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The Bijural Revision Services Unit (Taxation and Comparative Law) of the Legislative Services Branch of the Department of Justice is pleased to keep you posted on the most recent harmonization and bijuralism news.

Jurisprudence

Section 8.1 Applicable Only Where Private Law Concepts Invoked

The relationship between federal legislation and provincial private law can be one of complementarity or dissociation. The principle of complementarity as concerns the application of civil law and common law has constitutional foundations, and since 2001, is also affirmed at section 8.1 of the *Interpretation Act*:[1]

> *Both the common law and the civil law are equally authoritative and recognized sources of the law of property and of civil rights in Canada and, unless otherwise provided by law, if in interpreting an enactment it is necessary to refer to a province's rules principles or concepts, forming part of the law of property and civil rights, reference must be made to the rules, principles or concepts in force in the province at the time the enactment is applied.*

The recent decision of the Supreme Court of Canada in *AGQ v. Canada (Department of Human Resources and Social Development Canada)* ("*Bruyère*"),[2] clarifies the limits of complementarity under section 8.1 of the *Interpretation Act*.

At issue in *Bruyère* was whether the federal Crown could recover a debt owed by a Quebec resident, by garnishing sums payable to him under Quebec's *Act respecting Industrial Accidents and Occupational Diseases* ("AIAOD").[3] Section 144 of the AIAOD provides that indemnities payable under that Act are "unassignable, unseizable and untaxable."

The unanimous decision of the Supreme Court of Canada concluded that there was a conflict of purposes between the federal and provincial legislation, and held that the doctrine of paramountcy applied in the circumstances. In sum, the Canada Employment Insurance Commission's right to garnish amounts that are or will become payable to a debtor was not subject to Quebec rules exempting the amounts from seizure.

In rendering its decision the Court offered useful comments on the scope of deference to provincial legislation required by section 8.1 of the *Interpretation Act*. The Supreme Court addressed the arguments of the Attorney General of Quebec in the following terms:

> *[27] To identify Parliament's purpose in enacting s. 126(4) EIA, the Attorney General of Quebec suggests that this provision must be considered from the perspective that federal legislation generally favours the application of provincial legislation. Relying on s. 8.1 of the* Interpretation Act, *he argues that Parliament has consented to the application of the provincial rules respecting exemption from seizure, since it has not expressed an intention to exclude the application of provincial law for the purposes of s. 126(4) EIA. … The argument based on s. 8.1 of the* Interpretation Act *cannot succeed. Section 8.1 states that if in interpreting a federal provision it is necessary to refer to*

[1] RSC 1985, c I-21, as amended, hereinafter the "*Interpretation Act*."
[2] 2011 SCC 60, aff'g 2009 QCCA 2246.
[3] RSQ c A-3.001.

> *private law concepts, reference must be made to the law of the province in which the provision is to be applied: see P. A. Côté, with S. Beaulac and M. Devinat,* Interprétation des lois *(4th ed. 2009), at para. 1289. Here, the federal statute provides for a recovery mechanism, the requirement to pay. That mechanism does not require the application of private law concepts that make it necessary to refer to provincial law.*

The *Bruyère* decision highlights the basic requirement for the application of section 8.1 of the *Interpretation Act*: There must be a need to refer to private law rules, principles or concepts in interpreting a federal enactment.

In light of the *Bruyère* decision, the Crown has advised the Alberta Court of Appeal that it will pursue its appeal in *Re Mutter*.[4]

Recipient of Royalties Held to be Beneficial Owner

The Canada Revenue Agency assessed Velcro Canada Inc. ("Velcro Canada") for unremitted Part XIII[5] withholding tax and penalties for the years 1995 through 2004. The Agency took the position that the royalty recipient, Velcro Holdings BV ("VHBV"), a resident of the Netherlands, was not the beneficial owner of the royalties and was therefore not entitled to the benefits of the Canada-Netherlands Income Tax Convention (the "Convention").[6]

The Tax Court of Canada allowed the appeal, concluding that VHBV was the beneficial owner of royalties received from Velcro Canada.[7]

Pursuant to a 1987 license agreement (the "Original License Agreement"), Velcro Canada paid royalties to Velcro Industries BV ("VIBV"), a resident of the Netherlands for the use of Velcro Brand Technology. As a result of an October 26, 1995 corporate reorganization, VIBV became resident in the Netherlands Antilles. On October 27th, VIBV assigned its rights under the Original License Agreement to VHBV. VIBV, however, retained ownership of the underlying intellectual property. Under the assignment, VHBV undertook to pay to VIBV an arm's length percentage of net sales within 30 days of receiving royalty payments.

In the Tax Court, the parties agreed[8] that the test for "beneficial ownership" is that proposed in *Prévost Car* by Associate Chief Justice Rip (as he then was):

> *[100] In my view the "beneficial owner" of dividends is the person who receives the dividends for his or her own use and enjoyment and assumes the risk and control of the dividend he or she received.*[9]

Associate Chief Justice Rossiter looked to the ordinary meanings of the words "possession", "use", "risk" and "control" and concluded that VHBV had possession, use, risk (currency risk) and control of the royalties. The following factors contributed to the Court's finding: There was no automatic flow of the royalties from VHBV to VIBV; the royalties received by VHBV were intermingled with other monies and accounts of VHBV; and these accounts were used to satisfy VHBV's operational requirements.

The Court rejected the Crown arguments that VHBV acted as a mere agent[10] or as a nominee of VIBV.[11] On the matter of whether VHBV was a conduit for VIBV, the Court's comments were particularly definitive:

> *[51] … For the Court to find that VHBV was a conduit, there would have to have been no discretion with respect to the funds.*
>
> *[52] VHBV obviously has some discretion based on the facts as noted above regarding the use and application of the royalty funds. It is*

[4] For a summary of the lower court decision, see "Alberta Court Weighs Competing Policy Objectives to Fill Gap" *The Link*, No. 34 (October 2010) 1-2.
[5] Of the *Income Tax Act*, RSC 1985, c 1 (5th Supp), hereinafter referred to as the "Act." Unless otherwise stated, statutory references throughout are to the Act.
[6] SC 1986, c 48, Part 1, as amended by SC 1997, c 38, Part 6. Under the Convention (Article 12(3)), as a resident of the Netherlands and beneficial owner of the royalties, VHBV would be entitled to a maximum Canadian withholding rate of 10% for 1996-1998, and would not be subject to Canadian tax at all in respect of royalties paid after 1998.
[7] 2012 TCC 57.
[8] *Ibid* at para [25].
[9] 2008 TCC 231, at para [100], aff'd 2009 FCA 57. For a summary of the *Prévost Car* decision see "Court of Appeal Rules in *Prévost Car Inc.*" *The Link*, No. 30 (April 2009) 1. The Crown did not seek leave to appeal.
[10] *Ibid* at para [47].
[11] *Ibid* at para [50].

> *quite obvious that though there might be limited discretion, VHBV does have discretion. According to* Prévost, *there must be "absolutely no discretion" - that is not the case on the facts before the Court. It is only when there is "absolutely no discretion" that the Court take the draconian step of piercing the corporate veil.*

The Court also rejected the Crown's argument that the Netherlands Antilles resident VIBV was an express third party beneficiary under the assignment agreement, and that therefore VHBV's entitlement to royalties was not absolute, and VHBV could not be the beneficial owner.[12]

ITA Deemed Dividend Precludes Bad Debt Deduction

The relationship between federal law and provincial private law can be characterized as one of complementarity or one of dissociation. Complementarity exists where provincial private law completes federal legislation. Dissociation exists where federal legislation dissociates the effects of provincial private law concepts. The decision *Mills Estate v. The Queen*[13] illustrates dissociation as achieved through deeming provisions.

In 2000, Donald Mills (the "Taxpayer") was deemed, under paragraph 84.1(1)(*b*) of the Act, to have received an $11,222,515 dividend, which dividend was included in his income for the 2000 taxation year. The deemed dividend was based on the value of non-share consideration (promissory note) given on a sale of shares by the Taxpayer to a non-arm's length corporation. By 2002, the promissory note had declined in value and the taxpayer sought to deduct the unpaid portion ($10,588,133) as a bad debt under subparagraph 20(1)(*p*)(i). Both the Tax Court of Canada and the Federal Court of Appeal held against the taxpayer, finding that the paragraph 84.1(1)(*b*) deemed dividend was a dividend deemed to have been *paid* (emphasis added) and thus could not also be a debt owing that had been included in income in the year or a prior year, as required for the bad debt deduction.

On March 1st, 2012, the Supreme Court of Canada dismissed the application for leave to appeal filed by the estate of the Taxpayer.[14]

Relevance of Corporate Law Principles Confirmed

The Federal Court of Appeal has upheld the Tax Court of Canada's decision in *Envision Credit Union v. The Queen,*[15] though on a slightly different basis. At issue was whether the undepreciated capital cost (UCC) of depreciable property acquired by Envision Credit Union on the amalgamation of two other entities should be the original capital cost of the assets or the relevant UCC balances of the predecessor corporations. Advisors to Envision Credit Union had endeavoured to structure the amalgamation and certain other transactions to ensure that section 87 of the Act would not apply to the amalgamation.[16]

Contrary to the Tax Court of Canada's decision, the Federal Court of Appeal found that that the conditions for the flow-through of tax attributes under section 87 were met. In particular, the Court of Appeal found that the requirement that "all of the property … of the predecessor corporations immediately before the merger becomes property of the new corporation by virtue of the merger"[17] was met. It was sufficient in the Court's view that "[a]ll the property owned by the predecessors immediately before the amalgamation could be traced directly to property owned by Envision Credit Union after the amalgamation."[18]

The Federal Court of Appeal however agreed with the Tax Court of Canada that, even if section 87 did not apply, the corporate law principle established in *Black & Decker*[19] provides for the necessary flow through of tax attributes in

[12] *Ibid* at para [55].
[13] 2011 FCA 219, aff'g 2010 TCC 443.
[14] Docket #34443.
[15] 2011 FCA 321, aff`g 2010 TCC 576.
[16] See "Flow-through of Tax Attributes Achieved Through Provincial Law" *The Link*, No. 35 (January 2011) 2-3 for a more detailed statement of the facts and summary of the Tax Court of Canada decision.
[17] Paragraph 87(1)(*a*).
[18] *Supra* note 15 at para [39].
[19] [1975]1 SCR 411.

the circumstances. On this issue, counsel for Envision Credit Union argued that section 87 constitutes a complete code on the matter of the flow through of tax attributes in the context of amalgamation and,

> *[48] … [h]ence … Parliament should be taken to have excluded by implication common law principles established in* Black & Decker *which attribute similar tax consequences to amalgamations that satisfy corporate law but do not fall within section 87.*

The Court found that the comprehensive code principle of statutory interpretation had no application in the circumstances. The Court observed that section 87 specifically does not adopt a "continuation" model in its amalgamation rules. Under section 87, the amalgamated entity is considered to be a new corporation, thus the need for the series of rules which allow for the flow through of tax attributes. Having previously observed regarding "the 'comprehensive scheme' principle of statutory interpretation"[20] that,

> *[51] While this general interpretive principle is undoubtedly helpful, whether any given statutory provisions impliedly exclude the operation of the common law must also be approached on a case by case basis and with an eye to the participation of the statutory scheme in question ...*

the Court of Appeal concluded as follows,

> *[62] … Section 87 created a different model of amalgamation (the "new corporation"). There is thus no basis to imply a legislative intent that section 87 should occupy the field to the extent of excluding the common law consequences of "continuation" model amalgamations that do not qualify as amalgamations for the purposes of the section.*

Envision Credit Union is seeking leave to appeal this decision to the Supreme Court of Canada (docket #34619).[21]

Last Word in the Antle Trust Case

On February 2, 2012, the Supreme Court of Canada (dockets #33979 and 33987) dismissed the motions for reconsideration of the applications for leave to appeal the Federal Court of Appeal decisions in Paul Antle v. The Queen and The Renée Marquis-Antle Spousal Trust v. The Queen.[22] The Federal Court of Appeal held that no valid trust had been constituted in common law, and therefore upheld the Minister's assessments. The Supreme Court of Canada had previously dismissed the taxpayers' applications for leave to appeal on May 12th, 2011.

Please consult http://www.justice.gc.ca/en/bijurilex/ for other documents and resources on the subject of legislative bijuralism in Canada.

[20] Para [50].

[21] All materials for the leave application were submitted to the judges on April 23rd, including an article by Bruce Russell, "Envision - A Lesson in Statutory Interpretation" which was filed with SCC by taxpayer on April 2, 2012

[22] 2010 FCA 280.