are a fundamental principle of the Canadian GST/HST regime. In lay terms, they are a deduction from the amount of GST/HST ("GST" for purposes of this judgment) a business is required to pay to the government in each reporting period. An enterprise's ITC claim can be straightforward where it conducts one business in Canada engaged solely in selling GST taxable goods and services to Canadian residents but the Bank's ITC claim is not straightforward. The Bank's business has a number of facets and is not confined to Canada. In addition, the provision of 'financial services' by the Bank, its primary business, is subject to complex GST and ITC computation rules. Those rules, when coupled with the difficulty inherent in identifying the Bank's income (based on interest rate spreads) and the fact that money is fungible, lead to the issues in this application.

[7] A fulsome discussion of the ITC scheme, the relevant definitions contained in the *ETA*, the Bank's business, and its 2018 Application follows in this judgment. However, central to the Bank's proposed computation method is the concept of an allocation of its ITCs among its operating groups as one step of the calculation of its net GST payable. The Minister described the purpose of an allocation in the Decision:

> An allocation is a means of attributing an input to a particular supply or supplies. Attribution methods must accurately reflect […] the actual extent to which a particular input was acquired, imported or brought into a participating province for consumption or use, or was consumed or used ("acquired or used") for the purpose of making taxable supplies for consideration and for purposes other than making taxable supplies for consideration.

[8] The Bank's 2018 Application is based on a tiered allocation and computation of its ITC entitlement. Significant tiers or elements of the Bank's 2018 computation method were accepted by the Minister and are not in dispute. The Minister denied the 2018 Application because, in her view, the structure of BMO's proposed method to determine its ITC claim for its residual pool of GST costs did not provide a reasonable approximation of the goods and services (inputs) the Bank used for the purpose of making taxable supplies. Although the issue before me can be stated simply, its resolution is far from simple due to the nature of the GST regime and the calculation of ITCs by a financial institution, the structure of sections 141.01 and 141.02 of the *ETA*, the complexity of the Bank's proposed method, and the parties' multi-layered arguments.

II. **Overview of the GST and ITC regime**

[9] I will begin with an overview of the relevant concepts and provisions of the GST and ITC regime to provide context for the factual background to the Bank's 2018 Application and the issues raised by the Bank in this application for judicial review.

[10] The GST is a value-added sales tax (VAT) applied to a taxable supply of property or services for consideration (subs. 165(1) of the *ETA*). As a VAT, the GST is intended to be paid by the final consumer of the goods or services purchased. A business in the supply chain bears only the GST it collects on the value it adds to a property or service. The mechanism for ensuring the GST is a VAT is the ITC. Each business in the supply chain is entitled to claim ITCs to recover the GST paid to its suppliers (GST Cost) on purchases related to its taxable commercial activities. Using an example from the Bank's submissions, if a bookshop buys a book from a supplier for $80.00, the bookshop pays $4.00 in GST to the supplier. The bookshop then sells the book for $100.00 to a final consumer in Canada, adding $20.00 in value and charging $5.00 in GST to the consumer. The bookshop is entitled to an ITC of $4.00 (its recoverable GST Cost) and is required to remit to the government $1.00.

[11] Under the *ETA*, a "supply" is the sale, lease or other provision of a property or service and is either a taxable supply or an exempt supply. Taxable supplies are taxed at differing rates and a supply that is subject to a zero rate of GST (zero-rated supply) is nonetheless a taxable supply. These terms are defined in section 123 of the *ETA*. The term "financial service" is also defined in section 123 and includes deposit taking and lending services. The supply of financial services to a resident of Canada is an exempt supply (Schedule V to the *ETA*), while certain financial services provided to non-residents are zero-rated (taxable) supplies (Schedule VI to the *ETA*).

[12] The distinction between taxable supplies and exempt supplies is critical in the ITC regime and in this application. A business is entitled to claim ITCs in respect of the goods and

services, or inputs, it uses in making taxable supplies to its customers and clients. If a business engages solely in the provision of taxable supplies to its customers, its ITC claim is typically straightforward (e.g. the for-profit bookshop that only sells books to Canadians).

[13] In the present context, if the Bank provided financial services to Canadian clients only (exempt supplies), those clients would not pay GST to the Bank for those services and the Bank would not be permitted to claim ITCs for the GST it paid to acquire all the inputs (desks, purchased or leased premises, etc.) required to carry on its business. In reality, BMO provides financial services to both Canadian clients and non-resident clients. In GST language, it makes exempt and taxable supplies. Even though the Bank collects no GST from its non-resident clients in respect of its financial services because those supplies are zero-rated, it is entitled to collect ITCs in respect of the inputs used to make those supplies.

[14] The *ETA* does not require a specific allocation method or the use of specific accounting systems that would separate each property or service that a business uses in its provision of taxable and exempt supplies (*Magog (City of) v Canada*, 2001 FCA 210 at para 17 (*Ville de Magog*)). Rather, most businesses are permitted to select an ITC computation method, subject to the requirement in subsection 141.01(5) of the *ETA* that the business's method be fair and reasonable and be used by the business throughout the fiscal year.

[15] Generally, a business required to pay GST is subject to a self-reporting and self-assessment regime. The business calculates the net amount of GST it is required to submit to the Canada Revenue Agency (CRA) for each reporting period based on its selected ITC computation

method. The business's GST return and remittance is subject to audit. As part of the audit, the Minister has the right to determine whether the computation method chosen by the business is fair and reasonable. If not, the Minister reassesses the return and denies some or all of the ITCs claimed by the business, and issues an assessment. The business then has the right to object to the assessment and appeal the assessment to the Tax Court of Canada (TCC).

III. **The Pre-approval regime: Section 141.02 of the *ETA***

[16] Parliament amended the ITC regime for Canadian financial institutions in 2008 by enacting what is now section 141.02 of the *ETA*. The section creates two categories of financial institutions. Qualifying institutions (QIs) consist of large Canadian banks, insurers and securities dealers, including the Bank. Non-qualifying institutions are smaller financial institutions and are not subject to the pre-approval regime set out in section 141.02.

[17] An additional set of subsection 141.02(1) definitions is necessary to understanding the dispute between the parties. The subsection requires financial institutions to categorize the inputs used in their businesses as: (1) "excluded inputs", which are typically capital expenditures; (2) "exclusive inputs", which can be traced exclusively to use in the provision of either taxable or exempt supplies; and (3) "residual inputs", which are all remaining inputs. In an allocation of residual inputs, the "operative extent" and "procurative extent" of a property or service must be determined. The operative or procurative extent of a property or service is the extent to which the particular property or service is consumed or used (operative extent), or acquired or purchased (procurative extent), for the purpose of making taxable supplies for consideration or for a purpose other than making taxable supplies for consideration. The question posed is what are the

various assets and services purchased by the Bank being used for: the making of taxable supplies (the provision of financial services to non-residents of Canada) or the making of exempt supplies (the provision of financial services to Canadian residents)?

[18] Under the section 141.02 regime, QIs are subject to a distinct scheme for the computation of their eligible ITCs. Pursuant to subsection 141.02(18), a QI may apply to the Minister in advance of each fiscal year for approval of their proposed ITC computation method for the year. The Minister may approve or deny the use of the method (subs. 141.02(20)). The Minister's decision is separate from the audit process and is not subject to appeal to the TCC. If the Minister authorizes the method, that method must be used by the QI to prepare its GST return for the particular fiscal year (subs. 141.02(21)). Any audit of that return is limited to determining whether the approved method was used consistently through the year and applied correctly.

[19] If the Minister denies the application, she must provide reasons for the denial (subs. 141.02(22)) and her decision is subject to review by this Court. The QI cannot use its proposed allocation method and is deemed to have used residual inputs for the purpose of making taxable supplies at a prescribed rate of 12% (subs. 141.02(8)). In its submissions, the Bank highlights the impact to it of the application of the prescribed rate of recovery for residual inputs, stating that it normally recovers a materially higher percentage of its residual GST Costs through ITCs.

IV. **Factual background**

[20] The Bank is one of Canada's largest financial services institutions, providing a broad range of personal and commercial banking, wealth management and investment banking products to more than 12 million customers globally. BMO carries on business in Canada and through foreign branches, and owns an array of subsidiaries and other entities. As noted above, the Bank is a QI for purposes of section 141.02 of the *ETA*.

[21] The Bank engages in the provision of financial services, primarily deposit taking, borrowing and lending. The financial services BMO provides to its Canadian clients are exempt supplies. As a result, the Bank is not entitled to claim ITCs for the GST it pays to obtain inputs used to provide those services. Conversely, the financial services BMO provides to non-residents of Canada are generally taxable, zero-rated supplies and the Bank is entitled to claim ITCs for the GST it incurs on inputs used to provide those financial services.

[22] The Bank operates through five operating groups, three of which are customer-facing: Personal and Commercial Banking (P&C), Wealth Management and Capital Markets. The primary activity of the largest customer-facing operating group, P&C, is the provision of banking services (deposit taking and lending) to Canadians, mainly through BMO's many Canadian branches.

[23] The remaining two groups are Corporate, which includes the Bank's Treasury group, and Technology & Operations (T&O). Corporate and T&O centralize certain management functions of the Bank for the customer-facing operating groups. As its name suggests, T&O is responsible

for BMO's physical and technological infrastructure. The Corporate group centralizes the Bank's legal, tax, accounting and regulatory operations. The Treasury group within Corporate is responsible for the Bank's liquidity requirements. It raises funding for the Bank, including funding required by the three customer-facing operating groups, to ensure the Bank has available sufficient liquid assets to satisfy its financial commitments at all times. A material part of the Treasury group's liquidity operations involves the borrowing of funds in foreign markets (the supply of financial services, via the issuance of a debt security, to a non-resident of Canada).

[24] Following the introduction of section 141.02 of the *ETA*, the Bank applied to the Minister for authorization to use a particular ITC allocation method (Initial Method) in respect of each of its 2009-2016 fiscal years. The Minister authorized BMO to use the Initial Method for each such fiscal year.

[25] The Bank revised the Initial Method (Revised Method) for its FY 2017. BMO submitted its application to use the Revised Method to the Minister on August 3 and 4, 2016. After a long period of discussion and consultation, the Minister authorized the Bank's use of the Revised Method with modifications (2017 Approved Method) on January 29, 2018. In the authorization letter, the Minister stated that the remaining outstanding issues under discussion would be addressed during a future audit of the fiscal year.

[26] On February 28, 2018, the Bank submitted the 2018 Application requesting the Minister's approval to use the 2017 Approved Method for FY 2018. There was no significant

change in the Bank's business operations between FY 2017 and FY 2018. Again, a lengthy period of discussions, meetings, consultation and negotiation between the parties ensued.

[27] Despite many attempts by the parties to explain their respective positions and to resolve their disagreements, the Minister denied the Bank's 2018 Application on April 30, 2019.

V. **The Bank's proposed ITC computation method**

[28] The Bank's proposed method for computing its ITC entitlement for FY 2018 (2018 Method) relies on its financial reporting system and has two main phases. The Bank first calculates the total amount of GST paid by the Bank during the year and allocates that total GST Cost to each of the five operating groups. Second, a three-tiered allocation of the GST Costs incurred by the Bank is undertaken:

(1) Cost Allocation Formula (Technical Services Agreements (TSAs)). [redacted] This step of the 2018 Method is not in dispute.

(2) Specific use formula. [redacted]

[redacted] Again, this step of the 2018 Method is not in dispute.

(3) Output method formula (OMF). The Bank's 2018 ITC Claim in respect of its residual pool of GST Costs is calculated using a revenue-based OMF, which itself involves three steps. The focus of the OMF calculation is the Bank's interest revenues (or 'Outputs' using the Respondent's terminology): interest amounts that are the consideration for the supply of financial services (the borrowing and lending of money) for GST purposes. The Minister did not accept the Bank's OMF methodology and denied the 2018 Application. It is certain aspects of this step of the 2018 Method that remain in dispute.

[29] Before describing the three steps of the OMF, it is first necessary to understand the two components of the Bank's interest revenues derived from the supply of financial services to its customers. For GST purposes, BMO makes a supply of a financial service both when it borrows money (because it supplies a debt security and pays interest) and when it lends money (because it supplies funds and receives interest). Therefore, interest paid and interest received by the Bank are included in the OMF calculation.

[30] The OMF, as proposed, functions as follows: (A) the Bank calculates its aggregate interest revenues by adding [redacted] (collectively, Interest Amounts); (B) the OMF allocates the Interest Amounts from Corporate, including the Treasury group, among the three customer-facing operating groups [redacted]

(Treasury Allocations); and (C) a ratio (OMF ratio) is applied to the aggregated Interest Amounts in each customer-facing operating group to arrive at the proportion or percentage of the aggregated Interest Amounts derived from transactions in which the counterparty to the Bank was a non-resident of Canada (i.e. zero-rated transactions). The resulting percentage (Recovery Rate) is applied to each operating group's co-mingled residual GST Cost pool to determine ITC eligibility.

VI. **Decision under review**

[31] The Decision consists of a Decision letter and detailed attachment. It is supported by a lengthy Decision Report. The Minister identified a number of concerns with the 2018 Method in the Decision but the parties agree that the Minister's denial of the Application was in fact based on (1) the allocation through the OMF of the Interest Amounts of the Treasury group to the three customer-facing operating groups (OMF/Allocation Issue); and (2) the components of the formula itself and the use of the aggregated Interest Amounts to arrive at the Recovery Rate for determining ITC eligibility in each operating group (OMF/Recovery Rate Issues).

[32] The Minister used the Decision letter to set out the framework for her analysis of the OMF. She identified two guiding GST principles:

1. The Minister acknowledged that the Treasury Allocations to the customer-facing operating groups may align with the Bank's general allocation policies designed to meet its regulatory requirements but distinguished the GST regime. She stated that an allocation model for GST purposes must connect the purchase or lease of

an input on which GST was paid with the use of that input by the business in its operations:

> Treasury allocations to the customer facing operating groups may be in accordance with the bank's allocation policies in order to meet the regulatory requirements; however, the concept of an underlying allocation method or methods used must link a particular property or service on which tax was paid or payable to its use for the purpose of making taxable supplies for consideration and for purposes other than making taxable supplies for consideration.

2. The Minister then addressed the use of an OMF and emphasized that the Bank's output-based method must result in a "reasonable approximation" of the assets and properties actually used by it for the purpose of making taxable supplies:

> OMF is the least preferred method to determine the operative and procurative extent of business inputs. If an output method allocation is used, the calculation must give reasonable approximation of the inputs used for the purpose of making taxable supplies - in this case the zero-rated financial services provided by Treasury.

[33] The Minister concluded that the Bank's OMF did not result in a reasonable approximation of the inputs it used to provide zero-rated financial services to non-residents of Canada:

> The distortions noted in "Attachment A" to this letter, ha[ve] resulted in the method not providing a reasonable approximation of the inputs. This has resulted in an excessive amount of ITCs that you have proposed to claim through OMF for the zero-rated financial services provided by the treasury department of the corporate support services group. As explained in all our letters/submissions and meetings, the ITCs for the zero-rated financial services in question should be limited to the direct and allocable inputs for these services at the corporate level.

[34] In Attachment A to the Decision letter, the Minister reiterated the general principles governing the use of an ITC allocation method to determine the operative and procurative extent of a property or service. The Minister referred to the Bank's 2016 Annual Report and its description of the Treasury group and the operating groups as responsible for the ongoing management of liquidity and funding risk across the enterprise. The Minister noted that one of the main functions of a bank's treasury department is to manage capital and liquidity to ensure that all parts of the bank can readily access the cash they need to conduct business activities.

[35] Although Attachment A is lengthy and somewhat repetitive in structure, the Minister framed her denial of the 2018 Application around her concerns with the OMF and the two general principles cited in the Decision letter. The repetition in Attachment A occurs because the Minister addressed separately, but in largely parallel terms, the non-domestic lending and borrowing functions (interest income and interest expenses) of the Corporate and Treasury groups and the counterparties to those various transactions (foreign branches, foreign subsidiaries and third parties).

[36] OMF/Allocation Issue: The Minister stated that any ITC recovery for administrative and funding supplies provided by the Corporate group, including Treasury, should come from the GST Costs incurred or allocated to the Treasury function. The Minister concluded that the OMF did not respect this principle because it permits the Bank to dip into the GST Costs of the customer-facing operating groups.

[37] The Minister found that the Bank had claimed its eligible ITCs for the services provided by Corporate and Treasury to foreign branches, subsidiaries and third parties through its TSAs and cost recovery, each a prior pass or step in the 2018 Method. It followed that the OMF permits additional and ineligible ITC recovery by allocating Treasury revenues (Interest Amounts) to the customer-facing groups:

> Including the treasury revenues […] from the branches into the OMF formulae at par with the revenues from the supplies made by the customer facing groups of the bank to claim additional ITC is not acceptable by CRA since the treasury functions are provided by the corporate supporting group which is distinct from the three customer facing groups of the bank. Further, allocation of treasury revenue to the customer facing operating groups has no relevance to the ITC entitlement for the financial services provided by Treasury at the corporate level. ITC entitlement should be limited to the direct and allocable costs to treasury including any back office support for the financial services in question.

[38] OMF/Recovery Rate Issues: The Minister identified two issues in the OMF that, in her view, would distort the Bank's rate of GST Cost recovery such that the use of the OMF would not provide a reasonable approximation of the Bank's use of inputs for the purpose of making taxable (zero-rated) supplies for consideration. The first distortion resulted from the components of the OMF ratio used to establish the Recovery Rate, namely the Bank's exclusion of its Canadian intra-bank Interest Amounts from the denominator of the ratio.

[39] The second distortion identified by the Minister in the 2018 Method was the assumption that the cost of carrying on business in the Treasury group and the customer-facing groups was comparable. The Minister stated that this assumption skewed or distorted the Recovery Rate because it did not take into account the actual inputs required to undertake two very different businesses:

[40] The Minister concluded that the 2018 Method would result in an excess ITC claim based on the Treasury group's funding operations. In her view, the Bank should not ignore the fact that the non-resident financial services in question are provided by Treasury and not the three large customer-facing groups. The OMF does not maintain this distinction, permitting ITC recovery based in part on the Bank's provision of domestic financial services.

VII. **Issues**

[41] I have organized my analysis of the Bank's arguments into two broad sections:

1. The standard for the Court's review of the Decision; and
2. My review of whether the Decision was reasonable.

VIII. **Standard of review**

The Parties' submissions

[42] The Bank acknowledges that the presumptive standard of review of administrative decisions is reasonableness (*Canada (Minister of Citizenship and Immigration) v Vavilov*, 2019 SCC 65 at para 23 (*Vavilov*)) but submits that the presumptive standard is rebutted in the present case. BMO relies on constitutional principles, the emphasis in *Vavilov* on the importance of legislative intent, and tax administration principles to argue that this is one of the rare cases in which an administrative decision must be reviewed for correctness (*Vavilov* at paras 33, 69-70, 82, 108). The premise of the Bank's submissions is that, in denying its proposed ITC computation method pursuant to subsection 141.02(20) of the *ETA*, the Minister is imposing a significant financial burden by essentially determining a material component of its net GST payable for FY 2018. BMO argues that Parliament does not recognize a reasonable range of outcomes in determining a taxpayer's tax payable for the year. A review of the Decision for reasonableness "would inappropriately allow the Minister leeway to conclusively determine a qualifying institution's tax payable, without sufficient recourse to the courts".

[43] In the alternative, if the standard for the Court's review of the Decision is reasonableness, the Bank submits that the review must be rigorous. The Decision must be internally coherent and justified in relation to both the facts and laws that constrain the Minister (*Vavilov* at paras 85, 105, 120) and must bear the hallmarks of reasonableness: justification, transparency and intelligibility (*Vavilov* at para 99). The Bank also submits that the Minister's departure from her prior decisions must be explained in the reasons for the Decision (*Vavilov* at para 131).

[44] The Respondent submits that there is no basis to depart from the *Vavilov* presumption of reasonableness. In enacting section 141.02 of the *ETA*, Parliament delegated to the Minister the authority to approve a QI's proposed ITC computation method and Parliament's legislative intent must be respected. The Respondent argues that the very enactment of section 141.02 supports the presumption of reasonableness (*Vavilov* at paras 24, 30). The Respondent also argues that the Bank's characterization of the Minister's decision as a tax assessment is misguided and derives from its dissatisfaction with subsection 141.02(8) and the imposition of the deemed 12% ITC recovery rate for residual inputs.

[45] Further, the Respondent submits that the Bank has failed to identify specific text in section 141.02, or in the *ETA* generally, that demonstrates Parliament's intent to accord the Minister's subsection 141.02(20) decisions less deference. A detailed review of the scheme of section 141.02 and the fact that it specifically carves the approval process for a QI's ITC computation method from the general provisions for non-QIs indicates a conscious decision by Parliament to position the Minister as the gatekeeper of the QI approval process.

[46] As the hearing of this application drew to a close, the Federal Court of Appeal (FCA) issued its judgment in *Hunt v Canada*, 2020 FCA 118 (*Hunt*). The question before the FCA in *Hunt* was whether section 207.05 of the *Income Tax Act*, RSC 1985 (5th Supp), c 1 (*ITA*), offends section 53 of the *Constitution Act, 1867* and is unconstitutional as an improper delegation of a taxation power. At my request, the Bank and the Respondent provided written submissions regarding the impact of the FCA's analysis in *Hunt* on the present case. The Bank submits that the FCA's analysis is relevant to the Court's interpretation of section 141.02 of the

ETA and the scope of the Minister's approval authority under subsection 141.02(20). The Respondent contends that *Hunt* has limited application to this application because section 141.02 creates a regime that governs the accurate calculation of inputs and ITCs. It does not concern the imposition of tax or the delegation of a taxation power.

Analysis

[47] I have considered the Bank's submissions carefully but conclude that there is no basis for departing from the presumptive standard of reasonableness for my review of the Decision. I find that Parliament's intention to reserve the approval of a QI's proposed ITC computation method to the Minister is evident in section 141.02 of the *ETA* and must be respected (*Vavilov* at para 33).

[48] The SCC identified five situations in which a departure from the presumption of reasonable review is warranted: legislative intent (legislated standards of review and statutory appeal mechanisms) and the rule of law (constitutional questions, general questions of law of central importance to the legal system as a whole, and jurisdictional boundaries between administrative bodies) (*Vavilov* at para 69). The Court did not foreclose other situations that would call for correctness review but cautioned that such categories would be exceptional (*Vavilov* at para 70):

> [70] […] That being said, the recognition of any new basis for correctness review would be exceptional and would need to be consistent with the framework and the overarching principles set out in these reasons. In other words, any new category warranting a derogation from the presumption of reasonableness review on the basis of legislative intent would require a signal of legislative intent as strong and compelling as those identified in these reasons (i.e., a legislated standard of review or a statutory appeal

> mechanism). Similarly, the recognition of a new category of questions requiring correctness review that is based on the rule of law would be justified only where failure to apply correctness review would undermine the rule of law and jeopardize the proper functioning of the justice system in a manner analogous to the three situations described in these reasons.

[49] I find that none of the five situations identified by the SCC support a departure from the reasonableness standard. Parliament has not legislated a standard of review for, nor a statutory appeal from, a subsection 141.02(20) approval or denial. There is no constitutional question, general question of law of central importance or jurisdictional boundary at issue in this application.

[50] The Bank submits that the Decision falls within the SCC's category of the exceptional case but I do not agree. BMO focusses its submissions on constitutional arguments (and not constitutional invalidity), legislative intent and established principles of tax administration, and emphasizes the significant financial implications of the Minister's denial.

[51] The Bank's reliance on constitutional principles in support of correctness review stems from its characterization of the Minister's Decision as a determination of its net GST owing for FY 2018. The Bank submits that the fiscal consequences of the Decision extend beyond the approval of an ITC computation method, the narrow purpose of section 141.02. The Bank argues that the Minister's denial of the 2018 Application effectively determines the quantum of its ITC claim because subsection 141.02(8) automatically applies a 12% prescribed recovery percentage for residual inputs.

[52] BMO states that the power of taxation is a democratic power that must be exercised by the House of Commons (sections 53 and 54 of the *Constitution Act, 1867*). A taxation power may be delegated but only with clear and unambiguous language (*Ontario English Catholic Teachers' Assn v Ontario (Attorney General)*, 2001 SCC 15 at para 77 (*OECTA*)). As the exercise by the Minister of her approval authority under subsection 141.02(20) is the exercise of a taxation power, BMO argues that such authority must be narrowly constrained and subject to very careful and exacting review (*OECTA* at para 77).

[53] I do not agree with the Bank's characterization of the Minister's Decision and find that the Minister does not exercise a taxation power in exercising her approval authority pursuant to subsection 142.02(20) of the *ETA*. Whether the Minister approves or denies a QI's application, her authority extends only to a review of the computation method proposed. She does not determine the net GST payable by the QI, nor does she impose the 12% deemed recovery rate. The consequences of her denial are mandated by other subsections of section 141.02, including subsection 141.02(8), duly enacted by Parliament in accordance with sections 53 and 54 of the *Constitution Act, 1867*. The Bank's actual net GST payable will only be determined against its actual results, including the identification of its taxable and exempt supplies for the fiscal year, its gross GST paid and the application of the various provisions of section 141.02. The Bank's reliance on constitutional principles and the cautionary language in the *OECTA* case to argue for a departure from the presumptive standard of reasonableness review is not persuasive.

[54] As stated above, the specific question before the FCA in *Hunt* was whether section 207.5 of the *ITA* offends section 53 of the *Constitution Act, 1867* and is unconstitutional as an improper

delegation of a taxation power. The FCA answered the question in the negative. The TCC had also considered whether sections 207.05 and 207.06, separately or combined, constitute an invalid delegation of taxation power to the Minister. The FCA declined to address this second question because the answer depended on a number of subsidiary questions which the parties had not dealt with in their memoranda of fact and law. The FCA stated that, in order to answer those questions, the legislative provisions in question were to be interpreted using the accepted method of examining the text, context and purpose of the provisions (*Hunt* at para 11, with reference to leading cases including *Re Rizzo & Rizzo Shoes Ltd.*, [1998] 1 S.C.R. 27, 154 D.L.R. (4th) 193; *Entertainment Software Assoc. v Society Composers*, 2020 FCA 100 at para. 39 (*Entertainment Software*); *TELUS Communications Inc. v Wellman*, 2019 SCC 19). The FCA stated (*Hunt* at paras 13-14):

> [13] In some cases, after a full examination of the text in light of its context and purpose, the Court might conclude that Parliament's provision, in its authentic meaning, satisfactorily constrains the Minister's discretion and defines what she can do and how she should do it. The Minister would not be creating and imposing a tax or coming up with the tax rate on her own. She would not be a law unto herself.
>
> [14] But in other cases, the Court might conclude that Parliament's provision, in its authentic meaning, gives the Minister an unconstrained, undefined discretion without criteria. The Minister, not Parliament, would be creating and imposing the tax or coming up with the tax rate on her own. She would be a law unto herself.

[55] The Bank submits that *Hunt* provides "the proper analytical framework for determining the scope of the decision-making power conferred by Parliament on a tax authority, particularly for the purposes of section 53 of the *Constitution Act, 1867*". However, I agree with the Respondent that section 141.02 of the *ETA* creates a methodology for the calculation of ITCs and the Minister's review of a QI's application. The exercise of the Minister's approval authority

under subsection 141.02(20) is not an imposition of tax or the exercise of a taxation power. It is the exercise of a discretionary authority properly delegated to the Minister by Parliament to ensure computational accuracy. To paraphrase the FCA, the Minister is not imposing a tax or a specific tax rate on QIs; she is not a law unto herself. Parliament created the section 141.02 statutory scheme for QIs and determined the treatment and rate of recovery for a QI's ITC claim for residual inputs in the event the Minister denies an application.

[56] The analytical framework for my review of the Minister's Decision pursuant to subsection 141.02(20) is set out in *Vavilov*. That said, the SCC and FCA in *Vavilov* and *Hunt*, respectively, are aligned as to the nature of statutory interpretation. I acknowledge the Bank's arguments in its *Hunt* submissions regarding the importance not only of the text of section 141.02 but also its context and purpose. In my view, these arguments are properly considered within the *Vavilov* framework and the SCC's guidance regarding the nature and content of reasonableness review.

[57] The Bank relies on the SCC's statement in *Vavilov* that the "polar star" of judicial review is respect for legislative intent and that the presumption of reasonableness review is rebutted where a legislature signals that a different standard should apply (*Vavilov* at para 33).

[58] I find that Parliament's enactment of section 141.02 signals the legislature's intent to confer substantive authority on the Minister to approve or deny a QI's application for approval of its method of ITC allocation and computation (*Vavilov* at paras 23, 33). The Court must respect Parliament's intention. There is no indication in the section or in the *ETA* generally that the

exercise of such authority is to be reviewed by the Court for correctness (*Vavilov* at para 33). Contrary to the Bank's suggestion, the Minister's Decision is owed deference.

[59] The Bank argues that the legislative scheme of the *ETA* and relevant tax administration principles permit all taxpayers, other than QIs, to calculate their net GST owing using a system of self-reporting and self-assessment. Each such taxpayer selects an ITC allocation method that is fair and reasonable and if, on audit, the Minister determines that the method is not fair and reasonable, the taxpayer has the right to appeal the resulting assessment to the TCC. The TCC determines whether the assessment is correct, not whether it is reasonable. In contrast, if the Court reviews the Minister's Decision for reasonableness, the Decision does not have to be correct. In the Bank's view, such a result is contrary to Parliament's legislative intent and marks the only type of taxing decision where the Minister has the right to be wrong.

[60] I do not find the Bank's reliance on general tax administration principles persuasive. Parliament has enacted legislation that overrides the general principles applicable to non-QIs and has provided no indication that the Minister's decision was intended to be reviewed for correctness. The self-reporting regime applicable to non-QIs and their right of appeal to the TCC if the Minister contests their allocation method on audit are superseded by section 141.02.The application by analogy of a correctness standard for review of the Minister's Decision is not warranted.

[61] I agree with the Bank's submission that the effect of section 141.02 is to strip QIs of the right to appeal to the TCC the question of whether their ITC computation methods are fair and

reasonable. The approval of a QI's proposed method is now explicitly reserved to the Minister and the Minister's decision under subsection 141.02(20) is subject to judicial review in this Court. The criteria to be applied to the exercise of the Minister's authority, whether the method must be "fair and reasonable" or a "reasonable approximation" of the use of the inputs in question, is not determinative of the standard of review of the Decision.

[62] The Bank also argues that section 141.02 strips its right to appeal questions relating to its actual use of business inputs in a fiscal period to the TCC but here I disagree. Such questions are the subject of discussion on audit and a subsequent appeal to the TCC remains available. This argument goes to the scope of matters the Minister may consider in assessing a proposed computation method pursuant to subsection 141.02(20) and is an argument I return to in my substantive analysis of the parties' submissions.

[63] What then does the reasonableness standard entail in this case? The SCC describes a reasonable decision as follows (*Vavilov* at para 85):

> [85] […] a reasonable decision is one that is based on an internally coherent and rational chain of analysis and that is justified in relation to the facts and law that constrain the decision maker. The reasonableness standard requires that a reviewing court defer to such a decision.

[64] My review of the Decision begins with the reasons given by the Minister in light of the record and the submissions of the parties (*Vavilov* at paras 83, 86, 96, 125). The reasons must be justified, intelligible and transparent and must address the principal issues raised by the parties (*Vavilov* at paras 95, 99, 127). The SCC reviewed in detail the content of reasons a reviewing

court may expect and cautioned that a reasonableness review must consider both the decision maker's reasoning and the outcome of the decision (*Vavilov* at paras 86-87).

[65] The justification given by the decision maker must be reviewed against the relevant facts and law in each case (*Vavilov* at paras 105-106). The SCC stated that "the governing statutory scheme is likely to be the most salient aspect of the legal context relevant to a particular decision" (*Vavilov* at para 108). In this application, the legislative scheme of the *ETA* is central to my review of the Decision (*Entertainment Software* at paras 34-35). In exercising her authority under subsection 141.02(20), the Minister is constrained by the provisions of the *ETA* generally and the regime imposed by section 141.02.

[66] The Bank and the Respondent disagree on the scope of section 141.02 and the constraints on the Minister's approval authority. Their dispute centres on Parliament's purpose in enacting the section and the test against which the Minister is required to assess a QI's application under subsection 141.02(20). Although the parties discussed these issues in their standard of review submissions, they are also best addressed as part of my substantive analysis of the Decision.

[67] I return briefly to the Bank's submissions regarding *Hunt*. BMO relied on the FCA's statement in *Hunt* that a contextual and purposive statutory interpretation must be used to identify constraints on administrative decision-making powers to argue for correctness review. This issue is addressed directly by the SCC in *Vavilov* (at para 115) where the majority stated that issues of statutory interpretation may be evaluated on a reasonableness standard. The SCC then stated (*Vavilov* at para 117):

> [117] A court interpreting a statutory provision does so by applying the "modern principle" of statutory interpretation, that is, that the words of a statute must be read "in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament": *Rizzo & Rizzo Shoes Ltd. (Re)*, [1998] 1 S.C.R. 27, at para. 21, …[Additional citations omitted].

IX. **Analysis – Was the Decision reasonable?**

[68] I will first address the parties' arguments regarding the scope of the Minister's authority under subsection 141.02(20) of the *ETA*. These arguments focus on the mandate Parliament gave to the Minister in enacting section 141.02 and the importance of ITCs in ensuring the GST is a VAT.

[69] I will then review the Bank's submissions contesting the Minister's concerns and conclusions in the Decision regarding the 2018 Method and the structure of the OMF. Finally, I will address the Bank's submissions regarding the Minister's departure from her prior approvals of the Bank's ITC computation methods.

1. Scope of the Minister's approval authority pursuant to subsection 141.02(20) of the ETA

[70] The Bank submits that the Minister was required to undertake a textual, contextual and purposive analysis of the scope of her approval authority under subsection 141.02(20) in the Decision and that she unreasonably failed to do so (*Vavilov* at paras 117-121; *Entertainment Software* at paras 39-42). BMO states that a textual and contextual interpretation of section 141.02 must respect the fundamental role of ITCs in the GST regime, the principles of allocation methodology, and general tax administration principles. Further, the Minister was required to

turn her mind to the reason Parliament enacted section 141.02 and the mandate it intended to confer in so doing.

[71] The Bank makes two related submissions: (1) Parliament's purpose in enacting section 141.02 of the *ETA* was limited to ensuring that QIs may select only one method of ITC computation for a fiscal year; and (2) as a corollary, the Minister is bound by tax administration principles and the general rules contained in the *ETA* for ITCs. The law concerning 'fair and reasonable' ITC allocation (subs. 141.01(5)) and computation methods is unchanged and constrains the Minister's approval authority.

[72] There is a third aspect to the Bank's submissions regarding the scope of the Minister's approval authority. BMO argues that the Minister exceeded the scope of her authority under subsection 141.02(20) by raising factual issues at the approval stage. In its view, such matters must be left to the audit stage when the Bank's proposed method can be tested against its actual business and financial results for the fiscal year.

Textual analysis: The text of section 141.02 of the ETA

[73] Subsection 141.02(20) of the *ETA* sets out the Minister's authority to approve a QI's proposed computation method:

Authorization	**Autorisation**
(20) On receipt of an application made under subsection (18), the Minister shall	(20) Sur réception de la demande visée au paragraphe (18), le ministre :

(a) consider the application and authorize or deny the use of the particular methods; and	a) examine la demande et autorise ou refuse l'emploi des méthodes particulières;
(b) notify the person in writing of the decision on or before	b) avise la personne de sa décision par écrit au plus tard :
(i) the later of	(i) au dernier en date des jours suivants :
(A) the day that is 180 days after that receipt, and	(A) le cent quatre-vingtième jour suivant la réception de la demande,
(B) the day that is 180 days before the first day of the fiscal year to which the application applies, or	(B) le cent quatre-vingtième jour précédant le début de l'exercice visé par la demande,
(ii) any later day that the Minister may specify, if the day is set out in a written application filed by the person with the Minister.	(ii) à toute date postérieure que le ministre peut préciser, si elle figure dans une demande écrite que la personne lui présente.

[74] The text of subsection 141.02(20) and, more generally, section 141.02 imposes no substantive constraint or criteria on the exercise by the Minister of her authority under the subsection. Most notably, section 141.02 does not require the Minister to approve a QI's application to use an ITC computation method that is 'fair and reasonable', one of the Bank's central arguments in this application. Neither subsection 141.02(18) nor subsection 141.02(19), the provisions that set out a QI's right to apply for pre-approval and the form and manner of any such application, provide that the QI's proposed method must be fair and reasonable.

Subsection 141.02(22) requires the Minister to provide reasons in the event she denies a QI's application but places no obligation on the Minister to explain why the particular computation method was not fair and reasonable.

[75] In contrast, there are numerous instances in section 141.02 where Parliament imposes the fair and reasonable standard on ITC computation methods (see, e.g., subss. 141.02(16), (27), (28), (30), (31), (32) and (33)). Certain of those provisions apply only to financial institutions that are not QIs, others may apply to QIs but only in specific circumstances. None of the provisions apply where, as in this case, the Minister exercises her subsection 141.02(20) authority, approves or denies an application without modifications, and notifies the QI in accordance with subsections 141.02(20) and (22).

Purposive analysis: Parliament's purpose in enacting section 141.02

[76] The Bank submits that Parliament's purpose in enacting section 141.02 constrains the Minister's approval authority. BMO states that section 141.02 was introduced by Parliament in response to *CIBC World Markets Inc. v Canada*, 2011 FCA 270 (*CIBC World Markets*) and was intended to limit QIs to selecting, in advance, one ITC computation method per fiscal year. By way of factual background, CIBC had selected an ITC allocation method for its 1998 and 1999 fiscal years that resulted in the recovery of approximately 6% of the GST paid in each year. CIBC filed its GST returns using the selected method and the Minister accepted the ITC claims. Subsequently, CIBC adopted a different allocation method that resulted in an increased ITC claim and the recovery of approximately 25% of the GST paid in each of 1998 and 1999. The

bank made a second ITC claim using the more favourable method within the applicable limitation period and the Minister disallowed the additional ITCs claimed.

[77] On appeal, the FCA allowed the claims, concluding that there were no words in the text of the *ETA* that prohibited more than one ITC claim for the same taxation year. In fact, subsection 225(3) of the *ETA* contemplated the possibility that more than one claim could be made (*CIBC World Markets* at paras 31-32, 48). Although the second method was more favourable to CIBC, it was still fair and reasonable. The FCA concluded that "[p]rohibiting a later claim based on a method that has been accepted as "fair and reasonable" works a harsh result that, in my view, is not compelled by anything in the [ETA]" (*CIBC World Markets* at para 35).

[78] The Respondent submits that Parliament did not enact section 141.02 solely to address the issue of method shopping illustrated in *CIBC World Markets*. Rather, the new regime was primarily intended to respond to two cases: *Bay Ferries Limited v The Queen*, 2004 TCC 663 (*Bay Ferries*) and the FCA decision in *Ville de Magog*.

[79] In each of *Ville de Magog* and *Bay Ferries*, the taxpayer ITC methodology was accepted as fair and reasonable but the Minister took the position that there were more accurate methods available. In both cases, the Courts found that the taxpayers' methodology prevailed. On appeal by the taxpayer from the TCC, the FCA stated in *Ville de Magog* (at para 15):

> [15] The only issue before the judge was whether the method elected by the appellant was fair and reasonable, as required by subsection 141.01(5). She did not have to determine which of the two methods in question was the best. Moreover, Memorandum

> 700-5-1 acknowledges in its 23rd paragraph that more than one method may be fair and reasonable within the meaning of the Act (see also *Navaho Inn v. The Queen*, 3 GTC 2067, at page 2071 (T.C.C.)).

[80] The Respondent argues that the CRA and the Department of Finance were concerned that the two decisions provided QIs too much flexibility in selecting an ITC computation method. In the Respondent's view, the predominant reason for enacting section 141.02 was to reserve to the Minister the authority to approve the substance of QIs' ITC computation and allocation methodologies.

[81] The Respondent refers to a 2008 Ernst & Young report regarding the initial draft legislation containing proposed section 141.02. The authors of the report opine that the CRA and Department of Finance were concerned with the results in *Ville de Magog* and *Bay Ferries* and sought to rein in the broad latitude of the fair and reasonable test for QIs. The Respondent also cites subsection 141.02(17) which, when applicable, alone addresses the concern raised in *CIBC World Markets* and the use of multiple computation methods within a single fiscal year.

[82] The parties made submissions regarding the dates of the three decisions but I do not find the issue of timing determinative in establishing Parliament's purpose in enacting section 141.02. Parliament proposed the introduction of the section in 2007. It is arguable that, at that time, Parliament, the Department of Finance and/or the CRA, were aware of all three cases cited by the parties. The background information contained in the record regarding the introduction of section 141.02 does not speak to Parliament's purpose other than to describe in general terms the

introduction of a new legislative framework for an ITC allocation regime for financial institutions and the requirement for pre-approval in the case of QIs. It too is not determinative.

[83] In my opinion, a purposive review of the introduction of section 141.02 and the Minister's pre-approval of QI computation methods does not require the limited interpretation posited by the Bank. The structure of section 141.02 itself suggests a purpose broader than a specific response to *CIBC World Markets*. The enactment of a provision similar to subsection 141.02(17) in conjunction with a requirement that a chosen method be used throughout the fiscal year (e.g. as in paragraph 141.02(21)(a)) would address *CIBC World Markets*. There would be no requirement for a pre-approval process. I find that the Minister reasonably interpreted her role as not merely temporal, requiring the establishment of a computation method before the fiscal year in question; but also substantive, permitting her to consider the substance of the proposed method.

Contextual analysis: The continued relevance of fundamental ITC principles (section 169 and subsection 141.01(5))

[84] The Bank submits that general GST principles and rules for ITCs (section 169 and subsection 141.01(5) of the *ETA*), the context in which the Minister approves a proposed method, apply to limit the exercise of her subsection 141.02(20) authority. BMO argues that the Minister erred in the Decision Report by (1) stating that the provisions of section 141.02 override those general rules; and (2) failing to apply the fair and reasonable standard in the exercise her authority. I do not find the Bank's arguments persuasive.

[85] In the Decision Report, the Minister first stated that section 141.02 applies in conjunction with existing ITC provisions such as section 169 of the *ETA*. Subsection 169(1) permits the deduction of GST incurred in the course of a business's commercial activities. She then explained the import of section 169 and stated that the specific rules in section 141.02 supersede the general rules in that section and any applicable provisions in section 141.01. The Minister immediately provided clarification for her statement, indicating that "[f]or further clarification, specific rules for qualifying institutions in section 141.02 should be considered first". In other words, the specific provisions of subsection 141.02 take precedence over any contrary general rules (see, e.g. Justice Stratas' explanation in *CIBC World Markets* (at para 51) that paragraph 141.02(16)(b) is related to subsection 141.01(5) "in that it supersedes subsection 141.01(5) for financial institutions"). The Minister made no error of statutory interpretation in this regard.

[86] By way of example, the Minister explained in the Decision Report the interplay of subsection 141.02(8), the prescribed percentages for determining the extent of use of residual inputs, and the formulae described in subsection 169(1). Although this is merely one example of the Minister's recognition of the general scheme of the *ETA*, the Bank's argument that the Minister disregarded ITC principles, including section 169, is not accurate. She properly recognized their application to a QI's ITC computations, subject to the provisions of section 141.02. During cross-examination, the Minister's representative confirmed the Minister's approach, acknowledging that sections 169 and 141.02 apply to financial institutions, "because section 169 is the authority to an income tax (--), 141.02 dictates or describes the methodologies how it should be applied".

[87] In addition to its reliance on the continued application of general ITC principles, the Bank submits that subsection 141.01(5) of the *ETA* requires the Minister to assess the 2018 Method using the fair and reasonable standard. BMO argues that the law concerning fair and reasonable ITC allocation methods was unchanged by the introduction of section 141.02.

[88] The Respondent submits that section 141.02 is a comprehensive scheme that contemplates a regime distinct from that for non-QIs in process and content. The Respondent argues that Parliament deliberately omitted the fair and reasonable standard from subsection 141.02(20) and allowed the Minister a broader scope of inquiry into a proposed methodology. The Respondent states that, while the assessment of whether a QI's proposed method is fair and reasonable is one element of the Minister's review, she may also consider other factors in determining whether the method results in a reasonable approximation of the inputs used for the purpose of making taxable supplies.

[89] Subsection 141.01(5) states:

Method of determining extent of use, etc.	**Méthodes de mesure de l'utilisation**
(5) Subject to section 141.02, the methods used by a person in a fiscal year to determine	(5) Sous réserve de l'article 141.02, seules des méthodes justes et raisonnables et suivies tout au long d'un exercice peuvent être employées par une personne au cours de l'exercice pour déterminer la mesure dans laquelle :

(a) 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, and	a) la personne acquiert, importe ou transfère dans une province participante des biens ou des services afin d'effectuer une fourniture taxable pour une contrepartie ou à d'autres fins;
(b) 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,	b) des biens ou des services sont consommés ou utilisés en vue de la réalisation d'une fourniture taxable pour une contrepartie ou à d'autres fins.
shall be fair and reasonable and shall be used consistently by the person throughout the year.	

[90] I am not persuaded that the Bank's insistence on a contextual interpretation of subsection 141.02(20) results in the continued application of subsection 141.01(5). The Bank's submission that Parliament did not intend for the Minister to be able to disregard fundamental ITC principles in the exercise of her subsection 141.02(20) authority is too broad. Those principles, including the importance of ITCs to the GST regime and section 169 of the *ETA*, do not require the application of the fair and reasonable standard. The use of a standard other than that set forth in subsection 141.01(5) does not necessarily result in a derogation of ITC principles.

[91] In terms of the immediate context surrounding subsection 141.02(20), Parliament has imposed the fair and reasonable standard in a number of other subsections of section 141.02 (see paragraph 75 above). Parliament can reasonably be presumed to have purposefully omitted from

subsection 141.02(20) a requirement that the Minister consider a QI's proposed ITC computation method using the fair and reasonable test. The standard had long formed part of the fabric of section 141.01, as the Bank insists, and Parliament specifically included the standard in distinct aspects of the new section 141.02 scheme.

[92] It is instructive that the introduction of section 141.02 led to the amendment of subsection 141.01(5). Parliament has indicated that subsection 141.01(5) is subject to section 141.02. I find that this amendment, coupled with Parliament's use of the fair and reasonable standard in certain provisions of section 141.02, provides strong contextual evidence that the Minister was not constrained to apply the standard to her assessment of the 2018 Method under subsection 141.02(20). Therefore, she made no reviewable error in omitting to reference the standard in the Decision.

[93] In Attachment A to the Decision letter, the Minister set out the general principles guiding her review of the Bank's 2018 Method. She first referred to Bulletin B-106:

> An output-based allocation uses a calculation based on an output measure (e.g., revenue) to allocate the use of inputs to the extent that they cannot be allocated using tracking or causal allocation. If an output-based allocation is used, the calculation must give a reasonable approximation of the use of the inputs (emphasis added) for the purpose of making taxable supplies for consideration. For example, inputs should be used in the same proportion in making the supplies included in the calculation and the average profit margin for the supplies included in the calculation should be the same.

[94] The Minister then cited GST/HST Memorandum 8.3 (Calculating Input Tax Credits) (Memorandum 8.3) and general principles regarding output-based computation methods,

including the fact that a chosen method must be fair and reasonable. Memorandum 8.3 does not apply to financial institutions but the Minister's reliance on the Memorandum's summary of output-based methods in the Decision indicates that she recognized the importance of the fair and reasonable standard in the ITC computation scheme.

[95] I do not accept the Bank's position that subsection 141.01(5) requires the Minister to approve a proposed ITC computation method if it is fair and reasonable. Such an interpretation of subsection 141.02(20) ignores Parliament's distinction between QIs and non-QIs. The Bank provided no submissions as to why the Minister's application of the reasonable approximation standard to her assessment of the 2018 Method was unreasonable or otherwise improperly derogated from fundamental ITC calculation principles. The Minister's use of the standard is consistent with the CRA's guidance in Bulletin B-106 and I find no reviewable error in the Decision in this regard.

Scope of the Minister's approval authority vs audit matters

[96] The Bank returns to tax administration principles to argue that the scope of the Minister's authority under subsection 141.02(20) must be narrowly circumscribed to respect the distinction between the audit and approval processes and to safeguard its right to appeal audit disputes to the TCC. These submissions revisit the purpose and context of section 141.02. BMO argues that subsection 141.02(20) contemplates a methodology review. It does not extend to the review of a QI's underlying factual assumptions, the assessment of which must be reserved to audit.

[97] BMO submits that the Minister denied its 2018 Application based on her disagreement with its underlying business assumptions, thereby exceeding her authority. The Bank states that Canada's tax compliance system is premised on the principle of self-assessment based on a taxpayer's own views as to its tax payable (*BP Canada Energy Company v Canada (National Revenue)*, 2017 FCA 61 at paras 81-82). Section 141.02 is a departure from established principles and is unique because the Minister's approval process proceeds in the absence of actual data.

[98] The Bank argues that a QI must be able to self-report using an ITC computation method based on its expected future use of inputs. Unless the proposed ITC computation method is completely beyond reason, the Minister must accept the QI's business assumptions and approve the method as proposed. All disputes as to future use of inputs and the components of the proposed methodology will be dealt with at audit, assessment and, ultimately, by appeal to the TCC. The Bank emphasizes the need to maintain the distinction between assessment and audit, a distinction it states was blurred in this case as the same CRA personnel were involved in both. The audit process, a distinct, lengthy and detail-oriented process based on the QI's actual results, acts as a further limitation on a QI's ITC claim.

[99] The Respondent submits that the Minister is not required to assume that a QI's expected use of inputs is true. In its view, the Bank's argument is circular. The Respondent argues that the very purpose of a methodology review is to assess how the QI is going to use its inputs to establish quantitative amounts. While the Respondent acknowledges that what is and is not

methodology may be a fine line, the Minister is fully authorized to question the structure of the method proposed and the formula itself.

[100] I find that the Minister's approval authority under subsection 141.02(2) of the *ETA* requires her to focus on the structure of a QI's proposed methodology and the application of the methodology to the QI's business. The Minister is required to base her assessment on the business information submitted by the QI but is not required to adopt the QI's characterization of that information for GST purposes. She is not required to assume the accuracy of the proposed elements or structure of the QI's methodology.

[101] The Bank's position unreasonably limits the Minister's authority. I do not agree that the Minister must approve a QI's proposed ITC computation method unless it is "completely beyond reason". Other than insisting on the distinction between the approval and audit processes and the importance of the self-reporting principle, BMO has not identified any indication in the text or context of section 141.02 of Parliament's intention to so limit the Minister's authority. The Bank has not argued that the 2016 business information it provided to the CRA mischaracterized its business operations or that its 2018 operations would differ materially. The Bank's submission ignores the structure of section 141.02 and seeks to reinstate its pre-existing right of appeal of disputes regarding methodology to the TCC.

[102] Throughout section 141.02, Parliament carefully delineates the situations in which a financial institution and, more rarely, a QI, will have access to appeal to the TCC (see, e.g., subss. 141.02(27), (28), (29) and para. 141.02(31)(g)). The flowcharts provided by both

parties at the hearing of this application do not differ in their tracing through the section of the consequences of a Minister's approval or denial of a QI's application. Parliament has removed from the ambit of a TCC appeal the question of whether a QI's ITC computation method is fair and reasonable and authorized the Minister to assess, in advance, a QI's proposed method. The interplay of various subsections of section 141.02 prohibit an appeal of the Minister's decision to the TCC. This marked change to the rights of QIs does not alone mean that the Minister's approval authority must be narrowly circumscribed as argued by the Bank.

[103] Parliament intended a pre-approval process for the computation methods of QIs, without access to actual results. As stated above, neither the text of section 141.02 nor a purposive and contextual interpretation of the section indicates that the process is merely a temporal limitation placed on QIs to select one ITC computation method prior to the commencement of a fiscal year. The Minister must assess a QI's application, including the business information set out by the QI, against the applicable principles and provisions regarding ITC allocation methods.

[104] I find that the Minister acted within the scope of her subsection 141.02(20) authority in her assessment of the 2018 Application. She did not usurp the audit function. The Minister acknowledged the Bank's factual assertions as to the integrated nature of its business and relied on its expected future use of inputs to gauge the application of the 2018 Method against the Bank's 2016 financial information. The Minister focussed on the structure of the Bank's proposed 2018 Method. She questioned whether the proposed allocation method and OMF ratio resulted in a reasonable approximation of the inputs used for the purpose of making taxable supplies. I address whether the Minister did so reasonably in the next section of this judgment

Summary regarding interpretation of section 141.02 of the ETA

[105] The Bank summarizes the preceding sections of my analysis by posing two questions: (1) which party is right about the purpose of section 141.02?; and (2) what was the Minister's job under subsection 141.02(20)?

[106] I find that a textual, contextual and purposive analysis of section 141.02 of the *ETA* indicates that Parliament has conferred on the Minister the authority to approve the proposed ITC computation method of a QI by assessing the structure of the proposed methodology and the business information provided by the QI applicant. The Minister's authority is not limited substantively by criteria in subsection 141.02(20) or, more generally, section 141.02, nor is it limited to a temporal assessment.

[107] In enacting section 141.02, Parliament did not empower the Minister to disregard fundamental GST and ITC principles in exercising her pre-approval authority, nor did the Minister do so in this case. I have considered the Bank's reliance on those principles and on general principles of tax administration in support of its argument that the Minister must approve a proposed methodology if it is fair and reasonable. I do not agree. The Bank has not pointed to a specific derogation by the Minister of those principles in the Decision other than her failure to apply the fair and reasonable standard set out in subsection 141.01(5) of the *ETA*. However, I find that subsection 145.01(5) has been superseded by the specific QI regime in section 141.02. The structure of the section and Parliament's intentional use of the fair and reasonable standard in subsections other than subsection 141.02(20) are strong evidence of a contrary decision by the

legislature. The amendment to subsection 141.01(5) to render its application subject to the specific provisions of section 141.02 bolster this conclusion.

[108] The Bank argues that the Minister erred in failing to include in the Decision her statutory interpretation of subsection 141.02(20) before providing her substantive reasons for the denial. I do not find the argument indicative of a reviewable error. The Minister was not required to set out a comprehensive statutory interpretation of section 141.02 and subsection 141.02(20) in the Decision.

[109] The Minister explained the guiding principles for her assessment of the Bank's 2018 Application in Attachment A to the Decision letter, consistent with departmental guidance. She set out the test against which she would assess the 2018 Method (*Vavilov* at para 123). I find no evidence in the Decision or in the record that the Minister breached general GST principles or improperly ignored the importance of ITCs as the mechanism by which the GST remains a VAT. In light of my findings regarding the scope of section 141.02, I conclude that the Minister carried out her analysis within the contextual and purposive constraints of the legislation (*Vavilov* at para 108). The Minister exercised her discretion under subsection 141.02(20) in accordance with the statutory scheme of the *ETA*, the principles of ITC computation and allocations methods, and the specific regime contemplated by Parliament in section 141.02 (*Vavilov* at para 120).

2. Were the Minister's reasons for the Decision reasonable?

[110] The Minister gave three reasons for her denial of the Bank's 2018 Application:

- The Bank's allocation of the Treasury group's Interest Amounts (the Treasury Allocations) to the three customer-facing operating groups permitted the Bank to

recover a portion of the GST Costs of those groups but the operations of those groups are substantially confined to the provision of financial services to Canadians (exempt supplies).

- The components of the OMF ratio proposed by the Bank omitted one crucial factor, leading to a distorted Recovery Rate.
- The 2018 Method did not account for differences in operations and operating costs between the Corporate group, on the one hand, and P&C, Wealth Management and Capital Markets, on the other, resulting in further distortion of the Bank's ITC claim.

[111] The Minister concluded that the Treasury Allocations and the two distortions resulted in an ITC computation method that did not reasonably approximate the actual use of the Bank's residual inputs and an improperly elevated Recovery Rate. The Bank challenges each of the Minister's reasons for her denial. The Bank also submits that the Minister was required to justify the departure from her prior approvals of its ITC allocation methods and failed to do so.

OMF/Allocation issue: The Treasury Allocations

[112] The Bank submits that the Decision is fundamentally flawed due to the Minister's mischaracterization or misunderstanding of the nature of its business. BMO states that the lynchpin of the Minister's denial of the 2018 Application was her refusal to accept its Treasury function as an integral element of the customer-facing operating groups.

[113] The Treasury Allocations contemplated in the 2018 Application reflect the Bank's position that it carries on one integrated and inseparable banking business through five operating groups. The 2018 Method and OMF calculations rely on BMO's financial reporting systems, including its [redacted] calculations, and present its operations in a manner

consistent with its non-tax reporting. The Bank argues that its financial services business comprises the lending and borrowing of funds within Canada and in many other countries but the two elements of its business are not distinct. The one (lending) cannot exist without the other (borrowing). The Bank's regulators require such integration and mandate its public reporting on a consolidated basis.

[114] The Respondent states that the Minister understood the Bank's business and its integration argument. The Respondent submits that BMO's insistence that the Treasury Allocations are permissible because the customer-facing operating groups rely on the Treasury group for their funding and risk management is a non-answer. The issue before the Minister was whether the application of the 2018 Method reasonably identified how much of the Bank's residual GST Costs were incurred in making its zero-rated supplies of financial services.

[115] I find that the Minister did not misunderstand the nature of the Bank's business as an integrated operation functioning through five operating groups. In its written submissions, BMO states:

> The Minister denied the method based on a disagreement with BMO about certain facts of its business operations and tax principles. The Minister specifically denied that BMO's Treasury group was integrated with BMO's customer-facing business operations, even though such integration is expected by BMO's prudential regulator and its shareholders, is standard operating procedure for any large bank, and is reflected in BMO's financial results provided to shareholders.

[116] The Bank's statement misstates the Decision. The Minister did not deny the 2018 Application because she disagreed with BMO about the facts of its business operations or the

presentation of its business and financial reports on a consolidated basis for regulatory and shareholder disclosure purposes. The Minister recognized the integration of the Treasury group and the customer-facing operating groups as the "first line of defence" managing liquidity and funding risk across the Bank. She also recognized that one of the main functions of Treasury is to make sure that all parts of the Bank can readily access the cash they require for their business activities. The Minister did not question BMO's [redacted] allocate Treasury funds to other operating groups for financial reporting purposes.

[117] The Minister's concern focused on the extension of the integration argument to the provisions of the *ETA* and the principles of ITC calculation. The Minister is tasked with applying the byzantine rules of the *ETA* in her assessment of a QI's proposed ITC computation method. She is not concerned with issues of liquidity and shareholder disclosure. She has no obligation to conform her assessment of a proposed methodology to the reporting expectations of the Office of the Superintendent of Financial Institutions or the Ontario Securities Commission. The GST regime is supply-based, it is not business-based. There are clear and repeated distinctions regarding the status of supplies in the provisions of the *ETA* that must be respected.

[118] The ITC regime permits businesses to recoup the ITCs they incur in their business supply chain to ensure the GST is a VAT. The *ETA* creates two broad categories of supplies: taxable supplies and exempt supplies. The provision of financial services to Canadian residents is an exempt supply and the Bank is prohibited from recouping as ITCs the GST Costs it incurs in the making of those supplies. The provision by the Bank of financial services to non-residents is a

zero-rated supply. The Bank is entitled to claim ITC's in respect of the GST Costs it incurs in obtaining the inputs, whether goods or services, it needs for the purposes of making those zero-rated supplies. In considering the Bank's 2018 Application, the Minister is required to respect ITC principles. She is not permitted to disregard the categorization of supplies established in the *ETA* (*Shell Canada Ltd. v Canada*, [1999] 3 SCR 622, 178 DLR (4th) 26 at para 40). It follows that she made no error in distinguishing between the GST-exempt domestic supplies that make up the vast majority of the business of the Bank's three customer-facing operating groups and the zero-rated supplies made by the Treasury group.

[119] I emphasize that the Minister did not refuse the 2018 Application because the Bank proposed an ITC allocation method or because the Bank used an output-based method. There is no suggestion in the Decision that she misunderstood the difficulty in computing ITC claims in the provision of financial services where money is fungible and a bank's income cannot be directly traced because it is derived from a positive spread (the difference between the amounts a bank makes as a lender and the expenses it incurs as a borrower). Input- and output-based allocation methods are used by businesses and are accepted by the CRA. The issue before the Minister was specific to the Bank's 2018 Method and the allocation of the Treasury's identified, residual GST Costs to the customer-facing groups.

[120] The Respondent points to the cross-examination of the Bank's representative during which she confirmed that a portion of the Bank's ITC Claim resulting from the proposed allocation would derive from its exempt deposit and lending activities. She agreed with the Respondent's statement that, to the extent the Bank must engage in exempt lending- and deposit-

taking to enable Treasury to earn non-resident interest amounts, the Bank should be entitled to claim ITCs.

[121] The Respondent argues that the response of the Bank's representative contravenes the First Order Supply Rule: a business cannot recover GST incurred on inputs acquired to make exempt supplies, even when those exempt supplies enable the business to make other taxable supplies. The Rule links ITC entitlement to particular supplies and not to an overall business. The Respondent points to the fact that the Minister raised this issue a number of times during the application process and highlights her reference to the Rule in the Decision. The Respondent relies on the FCA decision in *Canada v 398722 Alberta Ltd.*, [2000] GSTC 32 at paragraph 22 (*398722*):

> [22] Any business may consist of a number of components, each of which is integral to the business as a whole. The definition of "commercial activity" recognizes that possibility but requires, for GST purposes, that any part of the business that consists of making exempt supplies be notionally severed. The statutory definition dictates that the business of the respondent is not a "commercial activity" in so far as it consists of the rental of the units of the four-plex. On that basis I agree with the Crown that the respondent is not entitled to an input tax credit to offset the GST payable on the self-supply of the four-plex.

[122] The Bank questions the application of the Rule, stating that it does not appear in the *ETA* and is not a judicial doctrine. BMO distinguishes the jurisprudence regarding the Rule (*398722*; *London Life Insurance Co. v Canada*, [2000] GSTC 111 (FCA); *General Motors of Canada Ltd. v Canada*, 2009 FCA 114 (*GMAC*)) on the basis that those cases involved materially different businesses. In each case, the FCA was focussed on the use of the inputs in question and not on the application of an ITC allocation and computation method by a financial institution.

[123] Subsections 141.01(2) and 169(1) of the *ETA* establish a fundamental limitation on the ability of a business to claim ITCs based on the purpose for which a business acquires goods and services. In order to claim ITCs, a business must have acquired goods and services in the course of its commercial activities (subs. 169(1)). The business is deemed to have acquired goods and services for consumption or use in the course of its commercial activities to the extent that the good or service is acquired "for the purpose of making taxable supplies for consideration" (subs. 141.01(2)). As stated above, the Bank's supply of financial services to a resident of Canada is an exempt supply. It is not a taxable supply. The Bank cannot claim ITCs on the bulk of its Canadian business. The Department of Finance Technical Notes from 2010 regarding the introduction of subsection 141.01(2) address the question of the immediate use of properties or services and the making of supplies using an example specific to financial institutions:

> The final point regarding the "purpose" test is that it looks to the first-order supplies to which the particular properties or services relate. To illustrate, suppose a registrant that meets the definition of "financial institution" only because of its level of investment income issues promissory notes on the short-term money market to raise funds for use in a business of the registrant of making taxable supplies. The issuance of the financial instruments is an exempt supply of financial services. Therefore, properties and services acquired for use in that capital-raising function would be considered to have been acquired for the purpose of making exempt supplies. This should not be confused with the purpose for the making of the exempt supplies themselves, which may ultimately be related to the making of taxable supplies by the registrant.

[124] The Minister refused to adopt the Bank's argument that it conducts one business through all of its operating groups for GST purposes because the argument fails to recognize the distinction in the *ETA* between the provision of taxable and exempt supplies. She justified her conclusion in reliance, in part, on the Rule and I am not persuaded that her conclusion was

unreasonable. As the FCA stated in *GMAC*, courts, and by extension the Minister in exercising her subsection 141.02(20) authority, must be sensitive to the economic realities of a business. However, those economic realities cannot supplant the operation of unambiguous legal provisions (*GMAC* at paras 62-63).

[125] The Bank argues that all supplies, whether direct or indirect, are purchased or used by a business for the same purpose, that is the making of supplies to other persons. In the Bank's case, it makes supplies in order to earn the spread. BMO refers to the Department of Finance Technical Notes from February 1994 and the introduction of section 141.01 of the *ETA* in support of its integration argument. Those notes acknowledge that all inputs are acquired by a business for the purpose of making supplies but also state that a distinction must be made between the provision of taxable and exempt supplies.

[126] To varying extents, many businesses that make taxable and exempt supplies can argue that they are engaged in one business, the purpose of which is to maximize profit. The question is how immediate the use of the indirect (residual) supplies in question is to the making of taxable supplies. The Rule, the background documentation and case law cited by both parties seek to identify the ambit of the purpose test set forth in subsection 141.01(2). The Technical Notes are consistent with the Minister's inquiry as to whether an allocation method results in a reasonable approximation of the use of residual (indirect) inputs by a business to make taxable supplies. The Minister's conclusion that the Bank's integration argument and 2018 Method extended its reach too far into the residual GST Costs of the customer-facing operating groups via the distortions identified was not unreasonable on the evidence before her. The Bank's

justification of the Treasury Allocations on the basis that Treasury's function is indispensable to the customer-facing groups' business is not a sufficient response to the purposive requirement of subsection 141.01(2) and the *ETA* distinction between exempt and taxable supplies.

[127] At the hearing, the Respondent relied on 2016 financial data from Bank's "Worked Example" to demonstrate the Minister's concern that the OMF permits the Bank to claim ITCs in respect of the residual GST Costs incurred by the customer-facing groups. The Bank submitted the Worked Example to the Minister during the course of the 2018 Application process to illustrate the 2018 Method against actual data. The Respondent's demonstration highlighted the seepage that occurs through the Treasury Allocations permitting the Bank's ITC claim to extend beyond the GST Costs incurred by Treasury. The demonstration also reflected the difficulty of tracing the Treasury group's recoverable, residual GST Costs once combined with the materially larger residual GST Cost pools of the customer-facing operating groups.

[128] As stated above, the Treasury Allocations co-mingled Treasury's residual GST Costs with the GST Cost pools of the customer-facing operating groups that were incurred primarily to provide financial services to Canadian residents. In the Minister's view, there was no reason for the Treasury Allocations as they made it more difficult for the Bank to identify the GST Costs incurred in the provision of taxable supplies. She took the position that Treasury's GST Costs, which were identifiable from the Bank's financial systems, should have been claimed as ITCs in Treasury to the extent they had not been fully claimed through the TSA and cost allocation steps of the 2018 Method. The Minister described her concern in the Decision and requested that the Bank identify those ITC-eligible GST Costs and claim them at the Corporate group level.

[129] In summary, the Minister emphasized the importance of the technical distinctions made in the *ETA* regarding the operative and procurative extent of a property or service (whether the good or service was acquired by a business for the purpose of making taxable or exempt supplies) and the purpose of an allocation method (the attribution of an input to a particular supply or supplies). The Minister explained in detail in Attachment A to the Decision letter her review of the Bank's methodology submission and her consideration of the role of the Treasury function.

[130] I find that the Minister made no reviewable error in concluding that: (1) the Treasury Allocations failed to maintain an acceptable delineation between the residual GST Costs of the three Canadian operating groups and the Treasury group; and (2) did not result in a reasonable approximation of the inputs the Bank used for the purpose of making taxable supplies of financial services to non-residents. The Minister reasonably concluded that the Bank's integration argument was not sufficient to address the concern that the Treasury Allocations were not consistent with the GST distinction between the making of exempt and taxable, zero-rated supplies. Her conclusions were based on an internally coherent chain of logic that was communicated at length to the Bank in the Decision and during the course of the parties' extensive discussions during the application process. The Minister explained her conclusions by reference to the statutory scheme of the *ETA* governing ITCs and QIs. She considered the evidence before her, including the Bank's Narrative and Worked Example.

The OMF/Recovery Rate distortions

The Formula Distortion

[131] The Minister's second reason for her denial of the Bank's 2018 Application was the structure of the ratio used in the OMF to calculate the Bank's ITC Recovery Rate following the Treasury Allocations. The Minister did not accept the Bank's omission from the denominator of the ratio of the Outputs (Interest Amounts) derived from its domestic intra-corporate transactions. She stated (Attachment A to the Decision):

> Corporate treasury provides the same or similar intra-bank financial services (funding) to its few foreign branches as it does to approximately 900 Canadian branches. However, the proxy in your methodology is carving out the corporate interest income/expenses (intra-bank) in the denominator to the Canadian branches since the intra-bank services in Canada are not considered as supplies. These services are real activities and the treasury would have incurred costs to perform these activities. This causes distortion to the proxy since the GST/FVAT included in the costs allocable to the Canadian branches are not recognized in the formulae even though the corresponding GST/FVAT is in the OMF pool.
>
> (Emphasis added)

[132] The OMF ratio calculates the Bank's Recovery Rate for residual inputs. The Recovery Rate is then applied to the co-mingled GST Costs in each of the customer-facing operating groups to determine the amount of those GST Costs the Bank may claim as ITCs. Returning to basic principles, an output-based allocation method using revenue relies on the fact that the business's revenues is a reasonable approximation of the GST Costs actually incurred by the business to make taxable supplies. According to the Minister, the Bank's OMF ratio should be structured as follows (bearing in mind that (1) the Bank's interest revenues or Outputs are derived from both its lending and borrowing activities; and (2) intra-bank revenues are the revenues derived internally from transactions between Bank branches):

Taxable Revenue (Outputs)	**Taxable Expenses (Outputs)**

(e.g. Interest income derived from zero-rated supplies)	+	(e.g. Interest expenses derived from zero-rated supplies, foreign intra-bank revenues/Outputs)

Total Revenues
(Interest income, Interest expenses, foreign intra-bank revenues/Outputs, domestic intra-corporate revenues/Outputs)

[133] However, the OMF ratio as proposed by the Bank was as follows:

Taxable Revenue (Outputs) (e.g. Interest income derived from zero-rated supplies)	+	**Taxable Expenses (Outputs)** (e.g. Interest expenses derived from zero-rated supplies, foreign intra-bank revenues/Outputs)

Total Revenues
(Interest income, Interest expenses, foreign intra-bank revenues/Outputs)

[134] The OMF ratio as proposed excludes from the denominator domestic intra-corporate Interest Amounts/revenues, a material proportion of the Bank's total revenues. The Interest Amounts in question are generated because the branches charge each other interest, generating a spread. On cross-examination, one of the Bank's representative explained that BMO removes domestic intra-corporate revenues from the denominator because they are not supplies for GST purposes. Conversely, inter-branch revenues between domestic and foreign branches are included in the numerator and denominator because the Bank considers those transactions to be supplies for GST purposes. The Bank argues that the inclusion in the denominator of Interest Amounts from non-supplies would in fact distort the ratio and would be contrary to the Department of Finance's references to the making of supplies in its explanation of section 141.01 in the 1994 Technical Notes.

[135] The Respondent argues that the exclusion of domestic intra-bank revenues is contrary to the principle of an output-based allocation method:

> […] A registrant who has 10% taxable Outputs can recover 10% of its total GST. That registrant cannot remove 1/3 of those Outputs and still claim ITCs on the GST incurred to make those Outputs, but that is exactly what the Bank proposed.

[136] The Bank's omission of its domestic intra-bank revenues from the OMF ratio was discussed at length by the parties during the 2018 Application process and by the Bank's representative on cross-examination. It is clear both that the Minister accurately identified the exclusion and that she does not dispute the Bank's statement that its domestic intra-branch transactions are not considered supplies for GST purposes. The dispute between the parties is whether the omitted revenues unreasonably skew the OMF ratio because they represent real activities and give rise to GST Costs.

[137] I have reviewed both parties' submissions and the evidence in the record in detail, particularly the excerpts of the cross-examinations cited by each party and the questions and answers surrounding the specific questions cited to me. I find that the Minister reasonably required the inclusion of the Bank's domestic intra-bank Interest Amounts in the denominator of the OMF ratio to ensure that the 2018 Method resulted in a reasonable approximation of the inputs the Bank used for the purpose of making taxable supplies (Bulletin B-106). I also find that the structural make-up of the OMF ratio was within the Minister's authority to assess and approve. A dispute regarding an element of the methodology should not be reserved to the audit stage.

[138] The Recovery Rate derived from the OMF ratio is applied against all of the Bank's residual GST Costs (other than those excluded by the application of prior passes of the OMF). Therefore, it was reasonable for the Minister to conclude that the denominator of the ratio must include all of the Bank's Interest Amounts. I accept BMO's position regarding the status of the domestic intra-bank supplies for GST purposes but cannot conclude that the Minister erred in finding that their status does not determine their role in a revenue-based allocation method. The excluded Interest Amounts resulted from real transactions even though those transactions were internal to the Bank. GST Costs were incurred in the performance of those transactions. Whether those GST Costs were minimal or not does not alter the necessary components of the OMF ratio.

[139] The Minister explained her reasoning in the Decision. Her conclusion is consistent with the evidence in the record, the principles of output-based allocation methods and the CRA's Bulletin B-106. The Bank's submission that "everything included in the numerator is included in the denominator" defeats the purpose of the ratio, which is to calculate ITC recovery based on aggregate taxable Interest Amounts/revenues and aggregate Interest Amounts/revenues.

[140] The issue is not one of allocation. The same concern would arise if the Bank conducted its Treasury function within the customer-facing operating groups. Each group would be required to determine what proportion of its GST Costs was incurred for the purpose of making zero-rated taxable supplies. If the determination were based on revenue, intra-bank supplies of financial services would be relevant to the calculation to the extent they generate interest revenue.

[141] The Bank argues that the Minister's focus on the OMF ratio was an impermissible attempt to reverse engineer a result (*Vavilov* at para 121). BMO states that the Minister should not have considered its ultimate Recovery Rate at the approval stage as it is premature. The Minister must instead focus on the proposed methodology. The Respondent states that the materially higher recovery rate alerted the Minister to a possible issue and caused additional investigation by CRA staff. The Minister did not require the Bank's Recovery Rate to meet a pre-ordained standard.

[142] The Bank argues that there is no indication in the record that the CRA's investigation triggered a more intensive review of the 2018 Method and I agree that the evidence of the Minister's representative in this Application is not conclusive of the Minister's thought process. She did not explain the distortion resulting from the OMF ratio on this basis in the Decision.

[143] The Minister's focus in the Decision was the structure of the OMF ratio and whether it undermined the 2018 Method as a reasonable output-based method. There is no evidence that she required the 2018 Method to produce a particular Recovery Rate. I find that the Minister's analysis of the OMF ratio was consistent with the Bank's evidence. Her conclusion that the Bank's formulation of the OMF ratio distorted the Recovery Rate and, ultimately, the Bank's ITC claim was justified and intelligibly explained in the Decision (*Vavilov* at para 99). The outcome of her analysis was reasonable when considered against the principle of a revenue-based output method. The fact that the Minister relied on the results of the CRA's work using the Bank's financial data in her assessment of the OMF ratio does not establish an attempt to reverse engineer the Bank's OMF.

The Business Distortion

[144] The Minister described the "business distortion" in the Decision by reference to the labour-intensive nature of Treasury's business operations as opposed to those of the customer-facing operating group. The Bank submits that the Minister was comparing apples to oranges. BMO focusses on its integration argument and the fact that Treasury is integral to the Bank's ability to generate income (the spread). Before me, counsel to the Bank emphasized that the structure of a business should not affect the amount of GST it pays. Whether the exempt and taxable supplies are made in the same group or in different groups, branches or subsidiaries, the rate of ITC recovery should remain the same.

[145] The Respondent defends the Minister's analysis, stating that the 2018 Method did not account for the very different costs of carrying on business in the customer-facing operating groups and Treasury. The Respondent characterizes the distortion as a volume distortion because the customer-facing operating groups, particularly P&C, conduct business through 900 branches and complete millions of financial transactions in what is a labour-intensive, and supply intensive, business. Conversely, the Treasury group focuses on fewer, larger transactions requiring much less physical infrastructure and incurring less GST Costs.

[146] I agree with the Bank that the Minister's business distortion is another aspect of her disagreement with BMO's position that its operations must be considered as an integrated whole for GST purposes. My analysis of that disagreement is set out above. The business distortion identified by the Minister buttresses her conclusion that the Treasury Allocations do not result in a reasonable approximation of the inputs the Bank used for the purpose of making taxable

supplies of financial services to non-residents. The nature of the overhead required vis-à-vis revenue generated is relevant to the Minister's assessment of the structure and complicating effect of the Treasury Allocations. The Minister explained her concern in the Decision and her communication of allocation concerns was clear. The Minister's reasoning is consistent with her broader analysis of the 2018 Method and the Treasury Allocations.

3. Inconsistency of the Minister's Decision with prior approvals

[147] The Bank submits that the Minister failed to provide an explanation for her departure from her approval of its proposed ITC computation methods each fiscal year since 2009. BMO highlights the SCC's statement that, if a decision maker departs from longstanding prior practice "it bears the justificatory burden of explaining that departure in its reasons" (*Vavilov* at para 131). Most notably, the Bank states that the Minister approved its subsection 141.02(18) application for FY 2017 less than one month before it filed the 2018 Application. The 2017 Approved Method contained the same Treasury Allocations now in dispute.

[148] The Respondent submits that the Minister advised the Bank several times during discussions that each application is a standalone application, evaluated on its own merits. The Respondent states that the Minister was not prepared to continue to defer contentious matters to audit.

[149] There are two distinct time frames at issue. The Minister's approval of the Bank's subsection 141.02(18) applications for the fiscal years 2009-2016 were based on a different methodology. In its written submissions, BMO explained the change as follows:

> 99. First, the Minister authorized the Disputed Treasury Allocation for every fiscal year preceding 2018. For the 2009-2016 fiscal years, the Minister annually approved of allocating Treasury's Interest Amounts entirely to Capital Markets. For the 2017 fiscal year, the Minister approved of allocating Treasury's Interest Amounts to all three customer-facing operating groups. The revised allocation reflects interviews with specialists in BMO's Treasury group and is the most current understanding of the business, consistent with [redacted].

[150] The Bank's explanation of the change in allocation methodology highlights one of the Minister's critical concerns with the 2018 Method. She found that the Treasury Allocations into the three large customer-facing operating groups complicated the Bank's ability to identify permissible ITC claims and allowed the Bank to access the GST Costs incurred by those operating groups in making exempt supplies. In my opinion, the methodologies proposed in 2009-2016 were materially different from the Bank's proposed allocation methods for 2017 and 2018. Therefore, I find that the Minister's denial of the 2018 Application cannot be characterized as a departure from her 2009-2016 approvals that required explanation in the Decision.

[151] The Bank's application in respect of FY 2017 was approved by the Minister on January 29, 2018. The Bank's 2018 Application was submitted very shortly thereafter and began a second long set of discussions, meetings and correspondence. The Minister's 2017 approval letter stated:

> Furthermore, at our meeting with the Bank of Montreal on January 11, 2018, it was brought to your attention that there are still outstanding concerns which were raised in the past that have been not been incorporated in your application. All these concerns will be addressed during a future audit of the fiscal year 2016/11/01 to 2017/10/31.

[152] There was discussion as to whether the Minister's 2017 approval was conditional. I agree with the Bank that there is no evidence the 2017 approval was conditional. There is a distinction between a conditional approval and an approval coupled with an agreement to resolve outstanding matters at a later date in the course of a different process.

[153] I also agree with the Bank that the Minister did not explain in the Decision her reasons for denying the 2018 Application as opposed to deferring the remaining outstanding matters to audit. The question before me is whether her failure to provide such an explanation is a reviewable error necessitating a reconsideration of the 2018 Application.

[154] As part of its guidance for reviewing courts in the review of an administrative decision for reasonableness, the SCC stated (*Vavilov* at para 131):

> [131] Whether a particular decision is consistent with the administrative body's past decisions is also a constraint that the reviewing court should consider when determining whether an administrative decision is reasonable. Where a decision maker *does* depart from longstanding practices or established internal authority, it bears the justificatory burden of explaining that departure in its reasons. If the decision maker does not satisfy this burden, the decision will be unreasonable. In this sense, the legitimate expectations of the parties help to determine both whether reasons are required and what those reasons must explain: *Baker*, at para. 26. We repeat that this does not mean administrative decision makers are bound by internal precedent in the same manner as courts. Rather, it means that a decision that departs from longstanding practices or established internal decisions will be reasonable if that departure is justified, thereby reducing the risk of arbitrariness, which would undermine public confidence in administrative decision makers and in the justice system as a whole.

[155] Notwithstanding the Bank's arguments, I find that the lack of explanation in the Decision of the Minister's refusal to approve the 2018 Application and defer outstanding matters to the audit stage as in 2017 does not result in an unreasonable decision. First, the Minister's failure to follow the same process as in 2017 was not a departure from a longstanding practice. One prior decision does not constitute a practice.

[156] Second, the unresolved issues between the parties in 2018 were not the same issues deferred to audit for FY 2017, with the exception of the Minister's concern regarding the Treasury Allocations to the customer-facing operating groups. The Bank takes the position that the CRA accepted the methodology of the Treasury Allocations but was skeptical that they would reflect the actual use of inputs by the Bank, resulting in the deferral to audit. In my view, the correspondence between the parties indicates that the nature and result (actual use of inputs) of the Treasury Allocations was at issue in 2017 and 2018.

[157] Third, the record establishes that the Minister signalled her unwillingness to defer the outstanding issues to audit as the 2018 discussions between the Bank and the CRA continued and agreement appeared unlikely. The Bank's reliance on its legitimate expectation is not persuasive in the current circumstances (*Vavilov* at para 131). I find that the Minister was not constrained to the same analysis of the 2018 Method as in 2017 and was not required to raise the same issues or permit the same resolution. The Minister undertook an independent analysis of the 2018 Method and the Bank was fully aware of the content of the Minister's review.

[158] In light of the SCC's emphasis on justification in administrative decisions, it would have been preferable for the Minister to state why she would not follow the deferral route for FY 2018. However, I find that her omission to explain in the Decision a different resolution than that in 2017 does not rise to the level of a sufficiently serious shortcoming that requires redetermination (*Vavilov* at para 100).

X. **Conclusion**

[159] The application for judicial review will be dismissed. The Minister explained and justified each of her concerns in the Decision. There is no doubt she had grappled at length with the Bank's evidence and central arguments and the applicable principles of the GST regime (*Vavilov* at para 128; *Entertainment Software* at para 45). The Bank's disagreement with each aspect of the Minister's analysis was argued in detail and with skill in this application, based on a voluminous evidentiary record. I find, however, that the Minister's denial of the 2018 Application was: within the scope of the approval authority delegated to her by Parliament under subsection 141.02(20) of the *ETA*; consistent with the evidence before her; and, principled and coherent, all as reflected in the Decision.

[160] The Bank requests that I order the Minister to grant an extension of time for the Bank to re-submit an application to the Minister for FY 2018 pursuant to subparagraph 141.02(19)(b)(ii) of the *ETA*. BMO states that its only recourse was to seek judicial review of the Decision and a possible appeal to the FCA, each a lengthy process. Such an extension would permit the Bank to file a revised 2018 Application reflecting the Minister's agreement with material aspects of the 2018 Method as proposed and incorporating revisions acceptable to the Minister.

[161] An order requiring the Minister to grant an extension is premature at this time as the Minister may unilaterally grant an extension of the filing deadline upon request. However, the circumstances of the Bank's application and the fact that the issues between the parties are well-defined weigh in favour of an extension of time pursuant to subparagraph 141.02(19)(b)(ii). Therefore, I direct the Minister to consider any such request promptly, recognizing the commercial time pressures BMO faces and the magnitude of the financial implications to the Bank of the denial of an opportunity to make a revised application for FY 2018.

[162] I note in closing that, during oral submissions on appropriate remedy, the Bank's counsel expressed significant concern with a comment made by the Respondent's counsel regarding the utility of any remission of this matter for re-determination should I find in the Bank's favour. The Respondent's counsel stated in oral submissions that any return of the 2018 Application for reconsideration on the basis that the Minister departed from her 2017 approval would have the same result. The Bank's counsel argues that this comment demonstrates that BMO would not be treated fairly. Although I have found in the Minister's favour, I wish to address the Bank's concern.

[163] I have re-read the transcripts from the hearing. The Respondent's comment was limited to a redetermination based solely on a finding that the Minister did not adequately explain her differing resolution of outstanding issues in the FY 2017 and FY 2018 application processes. It was not a broad comment that extended to any redetermination on the merits of the Minister's conclusions. In this context, the Respondent's statement does not indicate bias or an unwillingness to consider the substance of the Bank's arguments on the part of the CRA.

XI. **Costs**

[164] At the hearing of this application, the parties agreed to discuss the quantum of costs to be awarded. I have since received and reviewed correspondence dated October 22, 2020, in which the parties jointly propose that the successful party in the application be awarded a lump sum of costs in the amount of $42,000.00, inclusive of disbursements and tax. I see no reason not to adopt the proposal negotiated by the parties. Given my decision to dismiss the Bank's application, the Respondent is entitled to costs from the Bank in the amount of $42,000.00, inclusive of disbursements and tax.

JUDGMENT IN T-901-19

THIS COURT'S JUDGMENT is that:

1. The application for judicial review is dismissed.

2. The style of cause is amended to reflect the Attorney General of Canada as the Respondent.

3. The Bank shall pay the Respondent costs of this application in the amount of $42,000.00, inclusive of disbursements and tax.

"Elizabeth Walker"
Judge

FEDERAL COURT

SOLICITORS OF RECORD

DOCKET:	T-901-19
STYLE OF CAUSE:	BANK OF MONTREAL v ATTORNEY GENERAL OF CANADA
PLACE OF HEARING:	HELD BY VIDEOCONFERENCE BETWEEN TORONTO, ONTARIO AND OTTAWA, ONTARIO
DATE OF HEARING:	JULY 6, 2020, JULY 7, 2020 AND JULY 8, 2020
JUDGMENT AND REASONS:	WALKER J.
CONFIDENTIAL JUDGMENT AND REASONS ISSUED:	OCTOBER 29, 2020
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APPEARANCES:

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