Docket: 2008-3200(GST)G

BETWEEN:

SOCIÉTÉ EN COMMANDITE SIGMA-LAMAQUE,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeal heard on June 14, 2010, at Montréal, Quebec.
Before: The Honourable Justice Lucie Lamarre

Appearances:

Counsel for the appellant:	Dominic C. Belley Vincent Dionne
Counsel for the respondent:	Pierre Zemaitis

JUDGMENT

The appeal from the assessment of the Minister of Revenue of Quebec (the Minister) under the *Excise Tax Act* (ETA), dated July 9, 2008, in respect of the period of November 2004, is allowed, and the assessment is referred back to the Minister for reconsideration and reassessment on the basis that the appellant is entitled to a rebate for the tax that was paid in error in the amount of $543,080.21, within the meaning of subsection 261(1) of the ETA. However, the assessment does not change with respect to the input tax credits (ITCs) claimed on the deemed tax, within the meaning of subsection 169(1) and section 182 of the ETA. The Minister does not have to pay ITCs beyond the amounts allowed in the assessment of July 9, 2008.

Each party shall bear its own costs.

Signed at Ottawa, Canada, this 10th day of September 2010.

"Lucie Lamarre"

Lamarre J.

Translation certified true
On this 24th day of November 2010

François Brunet, Revisor

Citation: 2010 TCC 415
Date: 20100910
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REASONS FOR JUDGMENT

Lamarre J.

[1] The appellant filed a goods and services tax (GST) return for the period of November 2004 in which it claimed an amount of $543,080.21 as GST paid in error, within the meaning of subsection 261(1) of the *Excise Tax Act* (ETA), as well as an input tax credit (ITC) for the same period in the amount of $472,379.67 for the GST deemed to have been paid, within the meaning of subsection 169(1) and section 182 of the ETA (see tax return for a total amount of $1,015,566.30, representing the sum of the two amounts mentioned above as well as a small amount related to other expenses, with the explanatory schedule of calculations, Exhibit A-1, tab 6, pages 205-206).

[2] In an assessment dated July 9, 2008, the Minister of Revenue of Quebec, acting on behalf of the Minister of National Revenue (Minister), allowed ITCs only for an amount of $37,344.95 and refused to reimburse any of the so-called tax paid in error (see Reply to the Notice of Appeal, paragraphs 57, 68 and 69).

[3] The appellant is challenging the assessment on the ground that it is entitled to all the ITCs claimed, as well as to a rebate of the tax paid in error.

Facts

[4] On June 20, 2002, the appellant and a company called "Les Services Financiers Caterpillar Limitée" (**Caterpillar**) signed a lease agreement (**lease)** for eight units of heavy equipment (Exhibit A-1, tab 1). Under this lease, Caterpillar (**the lessor**) agreed to lease the appellant (**the lessee**) two hydraulic shovels and six trucks for a 60-month term, at the end of which the appellant had the option of buying all of the units at a predetermined price of US$1,618,328.80 (plus applicable taxes). The amount financed, 100% of the purchase price at the time of the signature, was US$8,517,520.

[5] For the duration of the lease, the appellant agreed to pay Caterpillar rent on each unit in instalments and according to the payment periods set out in each annex of the lease, including all of the applicable federal and provincial taxes on the payments (article 2.2 of the lease and the related annexes, Exhibit A-1, tab 1, page 9 and pages 26 to 68.12). Moreover, article 2.3 of the lease provided that the obligations of both the lessor and the lessee could not be affected by, among other things, insolvency or any bankruptcy proceeding by or against the lessee. Thus, any payment or other amount payable by the lessee under the lease was payable under any circumstances in accordance with the payments set out in the annexes (Exhibit A-1, tab 1, page 10). Under article 4.6 of the lease, the units remained movable property of the lessor, and article 4.7 provided that as long as the lessee was not in default on the payment, the lessee had the right of possession and use of the units for the duration of the lease, without impediment from the lessor. Under article 8.1, paragraph (e), the lessee was in default if he stopped operating its business or filed a proposal or gave notice of intent to file a proposal or brought proceedings under any law regarding bankruptcy, reorganization, insolvency or making arrangements. In the event of a default, the lessor could terminate the lease by written notice to the lessee, who still remained liable under the lease. The lessor then had the discretion to declare immediately payable the current value of the balance due with respect to the units and recover any additional damages and expenses incurred by the lessor because of the lessee's default and require that the lessee return the units to the lessor (article 8.2). The lessor could then sell the units and the proceeds of the sale could be used, among other things, to pay the amount owing by the lessee, as well as the current value of the balance owing, as liquidated damages (article 8.3).

[6] Furthermore, article 13 provided that the lessor retained title to, and ownership of, the units as a guarantee of the lessee's obligations and that the lessee's rights to peaceful enjoyment and use of the units existed as long as the lessee was not in default. The lease was governed by the laws of the province of Quebec (article 16).

[7] The appellant (the lessee) had agreed to obtain and remit to Caterpillar (the lessor) an irrevocable letter of guarantee in an amount of US$425,876 by which the lessor could, at any time if the lessee failed to respect its obligations, demand payment of this letter of guarantee (article 1.4 of the lease). This irrevocable letter of guarantee was issued by National Bank of Canada (Exhibit A-1, tab 2).

[8] On October 1, 2003, the appellant ceased its operations, and on January 15, 2004, filed a notice of intention to make a proposal to its creditors under the *Bankruptcy and Insolvency Act* (the BIA) (Exhibit A-1, tab 3, pages 82-84).

[9] On February 12, 2004, Caterpillar, through its lawyers, asked the appellant to pay the amounts owing to it and return the units (Exhibit A-1, tab 3, pages 83-84), and filed a requisition for a writ of seizure before judgment with the Superior Court of Quebec, on February 26, 2004 (Exhibit A-1, tab 3, pages 85 and following).

[10] The appellant's proposal, for which Raymond Chabot Inc. acted as trustee, was filed on June 7, 2004 (Exhibit A-1, tab 3, pages 95 and following). By this proposal, the appellant planned to sell all of its assets, through the trustee, to Century Mining Corporation (Century) for approximately $25,826,416. Century agreed to pay the appellant's creditors in cash or shares of Century, according to the creditor's choice, up to a certain amount.

[11] As for Caterpillar, it made a first claim, for an amount of CAN$8,999,068.24 (Exhibit A-1, tab 4, pages 136-138). This claim was based on the balance of the monthly payments set out in the annexes of the lease, to which was added the GST and QST that would have been collected if the appellant had met its obligations under the lease until it ended. This was clearly explained by Emmanuel Phaneuf, the trustee in bankruptcy, with supporting documents.

[12] Following this first claim, Caterpillar cashed the letter of guarantee from the National Bank of Canada for an amount of CAN$570,844.19 and sold the units that it had taken back from the appellant to a company called Acton Construction Inc. (Acton), for which Caterpillar received the net proceeds of the sale of CAN$7,560,597.42. Caterpillar then filed an amended claim with the appellant's trustee, reducing the initial amount claimed by the amount received from the bank on the letter of guarantee and from Acton on the proceeds of the sale of the units. The amount of the amended claim was now CAN$867,626.63 (Exhibit A-1, tab 4, pages 141-142). Caterpillar apparently was paid by the trustee in shares of Century and cash (Exhibit A-1, tab 4, page 126 and page 129).

[13] The trustee did not intervene in the sale of the units by Caterpillar to Acton, and the sale was made through an agent, who received a commission on the proceeds of the sale. Acton paid GST on the purchase of the units (Exhibit A-1, tab 5, pages 182-192).

[14] Guylaine Dallaire, C.A., tax expert, testified as to why the appellant had claimed an amount of GST paid in error. In her opinion, Caterpillar was asking for the unpaid rent in addition to the GST and QST. However, Caterpillar had taken possession of the equipment and the appellant was no longer running a business. The amount claimed by Caterpillar was based on the amount of rent that the appellant would have paid if it had completed the term of the lease, but in reality, the claim was made in a context of a breach of contract, and consequently no GST was payable. Now, the amount claimed by Caterpillar included CAN$543,080.21 in GST, which is the amount that the appellant is claiming from the Minister as GST paid in error within the meaning of subsection 261(1) of the ETA.

[15] Moreover, after subtracting the GST paid in error, Ms. Dallaire considered the application of section 182 of the ETA whereby a tax is deemed to be paid when an amount is paid following the breach of a contract. This tax is deemed to be included in the amount paid and corresponds to the amount claimed by the appellant of CAN$472,379.67, which is also in dispute. Section 182 of the ETA reads as follows:

> Forfeiture, extinguished debt, etc.
>
> **182.** (1) For the purposes of this Part, where at any time, as a consequence of the breach, modification or termination after 1990 of an agreement for the making of a taxable supply (other than a zero-rated supply) of property or a service in Canada by a registrant to a person, an amount is paid or forfeited to the registrant otherwise than as consideration for the supply, or a debt or other obligation of the registrant is reduced or extinguished without payment on account of the debt or obligation,
>
> (*a*) the person is deemed to have paid, at that time, an amount of consideration for the supply equal to the amount determined by the formula
>
> $$(A/B) \times C$$
>
> where
>
> A is 100%,

B is

(i) if tax under subsection 165(2) was payable in respect of the supply, the total of 100%, the rate set out in subsection 165(1) and the tax rate for the participating province in which the supply was made, and

(ii) in any other case, the total of 100% and the rate set out in subsection 165(1), and

C is the amount paid, forfeited or extinguished, or by which the debt or obligation was reduced, as the case may be; and

(*b*) the registrant is deemed to have collected, and the person is deemed to have paid, at that time, all tax in respect of the supply that is calculated on that consideration, which is deemed to be equal to

(i) where tax under subsection 165(2) was payable in respect of the supply, the total of the tax under that subsection and under subsection 165(1) calculated on that consideration, and

(ii) in any other case, tax under subsection 165(1) calculated on that consideration.

[Emphasis added.]

[16] The Minister accepted that the amount recovered by Caterpillar from the National Bank of Canada on the letter of guarantee was subject to section 182. The Minister thus granted ITCs to the appellant on this part only, and that is why ITCs of CAN$37,344.95 were allowed in the assessment of July 9, 2008.

[17] However, the Minister refused to apply section 182 to the amount received by Caterpillar from Acton following the sale of the units that had been leased. According to the Minister, the amount paid by Acton apparently was not paid in the context of the breach of the lease, but in the context of a sale of equipment between Caterpillar and Acton. In regards to the tax paid in error, the Minister also refused to pay this amount on the grounds that the appellant had not actually paid this tax.

Appellant's Submissions

[18] The heart of the dispute rests, according to counsel for the appellant, in the fact that Caterpillar's claim was calculated erroneously. Indeed, Caterpillar should not have included GST and QST in its proof of claim because there was no longer a taxable supply. Considering the amount received on the letter of guarantee and the net proceeds of the sale received from Acton, Caterpillar was fully compensated for the amounts owed to it under the lease. In fact, the balance indicated in the amended

claim of CAN$867,626.63, corresponds to the sales taxes (GST and QST) claimed by Caterpillar. In other words, if Caterpillar had not included these taxes in its claim, the appellant's debt to it would have been fully paid by the letter of guarantee and the net proceeds of the sale received from Acton. Hence, the appellant submits that it paid these taxes (including the GST) in error, because these taxes were added to the amount of the creditors' claims, for which Caterpillar received money and shares from Century, the company that took over all of the appellant's assets in exchange for assuming the debts owed to its creditors.

[19] As for the tax deemed paid under section 182 of the ETA, the appellant submits that it is not necessary for its application that the appellant paid an amount to Caterpillar. What counts is that Caterpillar was paid following the breach of the lease, and, in this context, the GST is deemed to be included in the payment. As evidence that the amount received from Acton was paid in the context of the breach of the lease, the appellant argues that this amount reduced the appellant's debt towards Caterpillar. Caterpillar had released the appellant. Regardless, the appellant submits that the opening words *in fine* of subsection 182(1) (**182 *in fine***) applies since Caterpillar's obligation towards the appellant to provide it with the equipment was set aside by the seizure. According to the appellant, the value attributable to its use of Caterpillar's equipment was quantified at CAN$7,560,597.42 under the amended claim. Accordingly, by selling the units to Acton, Caterpillar deprived the appellant of its right to full enjoyment in accordance with the lease, and thus reduced to CAN$7,560,597.42 its obligation under article 4.7 of the lease.

[20] The appellant thus submits that it had the right to claim ITCs on this deemed tax, which it estimates to be CAN$472,379.67 (Exhibit A-1, tab 6, p. 206).

Respondent's submissions

[21] Regarding the application of section 182 of the ETA, the respondent submits that Acton's payment to Caterpillar was made for the sale of equipment, for which Acton paid the GST. This payment was not made because of the breach of the lease, which is evident because the trustee was not involved in the transaction. Section 182 does not apply when the payment is made in consideration of a supply, which is the case here.

[22] As for section 182 *in fine*, the respondent submits that this applies to cases where the registrant (Caterpillar) would have had a debt towards the appellant and the appellant would have waived its debt following its non performance of its obligations under the lease. According to the respondent, Caterpillar no longer had any

obligation towards the appellant once the appellant was in default, as Caterpillar had the right, under the terms of the lease, to take back its units, which belonged to it in any case.

[23] As for the tax paid in error, the respondent submits that there is no evidence that tax was paid. There is no invoice to prove it. Moreover, there is no indication or documentation that states that the shares of Century and the cash payment to Caterpillar by the trustee was tax paid in error. This is purely the interpretation of the appellant who, in performing certain calculations, considered that this could be the case. The respondent submits that the evidence does not demonstrate that the appellant actually paid the tax that it claims to have paid in error. This cannot be deduced as the appellant is trying to do. The fact that the damages claimed by Caterpillar were calculated in a certain way does not lead to the deduction, after the fact, that the GST had to have been collected.

Analysis

[24] The other relevant provisions of the ETA read as follows:

> General rule for credits
>
> **169.** (1) Subject to this Part, where a person acquires or imports property or a service or brings it into a participating province and, during a reporting period of the person during which the person is a registrant, tax in respect of the supply, importation or bringing in becomes payable by the person or is paid by the person without having become payable, the amount determined by the following formula is an input tax credit of the person in respect of the property or service for the period:
>
> A × B
>
> where
>
> A is the tax in respect of the supply, importation or bringing in, as the case may be, that becomes payable by the person during the reporting period or that is paid by the person during the period without having become payable; and
>
> B is
>
> (*a*) where the tax is deemed under subsection 202(4) to have been paid in respect of the property on the last day of a taxation year of the person, the extent (expressed as a percentage of the total use of the property in the course of commercial activities and businesses of the person during that taxation year)

> to which the person used the property in the course of commercial activities of the person during that taxation year,
>
> (*b*) where the property or service is acquired, imported or brought into the province, as the case may be, by the person for use in improving capital property of the person, the extent (expressed as a percentage) to which the person was using the capital property in the course of commercial activities of the person immediately after the capital property or a portion thereof was last acquired or imported by the person, and
>
> (*c*) in any other case, the extent (expressed as a percentage) to which the person acquired or imported the property or service or brought it into the participating province, as the case may be, for consumption, use or supply in the course of commercial activities of the person.
>
> ...
>
> Rebate of payment made in error
> **261.** (1) Where a person has paid an amount
> (*a*) as or on account of, or
> (*b*) that was taken into account as,
>
> tax, net tax, penalty, interest or other obligation under this Part in circumstances where the amount was not payable or remittable by the person, whether the amount was paid by mistake or otherwise, the Minister shall, subject to subsections (2) and (3), pay a rebate of that amount to the person.

I – Rebate of GST payment made in error: subsection 261(1) of the ETA

[25] There does not seem to be any dispute that the appellant did not have to pay GST on the amount of Caterpillar's claim to the trustee in bankruptcy. Although the objections officer admitted in his memorandum that Caterpillar had determined the current value of the balance owing by the appellant as damages on the basis of the amount of rent to be paid monthly, including the GST and QST, he was of the opinion that there was no taxable supply provided to the appellant for which there would have been taxes applicable under the ETA (see Memorandum on Objection, Exhibit A-1, tab 13, page 240).

[26] Accordingly, the stumbling block does not lie in the fact that there was no tax payable, but in the fact that the respondent does not acknowledge that the tax was paid, whereas the appellant says that it paid this tax in error. Indeed, to be eligible for a rebate, the appellant must establish that it actually paid this tax that should not have been paid.

[27] The appellant submits that it paid it because the GST was included in determining the amount of Caterpillar's claim, which it received in return for cash and shares of Century, who had acquired all of the appellant's assets by assuming its debt.

[28] Regardless whether Caterpillar remitted the GST to the government (which it should have done if it had really collected it[1]), that does not change the appellant's right to a rebate, if it can in fact prove that it paid this tax in error to the supplier (Caterpillar here). As long as it can prove that Caterpillar collected this tax in error and that it paid it, the appellant is entitled to be reimbursed. Moreover, if Caterpillar had actually remitted this tax to the government, it is not Caterpillar who could claim a rebate, because it only remitted an amount collected as tax and paid by the appellant. (See *McDonell v. R*, [2005] G.S.T.C. 134, at paragraphs 21-34)

[29] With regards to whether Caterpillar collected the GST in error, I would tend to agree. Article 8.5 of the lease, which applies in case of default, reads as follows:

> [TRANSLATION]
> 8.5 Remedies under this agreement for benefit of the lessor should not be considered exclusive but cumulative and should be added to any other remedy open to it at law or in equity; provided, however, that the lessor shall not be authorized to recover an amount in damages higher than the amount …that it could have earned over time from the full execution of the lessee's obligations under the lease, including any fees, expenses and costs incurred by the lessor to exercise its rights under this lease and any charges related to a late payment, as provided in clause 2.2 of this agreement.

[30] Thus, the lessor (Caterpillar) was not authorized to recover an amount in damages higher than the amount that it could have earned from the complete execution, over time, of the obligations of the lessee (the appellant) under the lease. It seems clear to me that these damages could not include GST since, had this tax been collected normally, it would have been remitted to the government. In other words, the GST cannot be added to the amount that Caterpillar could have earned or received as profit if the lease had been executed in full.

[31] The question raised now is whether the appellant actually paid the GST that it is claiming under subsection 261(1) of the ETA. The appellant cites the following articles of the *Civil Code of Québec* (CCQ):

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1 See *ITA International Travel Agency Ltd. v. Canada*, [2002] F.C.J. No. 733 (QL) 2002 FCA 200, [2002] G.S.T.C. 58, confirming [2000] T.C.J. No. 866, [2001] G.S.T.C. 5

1553. Payment means not only the turning over of a sum of money in satisfaction of an obligation, but also the actual performance of whatever forms the object of the obligation.

1554. Every payment presupposes an obligation; what has been paid where there is no obligation may be recovered.

Recovery is not admitted, however, in the case of natural obligations that have been voluntarily paid.

1555. Payment may be made by any person, even if he is a third person with respect to the obligation; the creditor may be put in default by the offer of a third person to perform the obligation in the name of the debtor, provided the offer is made for the benefit of the debtor and not merely to change creditors.

A creditor may not be compelled to take payment from a third person, however, if he has an interest in having the obligation performed by the debtor personally.

1556. A valid payment may only be made by a person having a right in the thing due which entitles him to give it in payment.

However, payment of a sum of money or of any other thing due that is consumed by use may not be recovered against a creditor who has used it in good faith, even though it was made by a person who was not authorized to make it.

...

1567. The expenses attending payment are borne by the debtor.

1568. A debtor who pays his debt is entitled to an acquittance and to the turning over of the original title of the obligation.

...

1604. Where the creditor does not avail himself of the right to force the specific performance of the contractual obligation of the debtor in cases which admit of it, he is entitled either to the resolution of the contract, or to its resiliation in the case of a contract of successive performance.

...

1607. The creditor is entitled to damages for bodily, moral or material injury which is an immediate and direct consequence of the debtor's default.

> **1608.** The obligation of the debtor to pay damages to the creditor is neither reduced nor altered by the fact that the creditor receives a prestation from a third person, as a result of the injury he has sustained, except so far as the third person is subrogated to the rights of the creditor.
>
> ...
>
> **1611.** The damages due to the creditor compensate for the amount of the loss he has sustained and the profit of which he has been deprived.
>
> ...
>
> **1613.** In contractual matters, the debtor is liable only for damages that were foreseen or foreseeable at the time the obligation was contracted,...
>
> ...
>
> **1622.** A penal clause is one by which the parties assess the anticipated damages by stipulating that the debtor will suffer a penalty if he fails to perform his obligation.
>
> A creditor has the right to avail himself of a penal clause instead of enforcing, in cases which admit of it, the specific performance of the obligation; but in no case may he exact both the performance and the penalty, unless the penalty has been stipulated for mere delay in the performance of the obligation.

[32] In this case, Caterpillar made a claim for damages, calculated in accordance with the monthly rent to be paid, to which it added the taxes to be collected. Everyone agrees that no tax should have been collected on the damages claimed. However, Caterpillar included this tax in the overall amount of the claim for which it received shares of Century and cash, and it gave full release to the appellant from its debts. Moreover, it seems as if the fees, expenses and costs incurred by Caterpillar to exercise its rights under the lease and all of the charges related to the late payments were considered separately under the heading "Repossession Costs" (Exhibit A-1, tab 4, page 142).

[33] In my view, the appellant was right to submit that it paid this tax. If it had not been for these amounts of tax that Caterpillar used to establish the amount of its claim, Century, through the trustee, would not have had to pay Caterpillar in shares and cash. This is clear from the evidence that shows that, without the amount added for the taxes, Caterpillar had been fully compensated by the letter of guarantee and the proceeds of the sale of the units to Acton. Caterpillar enriched itself at the expense of the appellant, who transferred its assets to Century, who then, by

assuming the appellant's debts, enabled Caterpillar to profit by giving it, through the trustee, cash and shares for a value equivalent to the total amount of the tax added in the claim. Then Caterpillar gave the appellant full release, thus recognizing that the appellant had paid its debt. Now, this debt paid in cash and shares of Century by the trustee corresponded to the GST and QST added to the amount of rent still to be collected by Caterpillar. Caterpillar was not justified in collecting this tax because it did not provide any taxable supply. Thus, I conclude that the appellant was entitled to the rebate claimed under subsection 261(1) of the ETA.

II – Tax deemed paid: section 182 of the ETA

[34] The English version of the introductory passage of subsection 182(1) of the ETA reads as follows:

> Forfeiture, extinguished debt, etc.
>
> **182.**(1) For the purposes of this Part, where at any time, as a consequence of the breach, modification or termination after 1990 of an agreement for the making of a taxable supply (other than a zero-rated supply) of property or a service in Canada by a registrant to a person, an amount is paid or forfeited to the registrant otherwise than as consideration for the supply, or a debt or other obligation of the registrant is reduced or extinguished without payment on account of the debt or obligation,
>
> [Emphasis added.]

[35] The Supreme Court of Canada has propounded the general principles of interpretation, inter alia, in *Canada Trustco Mortgage Co. v. Canada*, [2005] 2 S.C.R. 601, at page 610, paragraph 10:

> 5.1 *General Principles of Interpretation*
>
> It has been long established as a matter of statutory interpretation that "the words of an Act are to 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": see *65302 British Columbia Ltd. v. Canada*, [1999] 3 S.C.R. 804, at para. 50. The interpretation of a statutory provision must be made according to a textual, contextual and purposive analysis to find a meaning that is harmonious with the Act as a whole. When the words of a provision are precise and unequivocal, the ordinary meaning of the words play a dominant role in the interpretive process. On the other hand, where the words can support more than one reasonable meaning, the ordinary meaning of the words plays a lesser role. The relative effects of ordinary meaning, context and purpose

> on the interpretive process may vary, but in all cases the court must seek to read the provisions of an Act as a harmonious whole.
> ...

[36] In view of the language of the Act, section 182 of the ETA applies first if "as a consequence of" (or "par suite" in the French version) the breach of an agreement for the making of a taxable supply in Canada by a registrant to a person, an amount is paid to the registrant otherwise than as consideration for the supply. If the words of the Act are applied in the present context, as a consequence of the breach of the lease of units from Caterpillar to the appellant, an amount would have had to be paid to Caterpillar otherwise than as consideration for these units.

[37] In view of the wording of the Act, I do not think that this part of section 182 of the ETA can be said to apply to Acton's payment. Indeed, according to the Act, it is true that anyone can pay the registrant (in this case, Caterpillar), but on the condition that this payment is not made as consideration for the supply (the units, in the case before us). By buying the units seized by Caterpillar, Acton paid Caterpillar the asking price for disposing of these units. Acton paid the GST itself when it bought these units. Although it was in consequence of the breach of the lease that Caterpillar seized the units in question, Acton acquired these units in a completely independent context, not in itself related to the breach of the lease. Acton paid Caterpillar in consideration for the units it acquired as part of its business operations.

[38] The fact that the payment Caterpillar received from Acton reduced the appellant's debt to Caterpillar does not, in my view, change the fact that section 182 does not apply. The debt was reduced in application of article 8.3 of the lease. If someone tied to the appellant, or having an interest in the extinguishment of the appellant's debt, or obliged to make the payment, as was the case with the National Bank, had paid the amount owed by the appellant under the lease, section 182 could be used to claim that there was a deemed tax.

[39] From what I understand, section 182 applies to cases where the payment is an economic substitute of the amount that should have been paid under the agreement[2] (the lease in this case), whereby the supplier who received the payment is required to remit to the government the tax deemed to be included, which can then be claimed as an ITC. That is why section 182 excludes any payment made as consideration for the supply, since in that case, the GST is payable in addition to this payment and remitted to the government by the registrant who collected it. Indeed, it would be illogical, in

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2 See David Sherman's comments in the editorial following the judgment in *MI Sask Industries Ltd. v. R.*, 2007 G.S.T.C. 17 (TCC).

my view, for a tax to be deemed included in Acton's payment, when Acton should have paid this tax separately. If the submission of the appellant were accepted, at the end of the day the tax would be counted twice on the same supply for the same period. According to the appellant's reasoning, since its debt consisting of residual rent to be paid was reduced by the amount equivalent to the proceeds of the sale of the units to Acton, Caterpillar should also remit to the government, in addition to the tax collected from Acton, a deemed tax on the use that the appellant would have made of these units had the lease not ended. This certainly could not be the intention of Parliament. By accepting to release the appellant, Caterpillar acknowledged having been compensated otherwise for the amount that it should have received under the lease, since Acton provided this amount. However, Acton paid the GST when acquiring these units, in a commercial activity. In my view, there cannot have been payment to the registrant (Caterpillar) otherwise than as consideration for the supply.

[40] As for the appellant's argument that section 182 *in fine* should apply on the grounds that an obligation of Caterpillar would have been set aside without payment because of the seizure of the units, I cannot agree.

[41] Articles 1842 and 1850 CCQ describe the lease as follows:

> **1842.** Leasing is a contract by which a person, the lessor, puts movable property at the disposal of another person, the lessee, for a fixed term and in return for payment.
>
> The lessor acquires the property that is the subject of the leasing from a third person, at the demand and in accordance with the instructions of the lessee.
>
> Leasing may be entered into for business purposes only.
>
> ...
>
> **1850.** Upon termination of the contract of leasing, the lessee is bound to return the property to the lessor unless, where applicable, he has availed himself of the option to acquire it given to him by the contract.

[42] Under the lease, Caterpillar was bound to allow the appellant to possess and use the units, as long as the appellant made its payments. The lease agreement provided that, in the event of default, Caterpillar had the right to terminate the lease and resume possession of the units, which, moreover, always belonged to it (articles 4.6 and 8.2 of the lease). The right of the lessee (the appellant) to the enjoyment and use of the units ended in the event of default (article 13 of the lease). As a result,

there could no longer be an obligation to put the units at the disposal of the appellant once the appellant was in default.

[43] In the context of article 1373 CCQ, the obligation is [TRANSLATION] "a legal relationship between two or more persons by which one person, called the debtor, is bound to render a prestation to another person, called the creditor, and which consists in doing or not doing something, subject to a legal compulsion".[3] Furthermore, article 1671 CCQ provides that an obligation may be extinguished by release. In the context of article 1687 CCQ, release of a debt is [TRANSLATION] "the conventional act by which the creditor completely or partially releases his debtor from his obligation".[4]

[44] Thus, a release or reduction of the obligation without payment cannot be claimed here, because Caterpillar's obligation towards the appellant simply no longer existed because the appellant was in default. The appellant could no longer exercise any legal action against Caterpillar. Caterpillar did not owe anything to the appellant and had no obligation to the appellant once it was in default. The appellant, no longer having right to the enjoyment and use of the units, could not extinguish with respect to Caterpillar an obligation it did not have.[5]

[45] I conclude from this that the appellant did not demonstrate that there was extinguishment without payment as regards Caterpillar.

[46] Furthermore, the explanatory notes for Bill C-70 (S.C. 1997, c. 10), reproduced in *Taxes à la consommation, Législation annotée 2008*, 17th edition (CCH), under the heading, [TRANSLATION] "Archives of explanatory notes", at pages 394 and 395, state the following:

> [FROM THE EXPLANATORY NOTES PUBLISHED BY FINANCE CANADA, JULY 1997]

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3 Jean-Louis Baudouin and Pierre-Gabriel Jobin, *Les obligations*, 5th ed. (Cowansville (Qc): Yvon Blais, 1998) p. 17.

4 *Ibid.* p. 786.

5 Furthermore, although no party in this case raised this issue, I would note that the English version of subsection 182(1) *in fine* differs from the French version. The English version mentions an obligation that is "reduced or extinguished" whereas the French version uses the terms "réduite ou remise". However, for the purposes of this case, I do not believe that this is important since I find that an obligation towards the appellant no longer exists after breach of the lease. If there is no obligation, we do not have to debate whether it was "reduced or extinguished" or "réduite ou remise".

> *Bill C-70-HST (S.C. 1997, v. 10):* Section 182 deals with the situation where, as a consequence of the breach, modification or cancellation of an agreement for the making of a taxable supply by a registrant, amounts are paid or forfeited by a person to the registrant otherwise than as consideration for the supply. The section also deals with situations where a debt or other obligation of a registrant to a person is reduced or extinguished without payment on account of the debt or obligation. In both cases, the registrant is treated as having made a taxable supply to the other person and as having collected tax on the amount paid, forfeited, reduced or extinguished. The person paying or forfeiting the amount is deemed to have paid tax and, if a registrant, may be entitled to an input tax credit for that tax.
>
> ...
>
> This amendment comes into force on April 1, 1997.
>
> [FROM THE EXPLANATORY NOTES PUBLISHED BY FINANCE CANADA, DECEMBER 1996]
> *Bill C-70 (S.C. 1997, c. 10)*: Section 182 deals with the situation where, as a consequence of the breach, modification or cancellation of an agreement for the making of a taxable supply, amounts are paid or forfeited by a person to a registrant otherwise than as consideration for the supply. The section also deals with situations where a debt or other obligation of a registrant to a person is reduced or extinguished without payment on account of the debt or obligation. In both cases, the registrant is treated as having made a taxable supply to the other person and as having collected tax equal to 7/107ths of the amount paid, forfeited, reduced or extinguished. The person paying or forfeiting the amount is deemed to have paid tax and, if a registrant, may be entitled to an input tax credit for that tax.
>
> ... That section applies tax to any amount that is paid or forfeited or by which a debt or other obligation is reduced or extinguished as a consequence of a breach, modification or termination of an agreement for a taxable supply.
>
> The amendment to the GST application rules ensures that section 182 applies with respect to such amounts paid, forfeited, reduced or extinguished after 1990, despite when the agreement for the supply was entered into. This application rule is not necessary under the existing legislation because existing subsection 182(1) deems a new supply to be made and the transitional rules for the GST specify that the tax applies to any supply deemed to have been made. In contrast, amended subsection 182(1) treats the amount paid or forfeited, or by which a debt or obligation is reduced or extinguished, as consideration for the original supply.
>
> This amendment comes into force on April 24, 1996.

[47] Accordingly, Parliament refers to, among other things, the amounts applied to reduce or extinguish a debt or another obligation as a consequence of the breach or termination of an agreement for the making of a taxable supply. In this case, as a

consequence of the breach of the lease agreement, the lessor, Caterpillar, had no obligation to put the equipment at the disposal of the lessee, the appellant. On the contrary, Caterpillar now had the right to retake possession of its units that were subject to the lease and the appellant no longer had any right to these units. Thus, an amount of CAN$7,560,597.42 cannot be said to be applied to reduce or extinguish Caterpillar's obligation to put this equipment at the disposal of the appellant, as the appellant argues.

[48] Last, for the above-mentioned reasons, and after reading these explanatory notes, I cannot conceive that Parliament intended that the tax would be deemed included when this tax was paid separately by Acton.

[49] In *Johns-Manville Canada Inc. v. R.*, 1985 CarswellNat at 666, [1985] 2 S.C.R. 46 a Supreme Court case, Mr. Justice Estey cited a passage from *Regent Oil Co. v. Strick* regarding "common sense":

> 21. This discussion of authorities takes one full circle to the words of Lord Reid in *Regent Oil Co. v. Strick*, [1966] A.C. 295, at p. 313:
>
> > So it is not surprising that no one test or principle or rule of thumb is paramount. The question is ultimately a question of law for the court, but it is a question which must be answered in the light of all the circumstances which it is reasonable to take into account, and *the weight which must be given to a particular circumstance in a particular case must depend rather on common sense than on strict application of any single legal principle.*
> >
> > (Emphasis added.)

[50] I accept the respondent's submission: section 182 *in fine* would be applicable in the event that Caterpillar itself would have had an already existent debt or independent obligation towards the appellant, for which there would have been compensation following the appellant's breach of the agreement. That is not the case here.

[51] For these reasons, I would allow the appeal to allow the rebate of the tax paid in error in the amount of $543,080.21, within the meaning of subsection 261(1) of the ETA. However, the assessment does not change with respect to the ITCs claimed on the deemed tax, within the meaning of subsection 169(1) and section 182 of the ETA. The respondent does not have to pay ITCs beyond the amount allowed in the assessment of July 9, 2008. Each party shall bear their own costs.

Signed at Ottawa, Canada, this 10th day of September 2010.

"Lucie Lamarre"

Lamarre J.

Translation certified true
On this 24th day of November 2010

François Brunet, Revisor

CITATION:	2010 TCC 415
COURT FILE NO.:	2008-3200(GST)G
STYLE OF CAUSE:	Société en commandite Sigma-Lamaque v. Her Majesty the Queen
PLACE OF HEARING:	Montréal, Quebec
DATE OF HEARING:	June 14, 2010
REASONS FOR JUDGMENT BY:	The Honourable Justice Lucie Lamarre
DATE OF JUDGMENT:	September 10, 2010

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