Federal Court of Appeal | Cour d'appel fédérale

**Date: 20160627**

**Docket: A-223-15**

**Citation: 2016 FCA 192**

**CORAM:** **NOËL C.J.**
**BOIVIN J.A.**
**DE MONTIGNY J.A.**

**BETWEEN:**

**KRUGER WAYAGAMACK INC.**

**Appellant**

**and**

**HER MAJESTY THE QUEEN**

**Respondent**

Heard at Montréal, Quebec, on June 21, 2016.

Judgment delivered at Ottawa, Ontario, on June 27, 2016.

REASONS FOR JUDGMENT BY: NOËL C.J.

CONCURRED IN BY: BOIVIN J.A.
DE MONTIGNY J.A.

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## REASONS FOR JUDGMENT

**NOËL C.J.**

[1] This is an appeal brought by Kruger Wayagamack Inc. (the appellant) from a decision of the Tax Court of Canada (2015 TCC 90) wherein Jorré J. (the Tax Court judge) dismissed the appellant's appeal from reassessments issued by the Minister of National Revenue (the Minister) pursuant to the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (the Act) with respect to its 2003, 2004, 2005, and 2006 taxation years.

[2] The legislative provisions relevant to the analysis are reproduced in Annex I to these reasons.

## I. BACKGROUND

[3] During the taxation years in issue, the appellant operated a paper mill in Trois-Rivières, Quebec and conducted scientific research and experimental development activities for which it became entitled to investment tax credits (the ITCs). As it had no income during that period against which the ITCs could be used, the appellant claimed refundable ITCs.

[4] Pursuant to subsection 127.1(1), when read with the definition of "refundable investment tax credit" in subsection 127.1(2) of the Act, a "qualifying corporation" is deemed to have paid on account of its taxes an amount equal to 40% of its ITCs at the end of the year. A "qualifying corporation" is defined as (subsection 127.1(2)):

a) a Canadian-controlled private corporation (other than an associated corporation) the taxable income of which does not exceed its business limit for the preceding year, or

b) a Canadian-controlled private corporation associated with another corporation, where the total of their taxable income does not exceed their total business limit for the preceding year.

[5] Pursuant to subsection 248(1) of the Act, a corporation's "business limit" is the amount determined under section 125. Subsection 125(2) provides the basic business limit of a

corporation, which is then subject to a reduction under subsection 125(5.1) commensurate with the corporation's – or any associated corporation's – tax payable under Part I.3.

[6] At all relevant time, 51% of the appellant's issued and outstanding shares were owned by Kruger Inc. (Kruger) through 3864057 Canada Inc., its wholly-owned subsidiary, and the remaining 49% were owned by SGF Rexfor Inc. (SGF), a corporation owned by the Government of Quebec. For present purposes, nothing turns on the fact that Kruger's stake in the appellant was held through a subsidiary.

[7] It is common ground that Kruger's taxable income well exceeded the total business limit contemplated by subsection 127.1(2) with the result that if Kruger was associated with the appellant during the four years in issue, the appellant exceeded the business limit. It also follows that Kruger was associated with the appellant if it can be established that it controlled the appellant.

[8] The Crown's primary position at trial was that Kruger had *de jure* and/or *de facto* control over the appellant (paragraph 256(1)(*a*)). The Crown further alleged that Kruger was deemed to control the appellant pursuant to paragraph 256(1.2)(*c*) because its shares had a fair market value which exceeded 50% of the fair market value of all the issued and outstanding shares of the capital stock of the appellant.

[9] The Tax Court judge found that Kruger controlled the appellant only by reason of this last provision. While Kruger's 51% ownership of the shares gave it control over operating

decisions, the Unanimous Shareholder Agreement (USA) took that control away with respect to many strategic decisions with the result that Kruger did not have *de jure* control (Reasons, paras. 29 to 71). Nor could it be said that Kruger had *de facto* control as nothing in fact overrode the effect of the USA insofar as the overall direction of the appellant was concerned (Reasons, paras. 72 to 89).

[10] It remained however that the shares held by Kruger had a fair market value that exceeded 50% of the fair market value of the overall issued and outstanding shares of the appellant with the result that Kruger was deemed to control the appellant pursuant to paragraph 256(1.2)(*c*) of the Act.

## II. ANALYSIS AND DECISION

[11] The only question which arises in this appeal is whether the valuation exercise which led to this conclusion was properly conducted. This valuation had to be made subject to the statutory prescription set out in paragraph 256(1.2)(*g*) of the Act which deems all the subject shares to be non-voting for purposes of this exercise.

[12] Emphasizing this constraint, the Tax Court judge gave extensive reasons as to why he preferred the opinion adduced by the Crown's expert, according to which Kruger's 51% share ownership in the appellant had a fair market value commensurate with that percentage (Reasons, paras. 90 to 160). He also explained at length why he could not accept the appellant's contention that the value of Kruger's shares had to be discounted based on liquidity and marketability concerns while those held by SGF did not (*ibidem*).

[13] The appellant submits that in rejecting this last contention the Tax Court judge either erred in applying the relevant legal principles or made a number of palpable and overriding errors (Memorandum of the appellant, paras. 47 to 57).

[14] The appellant first seizes on the Tax Court judge's statement at paragraph 127 and footnote 63 of his reasons to suggest that "the end result [of his reasoning] is that [Kruger's] block of shares would require a discount of 4.1% in order for it to not be associated with the [a]ppellant," (Memorandum of the appellant, para. 81). The appellant contends that this conclusion is either plainly wrong or reveals an error in principle, as it is clear that only a 2% discount is required to bring the value of Kruger's block of shares below 50% (*ibidem*).

[15] A fair reading of the reasons does not support this attack as it is clear from the reasons that the Tax Court judge was merely addressing the relative value of Kruger's 51% interest in relation to SGF's 49% interest based on the approach used by the appellant's own expert (Reasons, para. 121). The suggestion that the Tax Court judge thereby lost track of the numbers and that this "tainted his overall analysis" is without foundation (Memorandum of the appellant, para. 82).

[16] The appellant also challenges the Tax Court judge's understanding of the issue which he had to decide by highlighting the following two questions which he stated (Reasons, para. 92):

a) Does [paragraph 256(1.2)(*c*)] apply if Kruger's shares in the appellant are worth more than 50% of what someone would pay to buy all the shares of the appellant at once? or

b) Does [paragraph 256(1.2)(*c*)] apply if Kruger's shares are [worth] more than 50% of the value of all the shares with the shares owned by different owners valued separately, i.e. are Kruger's shares worth more than those owned by SGF?

[17] The appellant contends that the Tax Court judge failed to identify and address the first question as the only relevant question (Memorandum of the appellant, para. 80).

[18] That this is the only relevant question is uncontested. However, in setting out the above questions, the Tax Court judge was again addressing the issue as it was presented by the appellant's expert during the hearing (Reasons, para. 99). The answer that he gave is that regardless of the question asked, the fair market value of Kruger's shares exceeded the 50% threshold (Reasons, para. 123). I can detect no error in this regard.

[19] The appellant further asserts that the Tax Court judge erred in holding that the alleged discount for lack of liquidity and marketability would have impacted both Kruger's and SGF's block of shares the same way, so that the relative value of their share ownership remained unaffected (Memorandum of the appellant, para 86).

[20] It suffices to say in this respect that the findings made by the Tax Court judge in support of this conclusion are all factual (Reasons, paras. 114, 115, 117, 118, 130 to 162) and that no error of a palpable and overriding nature has been demonstrated with respect to any of them.

[21] I would dismiss the appeal with costs.

"Marc Noël"

Chief Justice

"I agree.
Richard Boivin J.A"

"I agree.
Yves de Montigny J.A."

Annex I

Relevant Legislative Provisions

| | |
|---|---|
| ***Income Tax Act***, R.S.C. 1985, c. 1 (5th Supp.), as amended | ***Loi de l'impôt sur le revenu***, L.R.C. 1985, c. 1 (5e supp.), telle que modifiée |
| **Associated corporations** | **Sociétés associées** |
| **256 (1)** For the purposes of this Act, one corporation is associated with another in a taxation year if, at any time in the year, | **256 (1)** Pour l'application de la présente loi, deux sociétés sont associées l'une à l'autre au cours d'une année d'imposition si, à un moment donné de l'année : |
| **(*a*)** one of the corporations controlled, directly or indirectly in any manner whatever, the other; | ***a*)** l'une contrôle l'autre, directement ou indirectement, de quelque manière que ce soit; |
| … | […] |
| **Control, etc.** | **Précisions sur les notions de contrôle et de propriété des actions** |
| **(1.2)** For the purposes of this subsection and subsections 256(1), 256(1.1) and 256(1.3) to 256(5), | **(1.2)** Pour l'application du présent paragraphe et des paragraphes (1), (1.1) et (1.3) à (5): |
| … | […] |
| **(*c*)** a corporation shall be deemed to be controlled by another corporation, a person or a group of persons at any time where<br>**(i)** shares of the capital stock of the corporation having a fair market value of more than 50% of the fair market value of all the issued and outstanding shares of the capital stock of the corporation, or<br>**(ii)** common shares of the capital stock of the corporation having a fair market value of more than 50% of the fair market value of all the issued and outstanding common shares of the | ***c*)** la société, la personne ou le groupe de personnes qui est propriétaire, à un moment donné, d'actions du capital-actions d'une autre société dont la juste valeur marchande correspond à plus de 50 % de la juste valeur marchande de toutes les actions émises et en circulation du capital-actions de cette autre société, ou qui est propriétaire, à ce moment, d'actions ordinaires du capital-actions de cette autre société dont la juste valeur marchande correspond à plus de 50 % de la juste valeur marchande de toutes les actions ordinaires émises |

capital stock of the corporation are owned at that time by the other corporation, the person or the group of persons, as the case may be;

et en circulation du capital-actions de cette autre société, est réputé contrôler cette autre société à ce moment;

…

[…]

**(*g*)** in determining the fair market value of a share of the capital stock of a corporation, all issued and outstanding shares of the capital stock of the corporation shall be deemed to be non-voting

***g*)** dans la détermination de la juste valeur marchande d'actions du capital-actions d'une société, toutes les actions émises et en circulation de ce capital-actions sont réputées ne pas conférer de droit de vote.

**FEDERAL COURT OF APPEAL**

**NAMES OF COUNSEL AND SOLICITORS OF RECORD**

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|---|---|
| **DOCKET:** | A-223-15 |
| **(APPEAL FROM A JUDGMENT OF THE HONOURABLE MR. JUSTICE JORRÉ OF THE TAX COURT OF CANADA DATED APRIL 14, 2015, DOCKET NUMBER 2011-1739(IT)G).** | |
| **STYLE OF CAUSE:** | KRUGER WAYAGAMACK INC. v. HER MAJESTY THE QUEEN |
| **PLACE OF HEARING:** | MONTRÉAL, QUEBEC |
| **DATE OF HEARING:** | JUNE 21, 2016 |
| **REASONS FOR JUDGMENT BY:** | NOËL C.J. |
| **CONCURRED IN BY:** | BOIVIN J.A.<br>DE MONTIGNY J.A. |
| **DATED:** | JUNE 27, 2016 |

**APPEARANCES:**

| | |
|---|---|
| Wilfrid Lefebvre<br>Vincent Dionne | FOR THE APPELLANT |
| Philippe Dupuis<br>Marie-Andrée Legault | FOR THE RESPONDENT |

**SOLICITORS OF RECORD:**

| | |
|---|---|
| Norton Rose Fullbright Canada S.E.N.C.R.L., S.R.L.<br>Montréal, Quebec | FOR THE APPELLANT |
| William F. Pentney<br>Deputy Attorney General of Canada | FOR THE RESPONDENT |