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# Decisions Involving Legal Relationships: Partnership, Employee Versus Independent Contractor, and Agency

Elizabeth J. Johnson and Jeffrey C. Johns\*

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**KEYWORDS:** RELATIONSHIPS ■ PARTNERSHIPS ■ EMPLOYEES ■ INDEPENDENT CONTRACTORS ■ AGENCY

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## INTRODUCTION

In complicated tax cases, it is always a great benefit when the judge hearing the case can bring an open mind and, as well, a sound knowledge of both the workings of the Income Tax Act<sup>1</sup> and the commercial law that is relevant to the issues at hand.

There is no doubt that Justice Bowman excelled in all of these departments and in balancing the competing interests of Crown counsel and taxpayers. He took on the challenges of many difficult cases involving complex questions of commercial law, and his legacies in this area will be lasting. Where Crown counsel wished to make an argument for more tax to be paid on the basis of a less than well-thought-out characterization of certain legal relationships or the legal effects of transactions, he subjected these arguments to rigorous scrutiny. At the same time, in certain areas, he had little patience for artificial or contrived arrangements that offended his

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\* Elizabeth J. Johnson is of Wilson & Partners LLP, Toronto, a law firm affiliated with PricewaterhouseCoopers LLP (e-mail: elizabeth.j.johnson@ca.pwc.com). Jeffrey C. Johns is of PricewaterhouseCoopers LLP, Toronto (e-mail: jeffrey.c.johns@ca.pwc.com).

1 RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as “the Act”). Unless otherwise stated, statutory references in this article are to the Act.

moral sense and did not hesitate to apply certain specific anti-avoidance rules when, in his view, taxpayers had crossed the limits of acceptable tax planning.

This article will revisit some of Bowman J's decisions that required a foray into the "legal relationship" question; in particular, it will focus on cases involving an issue arising from an argument as to the existence (or not) of a relationship of partnership, independent contractor or employee, or agency. A consistent theme may be found in the willingness of Bowman J to delve to the heart of, and weigh in on, the central issue in the case, even if there may have been distracting technical deficiencies in the arguments presented by either side or in the process itself.

## PARTNERSHIP

Questions of partnership, and the related tax consequences, have been litigated many times in the Canadian tax courts, and Bowman J heard many of the important cases in this area. What follows is a synopsis of some of the more interesting of those decisions, together with observations on some of the legacies of the former chief justice in this challenging area.

*Continental Bank of Canada et al. v. The Queen*<sup>2</sup> will likely be a leading authority on a variety of issues for many years. Continental Bank of Canada ("the bank") was a small chartered bank formed in the early 1980s when IAC, a finance company, decided to expand the scope of its business to include banking. The transactions in issue in this case took place in the context of the sale of the operations of the struggling bank in 1986. The banking business was sold to Lloyds Bank Canada. An offer was received (and accepted) from Central Capital Corporation ("Central") for the shares of the bank's leasing subsidiary, Continental Bank Leasing Corporation ("Leasing"). A sale of these shares would have resulted in the bank's realizing a capital gain; however, Central balked at taking on certain contingent liabilities of Leasing, and the share sale fell through. An alternative transaction was worked out by the parties (and their counsel), which involved a sequence of steps that were to take place over the course of several days between December 23 and December 29, 1986. These steps were intended to produce much the same result for the bank as if it had sold the shares of Leasing—that is, a capital gain.

The steps were as follows:

1. Leasing formed a partnership (Central Capital Leasing) with two subsidiaries of Central, "CCM" and "693396."
2. Leasing "rolled" its leasing assets into the partnership for a 99 percent partnership interest, electing under subsection 97(2) at the undepreciated capital cost of the assets.
3. Leasing was then wound up into the bank. The assumption was that on the winding up, the partnership interest would be distributed at its adjusted cost base (ACB) to Leasing.

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2 94 DTC 1858 (TCC). The subsequent history of the case is discussed below.

4. The bank sold the partnership interest to Central or a Central subsidiary, reporting the gain on this sale as a capital gain.

The minister reassessed Leasing by including \$84 million of recapture in its income, on the basis that the entire series of transactions was in substance a sale of its leasing assets. The minister also reassessed the bank for an income gain on the sale of the partnership interest, on the basis that it was income from an adventure in the nature of trade. The minister acknowledged that only one of the assessments could stand.

More specifically, the minister argued that the membership of Leasing in the partnership was a sham, that the membership of the bank and Leasing in the partnership contravened provisions of the Bank Act and were void, and that the purported subsection 97(2) election was invalid.

Bowman J commented on both the “ephemeral nature” of Leasing’s involvement in the partnership and some sloppiness in the documentation, which he put down to “the lateness of the hour, the speed at which the whole thing was put together and the impending festive season.”<sup>3</sup>

Central to the Crown’s argument was that certain provisions of the Bank Act prohibited the bank from directly or indirectly acquiring an interest in a partnership and that Leasing could not have rolled assets to the partnership for a partnership interest.

Bowman J accepted that the Bank Act had been breached; however, as he read the relevant provisions, the Bank Act itself provided a penalty for such an infraction, and section 20(1) of the Bank Act, which provided that no act of a bank was invalid by reason only that it was contrary to that statute, preserved the validity of the impugned act. The illegality of the act did not connote invalidity. The question was not what the law permitted the bank and Leasing to do, but what they had in fact done.

Bowman J then went on to consider the sham argument. After noting that “shams are more easily recognized than defined,” he painted a colourful backdrop with his opening comments:

This leads logically to the next question: did the appellants enter into the various transactions that they purported to, or was the elaborate series of steps envisioned by the master agreement a mere camouflage for what was in substance a single event, i.e., a direct sale of assets by CBL [Leasing] to CC [Central]? In cases of this type expressions such as sham, cloak, alias, artificiality, incomplete transaction, simulacrum, unreasonableness, object and spirit, substance over form, *bona fide* business purpose, step transaction, tax avoidance scheme and, no doubt, other emotive and, in some cases, pejorative terms are bandied about with a certain abandon. Whatever they may add, if anything, to a rational analysis of the problem, apart from a touch of colour in an otherwise desiccated landscape, they do not exist in separate watertight compartments. They are all merely aspects of an attempt to articulate and to determine where “acceptable” tax planning stops and fiscal gimmickry starts.<sup>4</sup>

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3 Ibid., at 1864.

4 Ibid., at 1866-67.

Bowman J concluded that although the legal relationships between the bank and Central were brief, they were not illusory. The relations between the parties were binding and not a cloak to disguise another type of relationship; consequently, they were not a sham, however much the tax result may have offended the minister or, for that matter, the court, and whatever might have been the overall ulterior economic motive. If the legal reality that underlies the ostensible legal relationship is the same as that which appears on the surface, there is no sham.

A variation on the sham argument was the Crown's argument that the bank was an agent of Leasing for the purpose of transferring the leasing assets to Central or its subsidiaries.<sup>5</sup> Bowman J essentially analyzed this as a disguised sham argument and found that, for much the same reasons as the partnership could not be ignored as a sham, it could not be accepted that the parent corporation was simply its subsidiary's agent. In Bowman J's view, it required extremely compelling evidence for one company—even a subsidiary—to be regarded as an agent of another, and it was even more difficult to regard a parent as its subsidiary's agent.

The Crown had argued that even if the partnership was respected, the subsection 97(2) election should be disregarded, because it was not consistent with the "object and spirit" of subsection 97(2) that a rollover should be obtained. Bowman J rejected this argument, finding that a taxpayer that availed itself of the rollover provided by subsection 97(2), with both its advantages and its potential disadvantages, could not be said to have acted in contravention of the object and spirit of the provision. Therefore, he rejected the argument that recapture should be considered to arise in Leasing on the transfer of the assets to the partnership.

The Crown's next argument was that the bank had an income gain when it disposed of the partnership interest. The immediate preordained resale of the partnership interest was the basis put forth for characterizing the partnership interest as being held on income and not capital account. Bowman J found that it was necessary to consider the bank's acquisition of the partnership interest on the winding up of its subsidiary and the resale of that interest in the context of the transactions as a whole. The shares of Leasing were, in the bank's hands, "obviously" capital assets. This was not a case of the bank's being engaged in a speculative profit-making scheme—assets that were not inventory in the subsidiary's hands did not become inventory in the parent's hands simply because of the rapid transfer.

The case had an interesting life after the Tax Court decision. With respect to the assessment of Leasing, the Crown was initially successful in appealing Bowman J's decision to the Federal Court of Appeal.<sup>6</sup> That court found that the purported rollover to the partnership failed because the parties did not create a valid partnership. In the view of the court, the requisite intention to create the relationship of carrying on a business in common for profit was absent; instead, the parties simply intended

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5 The issue of agency is discussed in a later section.

6 96 DTC 6355 (FCA).

to conduct a sale of assets through a device that they chose to call a partnership, but that was not. Moreover, the court found that even if the arrangement met the requirements to be a partnership, the participation of Leasing and the bank in the partnership was invalid by reason of the contravention of the Bank Act. Therefore, the court ordered restoration of the minister's assessment of Leasing on the basis that it had suffered recapture of capital cost allowance. In a separate set of reasons,<sup>7</sup> the Federal Court of Appeal dealt with the alternative assessment of the bank for an income gain on the disposition of the partnership interest and, on this issue, upheld the decision of Bowman J. The court acknowledged that it was not strictly necessary to deal with the issue in light of the finding that no partnership had been formed and thus no partnership interest created. The court held that on the assumption that what was disposed of by the bank was a partnership interest, there was no error in Bowman J's reasoning that the gain was a capital gain.

The case then proceeded to the Supreme Court of Canada,<sup>8</sup> where the bank and Leasing prevailed. Again, there were two decisions, one dealing with the minister's reassessment of Leasing for recapture and the other dealing with the alternative assessment of the bank for an income gain.<sup>9</sup>

In the Leasing decision, the court as a whole agreed with Bowman J that the fact that the ultimate objective of the series of transactions entered into was to exit the leasing business did not prevent a valid partnership from having been formed or Leasing's having been a member of that partnership even if only for a brief period. Having found that the transactions were not a sham, the Supreme Court of Canada found that the Federal Court of Appeal had incorrectly concluded that the legal and commercial reality could be ignored. The legal and commercial reality was, as found by Bowman J, that the parties intended to, and did, form a partnership within the meaning of the Partnerships Act. From this point on, there was a divergence of opinions. A minority of the court<sup>10</sup> considered that because of the Bank Act restrictions, Leasing could not validly become a member of the partnership, and therefore the minister's assessment of Leasing for the recapture should be upheld. However, the majority of the court held that although the Bank Act said that the bank should not have held shares in Leasing if Leasing was a partner in a partnership, this did not render Leasing's participation in the partnership invalid; therefore, the subsection 97(2) election was also valid.

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7 Ibid., at 6368-70.

8 98 DTC 6505 (SCC) (appeal by Leasing from the decision of the Federal Court of Appeal against it) and 98 DTC 6501 (SCC) (appeal by the minister of the Federal Court of Appeal's decision in favour of the bank).

9 This brief summary does not do justice to the various arguments raised and considered in the majority and dissenting judgments as to the interplay between the various provisions of the Bank Act, section 34 of the Ontario Partnerships Act, and the doctrines of ultra vires and illegality.

10 Bastarache J and L'Heureux-Dubé J concurring.

In the appeal dealing with the tax position of the bank, the court agreed with the Federal Court of Appeal that, on the assumption that the bank had transferred its partnership interest (validly acquired) to the Central Capital entities, this transfer was a capital transaction. Therefore, the minister's appeal was dismissed.<sup>11</sup>

Although the case involved many issues specific to institutions governed by the Bank Act, it remains a key decision on the question of whether only a brief participation in an arrangement characterized by the participants as a partnership will be respected and on the issue of characterization of a partnership interest as a capital property or otherwise.

A later (1999) partnership case, *Erb et al. v. The Queen*,<sup>12</sup> while clearly not in the rank of cases like *Continental Bank*, is nevertheless an interesting and useful decision. There were a number of issues in the case, which involved assorted members of the Erb family. The partnership question arose as follows. Three brothers, Douglas, Gary, and Fred Erb, were partners, together with a family corporation ("Enterprises") of which they were all shareholders, in a partnership that carried on two businesses, trucking and farming. In 1992, 1993, and 1994, Douglas and Gary each drew amounts from the partnership that exceeded their allocated share of the partnership income. The minister assessed them under subsection 15(2) on the basis that because they had drawn more than their respective shares of the partnership's income, they had become indebted to the partnership. In the view of the minister, this attracted the application of subsection 15(2), which, in its relevant parts, provided:

Where a person is . . . a shareholder of a particular corporation . . . and the person . . . has in a taxation year . . . become indebted to . . . a partnership of which the particular corporation is a member . . . the amount of the . . . indebtedness is included in computing the income for the year of the person.

Counsel for Douglas and Gary argued that a partner could not, as a matter of law, be indebted to a partnership of which he is a partner. There was considerable discussion of the case law (much of which was characterized by its antiquity), and Bowman J concluded that while the proposition advanced by counsel was overly broad, it was sufficient to say that

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11 The minister had attempted to introduce a new argument at the Supreme Court of Canada. Whereas the assessment had been based on the assertion that the gain on the disposition of the partnership interest was an income gain, the argument was introduced at the Supreme Court of Canada that because it was not lawful for the bank to be a partner in the partnership, the partnership (if validly entered into by Leasing) was no longer validly constituted once Leasing was wound up into the bank. Therefore, the bank had actually sold depreciable assets and not a partnership interest and should suffer recapture, since the assets had been distributed to it at their tax cost under subsection 88(1). The court found that because the assessment had always been based on the assumption that the bank had disposed of a partnership interest, this new argument could not be advanced at this late stage.

12 2000 DTC 1401 (TCC).

the law is clear that where a partner's capital account falls into a deficit position, or, to use the current colloquial expression, "goes negative," this does not create an indebtedness. I am not prepared to say that the concept of an indebtedness by a partner to a partnership of which he or she is a member upon which subsection 15(2) is premised is based on a legal impossibility.<sup>13</sup>

However, even if one could find an "indebtedness" in the excess of the drawings over the allocated income, Bowman J considered that as a matter of statutory construction, the specific provisions of the Act relating to withdrawals from a partnership should override the more general provision of subsection 15(2) based on the principle of *generalia specialibus non derogant*. Bowman J found that the effect of withdrawals of cash from a partnership in excess of earnings and in excess of the positive balance in a partner's capital account was specifically dealt with in subsections 53(1), 53(2), 40(3), 98(1), and 100(2). He summarized the basic effect of those provisions and, in particular, noted that whereas subsection 40(3) normally results in a deemed capital gain when the ACB of a particular property "goes negative," Parliament had made a specific exception to this rule in the case of a partnership interest, deferring the recognition of the gain until the partnership ceases to exist or the partnership interest is disposed of.

In light of these specific rules, Bowman J found that Parliament could not have intended subsection 15(2) to apply merely because a partner's capital account went into deficit:

The provisions that I have summarized contain a specific and complete code on one relatively narrow aspect of the fiscal consequences of being a partner. To import into the Act a presumption of indebtedness whenever a partner's capital account falls into a deficit provision, with the consequent application of subsection 15(2), is in my view contrary to the scheme of the Act and the explicit provisions of subsections 53(1) and (2), 40(3), 98(1) and 100(2). . . .

If, as the Crown contends, whenever a partner's drawings exceed the aggregate of his or her capital account and allocated earnings, so that the ACB of the partnership interest is put in a negative position, an indebtedness arises to which subsection 15(2) may apply, depending on the composition of the partnership, it would drive a coach-and-four through the carefully balanced code relating to such matters set out in the Act.

The position taken by the Minister on assessing would result in taxation under subsection 15(2) and again under subsections 98(1) or 100(2). Such double taxation is prohibited by subsection 4(4). Since, as a practical matter, subsections 98(1) or 100(2) would apply later than subsection 15(2) (if it applied at all), it would mean that by assuming an indebtedness and consequent taxation under 15(2) in circumstances where paragraph 40(3) would otherwise apply, the Minister could render the provisions of subsections 53(1), 53(2), 40(3), 98(1) and 100(2) inoperative. Such a result could not have been in accordance with the intention of Parliament. A result that is more consonant with the intent of Parliament would be to allow those provisions to operate

13 Ibid., at paragraph 79.

according to their terms without having that operation interfered with by what seems to me to be a highly questionable application of subsection 15(2).<sup>14</sup>

The partnership rules in the Act are complex and have a number of deficiencies. In some cases, taxpayers clearly rely on a reasonable interpretation of the rules by the Canada Revenue Agency (CRA), and in many cases the CRA has obliged. However, as this case makes clear, there is a general scheme to the rules that should be respected.

While Bowman J was unfazed by the tax-minimization motivation of the related-party taxpayers in the *Continental Bank* case, he showed a great deal less sympathy to taxpayers that used partnerships as a vehicle for accessing tax losses of unrelated parties, and did not hesitate in these circumstances to permit the Crown to invoke anti-avoidance rules such as that contained in section 103. This is evident from his rulings in *XCO Investments Ltd. et al. v. The Queen*<sup>15</sup> and *Penn West Petroleum Ltd. v. The Queen*.<sup>16</sup>

*XCO* was a case in which a corporation with tax losses (“Woodwards”) became a somewhat transitory partner in an existing partnership that was about to sell assets at a gain, and was allocated a much more significant portion of the gain than its economic interest in the partnership suggested was warranted. Woodward was a publicly owned department-store operator with substantial accumulated non-capital losses. *XCO Investments Ltd.* (“XCO”) and a second company, *West Topaz Property Ltd.* (“West Topaz”), also an appellant, were part of the Bosa group of companies, involved in real estate development in British Columbia. From 1986 to 1992, a partnership consisting of West Topaz as to 99 percent and XCO as to 1 percent held two apartment properties, the Westhill Apartments and the Topaz Apartments. In anticipation of a sale of the Westhill Apartments property at a substantial gain, the following occurred:

- Between March 12, 1992 and March 19, 1992, an agreement was reached under which Woodward would contribute cash equal to \$1.26 million to the partnership for a partnership interest. This amount was calculated by applying a discount factor to 80 percent of the partnership’s estimated net equity in the Westhill Apartments. This net equity was in turn calculated at \$2.3 million, based on a current value of \$10.8 million less \$8.5 million of debt, consisting of existing mortgages and a new mortgage of \$5 million to be placed on the property.
- On March 19, 1992, the partnership agreement was amended. Under the amendments, Woodward’s participation was limited to the Westhill Apartments property. The amendments provided that Woodward would have an 80 percent interest, XCO a 0.2 percent interest, and West Topaz a 19.8 percent

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14 Ibid., at paragraphs 83 and 85-86.

15 2005 DTC 1731 (TCC).

16 2007 DTC 715 (TCC).

interest. On a sale of the property, the partners would share in the distribution of the net proceeds in proportion to their interests. Woodward had the option of withdrawing from the partnership within six months, provided that if a sale of the Westhill Apartments occurred, no withdrawal was allowed until, at the earliest, the first day of the next fiscal year of the partnership. Woodward was not entitled to both a distribution of funds resulting from sale of the property and a return of contributed capital on withdrawal from the partnership.

- A purchase agreement dated March 20, 1992 was entered into with a third party for the sale of the Westhill Apartments by the partnership for \$10.8 million with a July 1992 closing date.
- On March 25, 1992, an escrow agreement was entered into pursuant to which \$1.25 million—being the amount of Woodward's capital contribution to the partnership—was to be held in trust by a law firm.
- Sometime prior to March 25, 1992, Woodward executed and delivered a notice of withdrawal withdrawing from the partnership. (The court noted in a footnote that in fact Woodward withdrew effective May 15, 1993.)
- The purchase closed on July 8, 1992. On July 13, 1992, Woodward received a cheque for just over \$1.8 million, being 80 percent of the net proceeds.
- For the April 30, 1993 year-end of the partnership, Woodward was allocated partnership income of \$5.7 million, of which the bulk related to the gain on the sale of the Westhill Apartments.

The CRA attacked the planning on several grounds and reassessed on the basis that all of the income allocated to Woodward should be reallocated to the other two partners. First, it was argued that Woodward was not a partner in the partnership. In the alternative, the CRA asserted that subsection 103(1) and/or the general anti-avoidance rule (GAAR) in section 245 applied. By the time of trial, the argument that Woodward was not a partner had been abandoned. Bowman J expressed the view that the Crown was correct not to press the argument that there was no valid partnership among Woodward, XCO, and West Topaz. Whether the reduction of tax was the “exclusive, principal, predominant or substantial reason” for Woodward's involvement in the partnership, none of these motivations detracted from the legal validity of the relations created by the documents.

With respect to the minister's reassessment on the basis of subsection 103(1), Bowman J commented on several aspects of the arrangements that he found “unusual.”<sup>17</sup> First, the additional mortgage of \$5 million placed on the property resulted in money that went in a circle, from another entity to the partnership and back to that entity, the only purpose of which was to reduce the net equity value of the property so that Woodward could buy into the partnership at a reduced amount. Further, although there was, in the court's view, no “legal impediment” to limiting

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17 Supra note 15, at paragraphs 19-21.

Woodwards' participation in the partnership's income and property to one part of the partnership's business, the fact that Woodward's participation was limited to an 80 percent interest in the Westhill Apartments was an "indication of the purpose of the somewhat strange form of division." As well, the fact that Woodward could not withdraw from the partnership until after the end of any year in which the property was sold had as its "obvious purpose" ensuring that if the property was sold, Woodward's proportionate share of any income or gain arising from the sale would be allocated to it. The fact that Woodward delivered its notice of withdrawal immediately on becoming a partner was interpreted as a means of ensuring that Woodward "disappeared from the scene" once its involvement in the sale of the Westhill Apartments had served its purpose.

The anti-avoidance rule in section 103(1) states:

Where the members of a partnership have agreed to share, in a specified proportion, any income or loss of the partnership from any source or from sources in a particular place, as the case may be, or any other amount in respect of any activity of the partnership that is relevant to the computation of the income or taxable income of any of the members thereof, and the principal reason for the agreement may reasonably be considered to be the reduction or postponement of the tax that might otherwise have been or become payable under this Act, the share of each member of the partnership in the income or loss, as the case may be, or in that other amount, is the amount that is reasonable having regard to all the circumstances including the proportions in which the members have agreed to share profits and losses of the partnership from other sources or from sources in other places.

Bowman J noted that from Woodward's point of view, there was no tax motivation—the partnership arrangement was a pure business proposition. For its participation, Woodward received a profit of about \$550,000. However, its contribution was both ephemeral and, for all practical purposes, risk-free; and from the point of view of XCO and West Topaz, the arrangements were completely tax-motivated. The arrangements fell squarely within the ambit of subsection 103(1), and it was unreasonable for Woodward to be allocated 80 percent of the income from the property.

On the other hand, the minister had gone too far in reallocating all of the income and gain to West Topaz and XCO. A reasonable treatment of the arrangement, in Bowman J's view, was to treat Woodward's share of the income as the amount it actually received (that is, approximately \$550,000). He expressed the theoretical basis for this reallocation as follows:

This allocation is more in keeping with the true economic reality of the arrangement. I am aware that economic reality is a concept that under recent jurisprudence is not in favour. Nonetheless it is an important ingredient in a determination of what is reasonable.<sup>18</sup>

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18 Ibid., at paragraph 35.

In light of his conclusion that section 103 applied, Bowman J indicated that he did not propose to deal at any length with the GAAR argument. Nevertheless, he did make two pointed comments concerning the application by the minister of the “reasonableness” standard in sections 103 and 245, and the interplay between GAAR and specific anti-avoidance provisions:

[First,] while “reasonable” is a relative term and what is reasonable must depend on all of the circumstances, its determination is clearly not a discretionary act on the part of the Minister. It would be wholly unacceptable if in reviewing the Minister’s decision on what is “reasonable” the court were fettered by the theory that the Minister’s decision was a discretionary one and the rules about reviewing a discretionary act and showing deference to the Minister’s decision had to be observed. However far reaching section 245 may be, it does not confer discretionary powers on the Minister, either in the decision to apply it or in the determination of its consequences.

Second, anti-avoidance sections such as 103 and 245 are not intended as a means of punishment for offending the Minister’s olfactory sense. They do not give the Minister carte blanche to impose sanctions for transcending his notion of fiscal rectitude. Section 245 is there to counteract serious forms of tax avoidance that would otherwise not be stopped by other specific anti-avoidance provisions. Where a specific anti-avoidance section covers a transaction but does not in the Minister’s view provide a remedy that the Minister considers sufficient, section 245 is not there to permit the Minister to top up the remedy that the Minister believes to be inadequate.<sup>19</sup>

The decision was upheld on appeal to the Federal Court of Appeal.<sup>20</sup> Counsel for the appellants advanced the argument that subsection 103(1) did not apply because there was profit trading, not loss trading, and cited in support of this argument the Tax Court decision in *Loyens et al. v. The Queen*<sup>21</sup> (a GAAR case). In that case, the court had declined to extend the principles enunciated in *OSFC Holdings Ltd. v. The Queen*<sup>22</sup> with respect to the abusive nature of “loss trading,” concluding that profit trading was not “interchangeable with” loss trading. In *XCO*, the Federal Court of Appeal held that subsection 103(1) addresses a different problem and provides a different test; by its terms, it applies where there is a sharing of income or loss of a partnership. The court found that there was sufficient evidence to support Bowman J’s conclusion that subsection 103(1) applied and the reasonableness of the allocation of income arrived at by the Tax Court.

*Penn West* was another case in which Bowman J found that subsection 103(1) applied to change a purported allocation of an item includible in income, on much the same reasoning that he brought to bear in the earlier *XCO* decision. *Penn West Petroleum Ltd.* (“*Penn West*”) was a partner in the *Penn West Petroleum* partnership,

19 Ibid., at paragraphs 39-40.

20 2007 DTC 5146 (FCA).

21 2003 DTC 355 (TCC).

22 2001 DTC 5471 (FCA).

together with two of its subsidiaries. The partnership acquired, on a rollover basis, several oil and gas properties that were subject to rights of first refusal held by an arm's-length party, Phillips Petroleum Resources Inc. ("Phillips"). The partnership agreement had provided from inception that where a partner received assets of the partnership on a redemption of its interest in the partnership, any items of income or gain resulting from that disposition would be allocated to the redeeming partner. The case involved a complicated sequence of events, but essentially the holder of the rights of first refusal (Phillips) was requested to acquire, from one of the existing partners, units of the partnership representing a 5.27 percent right to revenue of the partnership. It was put to Phillips that, under the partnership agreement, it would be entitled to redeem those units and that Penn West, as managing partner of the partnership, would cause the redemption to occur by transferring the assets that were the subject of the right of first refusal to Phillips, also resulting in an allocation of the related income to Phillips under the relevant provisions of the partnership agreement. The expectation was that this allocation would result in an erosion of Phillips's Canadian oil and gas property expense (COGPE) pool rather than the pools of the other partners. A clause was also negotiated that provided that if any taxing authority disagreed with this allocation, Phillips would pay an additional amount equal to 7 percent of any amount that was not allocated to Phillips.

It was not disputed that the proceeds of disposition of the property were deemed to be fair market value (FMV), and that if a partnership disposes of Canadian oil and gas properties, the proceeds of disposition must be applied to reduce the partners' COGPE pools. However, the minister challenged the allocation of the entire reduction to Phillips, taking the position that only 5.27 percent of the deemed FMV proceeds should reduce Phillips's COGPE pool and that the balance should reduce the COGPE pools of the other partners. The minister relied on subsection 103(1).

Bowman J questioned whether the provision of the agreement under which the notional proceeds arising from the FMV disposition of partnership property when it was distributed to a partner was even legally effective. While (consistent with his comments in *XCO*) he considered it clear that partners can agree among themselves, simply as a matter of contract, that different sources of income can be allocated to different partners, he expressed "serious reservations" as to whether the deemed disposition that falls on the partnership as dictated by the Act can be shifted contractually to one of the partners even though, as a civil matter, nothing has changed:

Obviously partners can contractually divide up a real pie any way they like but I have a conceptual difficulty in seeing how a pie that exists only because the *Income Tax Act* deems that it exists and belongs to the partnership can, by agreement, be given to one of the partners along with the tax consequences that flow from that notional ownership. Let us compare the effect under section 3.17 with the following hypothetical example. Three partners A, B and C would, in the normal course, share profits equally. To achieve a particular tax result, they agree that two thirds of the partnership income is to be allocated to partner C. They can obviously do that if the arrangement is genuine and legally binding and is not a sham. Partner C can keep the two thirds share of the partnership income. If the division is unreasonable and tax motivated, the Minister

can allocate some of the income back to A and B under subsection 103(1). This affects the incidence of tax but does not alter in any way the civil consequences of the agreement between the partners. What must be emphasized, however, is that subsection 103(1) is premised upon the existence of a legally binding agreement with genuine civil consequences. Here I am faced with the Minister's applying subsection 103(1) to what is, as a civil matter, arguably a legal impossibility.<sup>23</sup>

Since the minister had not argued that the provision under the partnership agreement was not legally effective, but only that subsection 103(1) overrode the allocation, Bowman J did not finally decide this point; however, he strongly suggested that, left to his own devices, he might have found that it was legally impossible to allocate deemed receipts to partners where such amounts are notional and arise solely from a provision of the Act.

Bowman J did decide that it was not reasonable in the circumstances to shift the deemed and indeed notional proceeds of disposition to Phillips together with the tax consequences. The reason for this conclusion seems to have been that Phillips got into the partnership with the obvious intent of getting right back out again. While it was a partner at law (despite the "ephemeral" nature of its participation), it became a partner solely in order to extract the assets from the partnership in a manner that was acceptable to the other partners.

Even though the relevant provision had been included in the agreement before the deal with Phillips was arranged, and it might have had as its genesis a commercial purpose that was justifiable in some circumstances (and it was admitted that such a provision was not commercially uncommon), on the facts of the case, it had been used in an unreasonable manner. In these circumstances, the tax burden did not fall on the person that logically should have had it, being the party that had rolled the assets into the partnership.

Consistent with his view of the planning in *XCO*, Bowman J did not attach weight to the fact that the transaction was not tax-motivated from the point of view of Phillips, which simply wanted to obtain the assets and was prepared, as a cost of doing so, to accept the tax results of the allocation in the partnership agreement. He observed:

Possibly in many cases where subsection 103(1) might apply the same pattern exists—a commercial transaction together with one partner to whom the tax consequences are either irrelevant or of less importance.<sup>24</sup>

He also rejected the proposition that a provision in a partnership agreement that has, at its inception, a fiscally "innocent" purpose cannot later acquire a fiscally inappropriate purpose that justifies the invocation of subsection 103(1). His view was that one must look at the purpose for which the agreement is being used—in this case, when a new partner joined the partnership.

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23 *Supra* note 16, at paragraph 33.

24 *Ibid.*, at paragraph 44.

Also of interest is Bowman J's rejection of the notion that subsection 103(1) should have overlaid on it a "misuse or abuse" concept—that is, that the minister should have the onus of showing abuse. Bowman J stated that the Crown had no such additional onus, although

[u]ndoubtedly the existence or non-existence of abuse is a factor that the court may take into account in determining whether the tax avoidance at which the section is aimed exists so as to justify the application of the provision.<sup>25</sup>

## EMPLOYEE VERSUS INDEPENDENT CONTRACTOR

The Tax Court of Canada and the Federal Court of Appeal have often been called on to determine whether a relationship is that of a contract of service or a contract for services. During his tenure at the Tax Court, Bowman J had his share of encounters with the issue and again brought to bear a practical, but at the same time rigorous, approach to the question.

Many of these cases have arisen in the context of a determination of whether an individual qualifies as an employee under employment insurance (EI) legislation; in fact, the EI cases are among the more interesting cases considered by Bowman J. For instance, *Abe Vergara o/a Sweet City v. MNR*<sup>26</sup> required Bowman J to determine whether an attendant at a "licensed adult entertainment services parlour" (in the plain words of Bowman J, a "body rub parlour") was properly classified as an employee. In *825209 Alberta Ltd. v. MNR*,<sup>27</sup> Bowman J's task was to determine the status of a variety of individuals who performed work for a company that owned a paint store and carried out painting contracts. Many of the individuals were musicians who supplemented their income earned from gigs by picking up odd painting jobs, and Bowman J had no difficulty concluding that they were independent contractors. The payments in issue (on which no withholdings had been made) included \$50 paid to an artist who showed up "higher than a kite" and was paid money to leave. Bowman J found that while this individual was "obviously independent," he was no contractor (nor, clearly, an employee) but "merely a free spirit of short passage."<sup>28</sup> Another case, *Pabary v. MNR*,<sup>29</sup> holds no great interest based on its facts but is notable in that Bowman J found himself forced to conduct the trial in the absence of the Crown's advocate, who had failed to turn up.

In his earliest consideration of the employee versus independent contractor question, the 1995 case of *Baxter v. The Queen*,<sup>30</sup> Bowman J looked to the decision of the

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25 Ibid., at paragraph 47.

26 2004 TCC 263. This case is discussed further below, in the text accompanying note 41.

27 2005 TCC 80.

28 Ibid., at paragraph 24.

29 2001 CarswellNat 3095 (TCC).

30 1995 CarswellNat 2058 (TCC).

Federal Court of Appeal in *Wiebe Door Services Ltd. v. MNR*<sup>31</sup> as the prime authority on the point. He stated that the “usual test” was that set out in *Wiebe Door*, which he described as a “four-in-one” test based on consideration of four enumerated factors: integration; ownership of tools; risk of loss/chance of profit; and supervision and control. However, he further stated that the decision in *Wiebe Door* stands for “nothing more than the self-evident proposition that you must look at all of the factors and that none predominates.” Throughout the time he served on the bench, Bowman J seemed most comfortable with the commonsense approach he had taken in *Baxter*, and at times expressed frustration with a formulaic or mechanical application of a set of prescribed tests, although his view of the relevant tests evolved somewhat over time.

Bowman J’s initial inclusion of integration as one of the factors in the four-in-one test based on *Wiebe Door* seems to have been an oversight; the four factors identified by the Federal Court of Appeal appear to be control, ownership of tools, chance of profit, and risk of loss. The Federal Court of Appeal actually found that the Tax Court had improperly applied the integration test—to the extent that it was a relevant test in the first place—by framing it as a test as that was focused on the extent to which the business could exist without the workers. In the view of the Federal Court of Appeal, to the extent that integration was a factor, it should be applied from the perspective of the worker and not the employer. In other words, a worker did not become an employee simply because there could be no business without the workers.

The integration test is based on the theory that work performed by an employee will be an integral part of a business while work performed by an independent contractor will only be accessory to the business. This theory has its origin in a judgment of Lord Denning in the UK case of *Stevenson, Jordan and Harrison, Ltd. v. Macdonald and Evans*.<sup>32</sup>

The fact that integration was not part of the four-in-one test was confirmed by the Federal Court of Appeal decision in *Precision Gutters Ltd. v. Canada (Minister of National Revenue)*,<sup>33</sup> where the court stated that while the case law may not have completely rejected the integration test, it had been found difficult to apply. The court preferred the approach of the Supreme Court of Canada in *671122 Ontario Ltd. v. Sagaz Industries Canada Inc.*, set out in the following passage:

The central question is whether the person who has been engaged to perform the services is performing them as a person in business on his own account. In making this determination, the level of control the employer has over the worker’s activities will always be a factor. However, other factors to consider include whether the worker provides his or her own equipment, whether the worker hires his or her own helpers,

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31 87 DTC 5025 (FCA).

32 [1952] 1 TLR 101 (CA).

33 2002 FCA 207.

the degree of financial risk taken by the worker, the degree of responsibility for investment and management held by the worker, and the worker's opportunity for profit in the performance of his or her tasks.<sup>34</sup>

Bowman J's interpretation of *Sagaz* was that, in effect, the Supreme Court endorsed the principles espoused by *Wiebe Door*.<sup>35</sup> In cases that he decided after *Precision Gutter*, Bowman J almost invariably<sup>36</sup> separated integration from the four-in-one test. Further, integration has largely been discounted as an important factor in the employee versus independent contractor question. From his position on the Tax Court, Bowman J played a role in this marginalization, stating in a 2003 decision that "it has never been a particularly useful or meaningful test,"<sup>37</sup> and, in 2004, opining that "to the extent that the integration test is comprehensible at all, I have yet to see it applied as a decision or even a helpful factor."<sup>38</sup>

Finally, in *Lang et al. v. MNR* (discussed below) Bowman J declared that the integration test "is of no assistance and is substantially discredited and any trial judge who relies on it does so at his or her peril."<sup>39</sup>

In *Wiebe Door* and *Sagaz*, the intent of the parties was never mentioned as a factor that should be considered in making an employee/independent contractor determination. Accordingly, it was not considered in determinations made by the courts. However, this began to change in 2002.

In 2002, the Federal Court of Appeal released its decision in *Wolf v. The Queen*.<sup>40</sup> The case involved a mechanical engineer who had entered into an agreement to provide services to an airplane manufacturer. Because the engineer provided his services in Quebec, it was the Quebec Civil Code and not the common law that took precedence. Nevertheless, the justices of the Court of Appeal found that the common-law tests were still applicable to the determination. Each member of the court came to the same conclusion (that the engineer was an independent contractor), but for different reasons. Décaré J, in his reasons, found that the intent of the parties should be at the heart of the determination, since the matter at issue was the nature of the contractual relationship. The judgment of Noël J also mentioned intent, indicating that it should be relevant where the traditional tests yield no conclusion.

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34 2001 SCC 59, at paragraph 47.

35 See *Lang et al. v. MNR*, 2007 DTC 1754, at paragraph 15 (TCC).

36 With the exception of *825209 Alberta Ltd.*, supra note 27.

37 *Judy D'Angelo and Peter D'Angelo O-A Shorehaven Terrace Apartments v. MNR*, 2003 TCC 572, at paragraph 13.

38 *Page v. MNR*, 2004 TCC 211, at paragraph 27.

39 Supra note 35, at paragraph 14. This statement may be directed at Bowman J's colleagues on the court who had rendered a number of decisions that relied on the integration test overturned by the Federal Court of Appeal. One of these decisions, *Mirchandani v. Canada (Attorney General)*, 2001 FCA 15, was referred back to the Tax Court for redetermination by a different judge. It was Bowman J himself who decided the redetermination.

40 2002 DTC 6853 (FCA).

After the release of *Wolf*, when Bowman J was tasked with making employee/independent contractor determinations, he appeared to express concern with a whole-hearted embrace of intention as a major factor in the determination.

In *Vergara*, Bowman J made the point that contractual stipulations should be approached with caution. He stated that the labels that parties put upon a relationship are not determinative and that, before a court can give any weight to declarations by the parties as to their relationship,

it must be satisfied that the parties understand what they are agreeing to. This presupposes a reasonable level of comprehension of the legal and factual distinction between the two types of relationship. An illustration of the degree of uncertainty that exists in this area is the *Sagaz* decision. There, the Supreme Court of Canada arrived at precisely the opposite conclusion from three judges of the Ontario Court of Appeal (Catzman, Borins and Sharpe JJ.A.) (46 O.R. (3d) 760 (Ont. C.A.)). If such a degree of doubt exists at those levels, it will be apparent that a court will have difficulty in finding in a formula of words in a written agreement a meeting of the minds between two individuals that can be of much assistance in determining the issue.<sup>41</sup>

Bowman J referred to Noël J's reasons in *Wolf*, which stated that intention could be utilized in a "close case" where the consideration of the usual factors did not yield a clear result.

Bowman J's caution in embracing intent as a factor can also be seen in another case, *P.S. Sidhu Trucking Ltd. v. MNR*, decided in 2005. In that case, Bowman J mentioned *Wolf* but stated, "I do not think that any useful purpose would be served by attempting to analyse and reconcile the three sets of reasons of Desjardins, Décary and Noël JJ."<sup>42</sup>

In 2006, the Federal Court of Appeal released its decision in *Royal Winnipeg Ballet v. Canada (Minister of National Revenue)*.<sup>43</sup> In this case, two members of the court (Desjardins and Sharlow JJ) endorsed the idea that the nature of the contractual relationship between parties should be determined by first considering whether there was a common intention to create a certain relationship and then applying the *Wiebe Door* factors to determine whether the facts were consistent with the intent. The third justice, Evans J, dissented and expressed concern about relying too heavily on the intentions of the parties.

In the year following the decision in *Royal Winnipeg Ballet*, the Federal Court of Appeal released three further decisions dealing with the question of relationships, two of which reversed the Tax Court's ruling and all of which seemed to place a different emphasis on the importance of intent and even of the *Wiebe Door* factors.<sup>44</sup> It

41 *Supra* note 26, at paragraph 21.

42 *P.S. Sidhu Trucking Ltd. v. MNR*, 2005 TCC 630, at paragraph 13.

43 2006 FCA 87.

44 *City Water International Inc. v. Canada*, 2006 FCA 350; *Combined Insurance Company of America v. Canada (National Revenue)*, 2007 FCA 60; and *Gagnon v. Canada (National Revenue)*, 2007 FCA 33.

was these conflicting decisions that undoubtedly caused Bowman J to speak up at his next opportunity to consider the employee/independent contractor issue.

On September 14, 2007, Bowman J issued his judgment in the *Lang* case, which concerned the employment status of individuals engaged to perform furnace- and duct-cleaning duties. Bowman J took the opportunity to review the jurisprudence of the Federal Court of Appeal on the issue, starting with *Wiebe Door* and ending with the judgment in *Gagnon* (the third case referred to above). His purpose was to attempt to determine the state of the law, and in doing so, he was not shy to point out inconsistencies in the positions taken by the Federal Court of Appeal. As a result of his review, he felt able to draw five general conclusions:

- (a) The four-in-one test in *Wiebe Door* as confirmed by *Sagaz* is a significant factor in all cases including cases arising in Quebec.
- (b) The four-in-one test in *Wiebe Door* has, in the Federal Court of Appeal, been reduced to representing “useful guidelines” “relevant and helpful in ascertaining the intent of the parties.” This is true both in Quebec and the common law provinces.
- (c) Integration as a test is for all practical purposes dead. Judges who try to apply it do so at their peril.
- (d) Intent is a test that cannot be ignored but its weight is as yet undetermined. It varies from case to case from being predominant to being a tie-breaker. It has not been considered by the Supreme Court of Canada. If it is considered by the Supreme Court of Canada the dissenting judgment of Evans J.A. in *Royal Winnipeg Ballet* will have to be taken into account.<sup>45</sup>
- (e) Trial judges who ignore intent stand a very good chance of being overruled in the Federal Court of Appeal. (But see *Gagnon* where intent was not considered at trial but was ascertained by the Federal Court of Appeal by reference to the *Wiebe Door* tests that were applied by the trial judge. Compare this to *Royal Winnipeg Ballet*, *City Water International Inc.* and *Wolf*.)<sup>46</sup>

Bowman J indicated that, in light of these conclusions, he was compelled to consider the case before him on the basis of four alternative hypotheses:

1. The parties’ intent was determinative.
2. *Wiebe Door* was all that needed to be considered, without regard to intent.
3. Intent acted as a tiebreaker where *Wiebe Door* did not point conclusively in any direction.
4. The determination should be based on common sense, instinct, and a consultation with the man on the Clapham omnibus.

On consideration of these four hypotheses, Bowman J concluded that the duct cleaners were independent contractors.

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45 This appears to be again an urging from Bowman J that intent not be overemphasized as a factor.

46 *Supra* note 35, at paragraph 34. For the trial decision in *Gagnon*, see *Gagnon v. The Queen*, [2004] 2 CTC 2231 (TCC).

In *Lang*, Bowman J took a laudable stand on behalf of himself and his colleagues in highlighting some of the uncertainties created by the judgments of the Federal Court of Appeal. It is interesting to note that in each of the cases considered by the Federal Court of Appeal on the issue of employee/independent contractor in the time since the decision in *Lang*, the appeals have been dismissed.<sup>47</sup> Perhaps, then, Bowman J's urgings that the Court of Appeal provide more consistency in its consideration of the issue will ultimately result in greater certainty for taxpayers.

## AGENCY

Bowman J's decision in the *Continental Bank* case, discussed above, briefly addressed what, in his view, was necessary to establish an agency relationship. It will be recalled that one of the arguments made by the Crown in that case was that, notwithstanding that in the transactions at issue, the subsidiary company (Leasing) had been wound up into its parent (the bank) and Leasing's assets had been distributed to the bank on that winding up, the bank was simply acting as its subsidiary's agent in disposing of the assets (which the Crown argued were depreciable assets, not a partnership interest) to the Central partners. In his reasons, Bowman J stated that "extremely compelling evidence" was required for one company to be regarded as an agent of another and it was even more difficult to regard a parent as its subsidiary's agent.<sup>48</sup>

Another case in which a question of agency arose was *Nova Scotia Power Inc. v. The Queen*,<sup>49</sup> which Bowman J heard in 2001. The relevance of this case to general questions of agency is limited, because what was really in issue was whether a particular entity was a Crown agent and, if so, what were the implications. Nevertheless, Bowman J made some interesting observations on the difficulties inherent in applying an agency characterization.

*Nova Scotia Power* was also an unusual case in that it came to the Tax Court as a reference under subsection 173(1),<sup>50</sup> rather than as an appeal under subsection 169(1). The fact that the proceedings were a reference by way of stated case, and that the questions that had been framed for answer by the court struck the Tax Court (and, subsequently, the Federal Court of Appeal) as not being the correct questions to have asked, may explain some of the difficulties in the decision rendered by Bowman J, which was reversed on appeal.

The basic question posed was whether Nova Scotia Power Corporation ("NSPC"), a provincially owned Crown corporation that, in 1992, transferred all of its assets to

47 *1536378 Ontario Limited (B-Pro Grooming) v. Canada (National Revenue)*, 2007 FCA 334; *National Capital Outaouais Ski Team v. Canada (National Revenue)*, 2008 FCA 132; *Kilbride v. Canada*, 2008 FCA 335; and *Stawicki v. Canada (National Revenue)*, 2008 FCA 350.

48 *Supra* note 2, at 1869.

49 2002 DTC 1432 (TCC).

50 Subsection 173(1) allows the minister of national revenue and a taxpayer to refer a question to the Tax Court where both parties agree to do so.

Nova Scotia Power Inc. (“NSPI”), the appellant in the matter, was an agent of her majesty the queen.

Between 1973 and 1992, NSPC had borrowed significant amounts of money and had used some of those borrowings to purchase depreciable assets. Although NSPC initially filed no tax returns for the period prior to 1992, because it was not subject to tax, in 1988 it filed tax returns for the period from 1980 to 1993, in which it purported to elect to add a portion of the interest on the funds borrowed by it to the capital cost of its depreciable assets, pursuant to subsections 21(1) and (3).<sup>51</sup> The total additions amounted to almost \$1 billion.

At the same time, NSPI (the transferee of the assets) filed revised capital cost allowance schedules for its 1994, 1995, and 1996 taxation years, based on the position that the additions to NSPC’s capital cost for its assets resulted in an increased cost to NSPI for the assets at the date of their acquisition pursuant to subsection 85(5.1). The parties were apparently agreed that this provision applied to determine the opening cost to NSPI of the depreciable assets acquired from NSPC.

The minister reassessed NSPI for its 1994-1996 taxation years on the basis that there should be no addition to the capital cost of the assets acquired. The basis for this reassessment was that NSPC had been an agent of her majesty the queen in right of Nova Scotia during the years it had purported to elect to make additions to its capital cost of property and, as a result, the Act had no application to NSPC in those years, pursuant to section 17 of the Interpretation Act.<sup>52</sup> Complicating matters, section 4(1) of the provincial act governing NSPC, the Power Corporation Act,<sup>53</sup> stated that the corporation was “an agent of Her Majesty in right of the Province”; however, it seemed that the parties did not consider this conclusive of the issue.

To address the issue of NSPI’s opening capital cost balance, NSPI and the minister agreed to refer certain stated questions to the Tax Court on an agreed statement of facts. They framed the questions for determination as follows:

- (1) Did Nova Scotia Power Corporation (NSPC) conduct its principal income-earning activities as an agent of Her Majesty the Queen such that section 2 of the *Income Tax Act* (including ancillary provisions such as section 21 of the Act) did not apply to it? And
- (2) If the answer to (1) is no, was Nova Scotia Power Corporation an agent of Her Majesty the Queen with respect to the ownership of assets used in its business such that section 21 of the *Income Tax Act* did not apply to depreciable assets acquired by it?<sup>54</sup>

51 These provisions permit a taxpayer to elect to capitalize interest charges incurred on funds borrowed to acquire depreciable property.

52 RSC 1985, c. I-21, as amended.

53 SNS 1973, c. 47, as amended.

54 *Supra* note 49, at paragraph 1.

In the course of his reasons, Bowman J several times expressed his frustration with the hearing process, which required him to consider the questions put by the parties, in contrast to an appeal, in which he would have felt freer to define the issues as he perceived them. He first observed that the parties presumably would not find it useful to simply have an answer to the question of whether, up to 1992, NSPC was an agent of her majesty the queen—which seemed to be answered in the affirmative by section 4(1) of the Power Corporation Act.<sup>55</sup> However, he then stated that he would not assume that the parties intended him to deal with both parts of each question. He advised them that, if they wanted

a determination whether the conclusion stated in the second part of each question follows as the result of an affirmative answer to the first part or whether a negative answer to the first part necessarily negates the second part they should apply to the court with further argument and if necessary further evidence.<sup>56</sup>

In the end, he answered only the first part of each of the questions.

The Crown's essential argument was that the exemption from federal tax enjoyed by NSPC derived from section 17 of the Interpretation Act, which provides that no enactment is binding on her majesty or affects her majesty or her majesty's rights or prerogatives in any manner, except as mentioned or referred to in the enactment. According to this argument, NSPC acted in all respects simply as an agent of the Crown, and there was no tax payable in respect of income from its operations because those operations and any income therefrom belonged to the Crown.

NSPI's main argument seemed to be premised on the thesis that the exemption from tax enjoyed by NSPC derived from paragraph 149(1)(d) of the Act, which provides an exemption to a corporation where 90 percent or more of the corporation's shares are owned by her majesty in right of Canada or a province.<sup>57</sup> The theory seemed to be that if the exemption derived from the application of paragraph 149(1)(d), there was nothing to prevent the filing of returns or the making of the election; the income of the corporation was simply not subject to tax.

Bowman J observed that it might have been "useful" to have framed the question differently—that is, to have asked whether the exemption from tax derived from section 17 of the Interpretation Act or paragraph 149(1)(d) of the Income Tax Act.<sup>58</sup>

In his decision, Bowman J considered a number of authorities that supported the proposition that the fact that a corporation is described in the statute creating it as "an agent of Her Majesty the Queen" does not mean that it is an agent for all purposes. He considered that one cannot approach the question of whether a corporation is

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55 *Ibid.*, at paragraph 5.

56 *Ibid.*, at paragraph 15.

57 As noted by the court, section 27 removes prescribed federal Crown corporations from the ambit of paragraph 149(1)(d).

58 *Supra* note 49, at paragraph 16.

an agent of the Crown for all purposes (so that its income is earned and its property held for and on behalf of the Crown) as a pure question of law, divorced from what the parties actually did. He examined various provisions in the statute governing NSPC and found that the factors within the statute itself that supported the conclusion that NSPC was an independent corporation and not an agent of the Crown in respect of its business and ownership of its property outweighed the factors that pointed in the other direction. In particular, he pointed out that the Power Corporation Act treated NSPC as owning its own property and carrying on its own business separate from the province. Further, NSPC had all the powers of a corporation incorporated under the provincial corporate legislation, could borrow on its own account, and, with the approval of the provincial governor in council, could issue bonds or debentures. Finally, the statute specifically permitted the governor in council to guarantee the debts of NSPC, a provision that would be meaningless if NSPC were merely an agent of the province. All of these facts, in Bowman J's view, indicated that an agency relationship was not present. Although other factors—that the employees of NSPC were considered public service employees for the purposes of the provincial employee's superannuation legislation, that NSPC had expropriation powers, and that NSPC was included in the provincial "proceeding against the Crown" legislation—argued against an agency relationship, Bowman J found that, overall, NSPC was not an agent of the province.

Bowman J clearly was required to take into account section 4(1) of the Power Corporation Act. He undertook a lengthy review of precedents considering statutory references to a corporation's being an agent of the Crown. He further considered other provincial legislation that made specific reference to the extent to which the corporation was an agent of the Crown (as contrasted with the general reference in the Power Corporation Act to NSPC as an agent of the province). On the basis of this analysis, Bowman J concluded that the provisions of the Power Corporation Act did not support a finding that NSPC was assimilated to the Crown so that its separate identity merged with the Crown and it became a mere alter ego of the Crown in carrying on the business for which it was created. Rather, one of the purposes of a Crown corporation is to permit the corporation to carry out its purposes independently of the government. As a result, Bowman J concluded that his answer to the first part of each question in the stated case must be "no," an answer that presumably favoured NSPI.

The Crown appealed the decision, successfully, to the Federal Court of Appeal.<sup>59</sup> Interestingly, the court did not hesitate to express the view that the premise upon which the questions were stated was false and that, given the premise from which they began, it was not surprising that the parties devoted the whole of their argument to the question of whether NSPC was an agent of the Crown. The court observed, "The fact that this was considered to be the issue is somewhat surprising since section 4

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59 *The Queen v. Nova Scotia Power Inc.*, 2003 DTC 5090 (FCA).

of the *Power Corporation Act* specifically makes NSPC an agent of the Crown.<sup>60</sup> The real issue, in the court's view, was whether the finding of Crown agency led to the conclusion that the entity enjoyed Crown immunity from the operation of statutes, and this question turned on the scope of the corporation's mandate and whether, on the facts, it was acting within that mandate. The court concluded that NSPC was clearly acting within its authorized purposes in operating its electrical system and in borrowing money, and accordingly that it benefited from Crown immunity. There was no need to invoke a particular kind or breadth of agency relationship. However, the court echoed Bowman J's frustration with the fact that the questions put by the parties did not frame the actual issue between them in a satisfactory way.

NSPI then appealed the case to the Supreme Court of Canada, which upheld the Court of Appeal's finding.<sup>61</sup> By this point, the two questions as framed were essentially ignored, although they were set out in the judgment. The issues were described by the Supreme Court as being simply whether section 4 of the *Power Corporation Act* made NSPC an agent of the Crown and whether NSPC was acting within the purposes for which it was made an agent. The Supreme Court noted that there are two ways for an entity to become a Crown agent. The first way is for the Crown to exercise a degree of control over the entity such that it can be said to be in *de jure* control. This determination requires an examination of the relationship between the parties. The second way is for the legislature to expressly legislate the entity to be an agent. In the court's view, the answer in this case was clear. The statute had made NSPC an agent of the Crown. As such, it was immune from the operation of statutes provided that it was acting within the purposes for which the legislature made it an agent, and this test was clearly satisfied.

To conclude this discussion of the agency issue, it is in order to briefly examine Bowman J's decision in *United Parcel Service Canada Ltd. v. The Queen*.<sup>62</sup> Bowman J attempted to apply a creative solution to achieve what seemed to be the fair and right result, only to be overturned by the Federal Court of Appeal,<sup>63</sup> and then ultimately vindicated by the Supreme Court.<sup>64</sup>

The case involved UPS, the well-known shipping courier company, which also acted as a customs broker for its customers. In doing so, it handled payment of goods and services tax (GST) on imported goods as agent for those customers. For various reasons, from time to time GST remittances would be overpaid. When this happened, UPS would issue a credit note to its customer and obtain a document signed by the customer stating that the customer would not claim an input tax

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60 Ibid., at paragraph 19.

61 *Nova Scotia Power Inc. v. Canada*, 2004 SCC 51. Before the case went to the Supreme Court NSPI brought a motion in the Federal Court of Appeal for reconsideration of the judgment on the basis that the judgment did not accord with the reasons. The motion was refused: 2003 FCA 163.

62 2006 TCC 450.

63 2008 FCA 48.

64 2009 SCC 20.

credit in respect of the overpaid amount. When UPS attempted to claim a reduction of its GST liability in the amount of the overpayments, the CRA disallowed the claim, on the basis that UPS had not actually paid the GST itself but instead had paid it as an agent. In the CRA's view, because there are no provisions in the Excise Tax Act<sup>65</sup> that specifically allow an agent access to input tax credits, it was only the customers of UPS on whose behalf the GST had been remitted that could claim them.

Bowman J allowed UPS's appeal. He observed that UPS's "entitlement to the amount as a matter of fairness is unquestioned."<sup>66</sup> Nevertheless, the court was dealing with a technical statute, and if UPS had a right to recover the overpayment, that right must be found in the statute.

Although it was clear that UPS was the agent for its customers, Bowman J reasoned that a basis could be found within the relevant statutes for concluding that UPS, having been obliged to pay the GST, was also entitled to avail itself of the refund mechanism in the ETA. He referred to section 212 of the ETA, which makes anyone who is liable under the Customs Act to pay duty on imported goods also liable to pay GST on the value of the goods. He then referred to section 18(2) of the Customs Act, which he concluded made any person acting as agent for an importer jointly liable with the importer for all duties levied on imported goods. On Bowman J's reasoning, UPS was liable for duties payable on the imported goods and thus was also liable for GST under section 212 of the ETA. UPS was thus entitled to a rebate under section 261, or a reduction of tax under section 296, in respect of the overpayments.<sup>67</sup>

Not surprisingly, the Crown appealed the decision. The Federal Court of Appeal overturned Bowman J's decision, finding that section 18(2) of the Customs Act had no application in the case. Further, because UPS was acting as an agent, it was not legally the person who had paid the GST and therefore was not entitled to recover it. The Court of Appeal was of the view that the provisions on which the Tax Court had based its reasoning did not support the claim, and there was no alternative basis on which to find for UPS. The court also appeared considerably less concerned with whether the result was fair or not, pointing out that the company could have chosen to operate differently if it had wished to avoid the problem, or to attempt to recover the tax in another manner. UPS found a more sympathetic audience in the Supreme Court of Canada, which reversed the Court of Appeal's ruling and found for UPS, although on a different basis than that of the Tax Court. Eschewing the creative arguments crafted by Bowman J, the court found that section 261, the rebate provision, did not require an inquiry into liability for payment; it simply required that a

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65 RSC 1985, c. E-15, as amended (herein referred to as "the ETA").

66 *Supra* note 62, at paragraph 18.

67 Section 261 of the ETA provides, generally, for a rebate to be paid to a person that has paid an amount that was not payable or remittable by the person. Section 296 of the ETA provides that any amount that could have been claimed under section 261 but was not is to be applied to a person's net tax.

payment actually have been made by the person requesting the rebate. Since UPS was the entity that had made the overpayments, it was entitled to a rebate of those overpayments under section 261, and thus a reduction of tax under section 296.

### **CONCLUDING COMMENTS**

A review of Bowman J's decisions in any particular area leaves the reader with respect for the breadth of his knowledge, his courage in speaking his mind, and his intellectual honesty in attempting to reach a conclusion that he believed was consistent with principles of equity and fairness, and also grounded in the words of the statute. There have been few judges of the Tax Court of Canada who have left such an impressive legacy.

