Docket: 2013-385(GST)G

BETWEEN:

INVESCO CANADA LTD.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Appeals heard on April 28, 29 and 30, 2014, at Toronto, Ontario

Before: The Honourable Justice Diane Campbell

Appearances:

Counsel for the Appellant:	John Tobin / Stuart Svonkin
Counsel for the Respondent:	Marilyn Vardy / Andrea Jackett

JUDGMENT

The appeals from assessments made under Part IX of the *Excise Tax Act* for the periods April 1, 1999 to October 31, 1999 (the 2011 Notices of (Re)Assessment dated February 23, 2011) and November 1, 1999 to July 31, 2000, January 1, 2002 to December 31, 2002, October 1, 2003 to December 31, 2003, January 1, 2004 to December 31, 2004, January 1, 2005 to September 30, 2005 and January 1, 2006 to December 31, 2006 (the 2012 Notices of (Re)Assessment dated February 24, 2012) are allowed, with costs to the Appellant, and the (Re)Assessments are referred back to the Minister of National Revenue for reconsideration and reassessment in accordance with the attached Reasons for Judgment. In accordance with paragraph 4 of the within reasons, the Appellant did not pursue its appeal of Aim Funds Management Inc. in respect to the periods from April 1, 1999 to July 31, 2000.

Signed at Ottawa, Canada, this 23rd day of December 2014.

"Diane Campbell"

Campbell J.

Citation: 2014 TCC 375
Date: 20141223
Docket: 2013-385(GST)G

BETWEEN:

INVESCO CANADA LTD.,

Appellant,

and

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Respondent.

REASONS FOR JUDGMENT

Campbell J.

Introduction

[1] The sole issue in these appeals boils down to this: a determination of the value of the consideration paid by various mutual fund trusts (the "Funds") to the Appellant (also referred to as the "Manager") for the supply of management services which it provided to each of the Funds. To determine the value, I must look at what the actual consideration consisted of in these circumstances. Ultimately, this will determine whether the Appellant properly collected and remitted the appropriate amount of GST on the fees that were charged to each Fund.

[2] Although several of the Respondent's assumptions of fact, contained in the Reply to the Notice of Appeal as well as the submissions, address the legal arrangements and cash payments, with respect to both mutual fund corporations and mutual fund trusts as seemingly one and the same, they are, in fact, very different creatures. The appeals before me are restricted to the management fees that were paid by the Funds to the Appellant with respect to the mutual fund trusts. The Appellant did not appeal the assessments respecting the mutual fund corporations.

[3] These appeals are from reassessments made under Part IX of the *Excise Tax Act* (the "*ETA*"). The Appellant is appealing three sets of Notices of Reassessment:

(a) those dated February 23, 2011, issued in the name of Invesco Canada Ltd. ("Invesco") for the period from April 1, 1999 to October 31, 1999 in respect of Trimark Investment Management Inc. ("TIMI");

(b) those dated June 10, 2011, involving Aim Funds Management Inc. ("AIM") for the same period, April 1, 1999 to October 31, 1999; and

(c) those dated February 24, 2012, involving AIM and TIMI immediately prior to and following the amalgamation of AIM and TIMI (now referred to as Invesco) on August 1, 2000 for the periods between November 1, 1999 and December 31, 2006.

[4] During the hearing, the Appellant advised the Court that it did not intend to continue its appeal of the reassessments as they related to AIM, for the periods prior to the amalgamation, that is, for the periods from April 1, 1999 to July 31, 2000.

[5] The Appellant provides management services to the Funds within the mutual fund industry (the "Industry"). For the provision of these services, which are taxable supplies, the Appellant charges management fees to the Funds. Goods and Services Tax ("GST") is charged, collected and remitted on these fees, pursuant to the *ETA*. The Industry operates within a highly-regulated environment, according to national and provincial securities laws. This ensures transparency for investors, who place custody of their money with an investor to purchase either shares in a mutual fund corporation or, as in these appeals, units in a trust fund. Such an arrangement permits individual investors access to a wide-ranging portfolio and professional advice and management in respect to their investments that a smaller investor could not otherwise access.

[6] In exchange for agreeing to manage the day-to-day business activities of the Funds, the Appellant/Manager earns income by charging management fees, which are generally charged against all assets of the fund. In some instances, to remain economically viable players in the market, the Manager must attract and retain the larger, sophisticated investor groups, such as pension funds (the "Large Investors"). As an inducement, the Manager has discretion to reduce the normal management fees that are charged to ordinary investors in the funds. This practice, of management fee reductions, gives rise to special distributions made by the Funds to the Large Investors. These special distributions, equal to the amount of the management fee reduction and paid on a monthly or quarterly basis, are known as the "Management Fee Distributions".

[7] These appeals concern the GST treatment of those Management Fee Distributions. No GST was collected or remitted on the distributions. The Minister of National Revenue (the "Minister") reassessed the Appellant/Manager on the basis that these Management Fee Distributions were part of the consideration, in addition to the amount of the Manager's reduced fee, paid or payable by the Funds for the supply of management services by the Appellant/Manager.

Facts and Background

[8] The only witness was David Warren, Executive Vice-President and Chief Financial Officer of the Appellant. Seven "Joint Document Brief" books were filed by the parties. While the testimony and argument focussed on one set of mutual trust fund documents, these were representative of all the documentation at issue in these appeals.

[9] To determine what the Funds actually paid to the Appellant/Manager for the management services, the Appellant focussed on the legal rights that existed among the Manager, the Funds and the Large Investors, as set out in the relevant documentation. To establish the "factual matrix" underpinning the documentation, the Appellant emphasized that I must analyze the evidence before me, with a view to establishing:

(a) the commercial purpose of the transactions;

(b) the context; and

(c) the market in which the parties operated.

[10] The Appellant is in the business of sponsoring, managing and distributing mutual funds. The Appellant wears two hats with respect to the Funds: it is a trustee of the Funds and it also provides investment management services and stock advice to the Funds. On August 1, 2000, AIM, the mutual fund manager for the AIM group of funds, and TIMI, the mutual fund manager for the Trimark group of funds, amalgamated to form Aim Funds Management Inc. ("AFMI"), the predecessor to Invesco. During the relevant periods, Invesco offered mutual funds to public investors under the AIM and TIMI brand names, pursuant to an annual Prospectus and an Annual Information Form (the "AIF"), together referred to as the "Offering Documents".

[11] The management fee that the Funds paid the Appellant/Manager is fixed by contract in a document called the "Management Agreement". The fee is charged to each Fund for which the Appellant provided services. They accrue daily and are generally charged against the assets.

[12] The Appellant markets the Funds toward two groups of investors, retail investors and the Large Investors, the latter group being generally comprised of the institutional investors. It is the investors who pay the management fees, although indirectly. These fees, together with other Fund expenses, reduce the profit within the mutual trust funds, thereby reducing the income that will be available to be distributed to investors. The logic is that, if the Manager of a trust fund is able to induce Large Investors to purchase units by offering a reduced fee, then that reduced fee should produce higher distributions to the investors because of the increased monetary base.

[13] Unlike the Large Investors, the retail investors have no ability to negotiate reduced management fees but the Funds do provide them with investment expertise and diversification that would otherwise be unavailable to them in the marketplace. According to Mr. Warren's evidence, the Large Investors generally do not have a financial advisor but, instead, work through consultants in negotiating a management fee reduction. These investors would receive the benefit of a negotiated fee reduction through a management fee distribution, calculated and equal to the difference between the potential management fee amount that the Appellant could have charged and the amount of the negotiated management fee reduction or discount applied to the "gross" fee. This was referred to as the net management fee (Cross-examination of Mr. Warren, Transcript, Volume 2, pages 230 to 231).

[14] The Appellant was prepared to charge the Funds a reduced management fee for its supply of management services because, overall, the gross amount of fees earned by the Manager against the Funds' net assets would significantly increase as a consequence of a large investment in the Funds. This was so even though the fees to a Large Investor may have been offered at a lower percentage rate. A fund would also benefit because the size of its investment portfolio increased when Large Investors became unitholders in a fund. If retail investors are also unitholders in a fund where Large Investors are attracted by a reduced fee to become unitholders, the entire fund and all investors are impacted by the increased fund assets available for investment.

[15] Since the trustee has a fiduciary duty to the entire Fund, structuring an arrangement that allows for a management fee reduction to effectively benefit the Large Investors, without negatively impacting other investors in the Fund, has remained an issue that the Industry has grappled with for many years.

[16] Prior to 1995, the management fee reduction was achieved through a rebate from the Appellant to the Large Investors. Under this approach, the Appellant charged the Funds the full management fee as set out in the Management Agreement. The Appellant then paid the Large Investors a "management fee rebate". In 1995, the Ontario Securities Commission (the "OSC"), along with other regulators within the industry, became concerned that this method of paying rebates to unitholders could trigger subsection 12(2.1) of the *Income Tax Act* (the "*ITA*") and subject the Funds to a detrimental and unanticipated income tax inclusion. In a 1994 Technical Interpretation, the Canada Revenue Agency (the "CRA") advised of the adverse income tax consequences and concluded that a double tax - one to the investors in receipt of management fee rebates and another to the trust funds - would be the result.

[17] By correspondence dated June 29, 1995, the OSC wrote to Appellant Counsel with the following request:

> 4. Please disclose the fact that the repayment of management fees to an investor may trigger negative tax consequences to the investor and/or the Funds and provide an opinion from tax counsel or provide for an indemnification to the Fund from Trimark for any tax liabilities of the Funds with respect to the repayment of management fee.
>
> (Joint Document Brief, Volume 1, Tab 1, page 2)

It became critical for this arrangement, that had been in place until 1995, to be revamped in order to avoid any risk of double taxation through the application of subsection 12(2.1) of the *ITA*. This provision provides that inducement payments or reimbursements made to beneficiaries of trusts are to be included in the income of the trusts. Since the management fee rebates to the Large Investors could be considered inducement payments meant to reimburse expenses of the trusts, pursuant to subsection 12(2.1), paragraph 12(1)(x) would cause those rebate amounts to also be included in the income of the Funds, resulting in double taxation of the rebate amounts. As a result, changes were introduced in 1995 in order to avoid the potential application of subsection 12(2.1). The Appellant had to alter the manner in which the management fee rebate amounts were made but, in

doing so, the trusts were also constrained by subsection 104(7.1) of the *ITA*. As explained by Appellant Counsel in his opening submissions at paragraph 64:

> … You will know that this provision would deny a trust the ability to deduct its distributions of income and net realized gains. The Funds would not want to lose those flow-through deductions for the whole fund in order to solve the large investor subsection 12(2.1) issue.

[18] To avoid these potential income tax consequences, the Appellant changed the method of making management fee rebate payments to unitholders in the Funds and instead, the Appellant/Manager was given discretion to negotiate with the Large Investors for a reduction in the management fee it charged to the Funds. This was in return for the Funds agreeing to make a distribution of the amount of this reduction to the Large Investors. Consequently, the Funds would then have additional resources to make special trust distributions to the Large Investors because the Appellant had reduced its fee for the services it was providing.

[19] The Appellant described the new method of paying management fee rebates as follows:

1. The Appellant/Manager calculated the net management fee it charged the Funds by taking "Factor A" (the maximum stated management fee) and subtracting "Factor B" (the fee reduction offered by the Appellant to the Funds calculated with respect to specific Large Investors).

2. The Appellant collected GST on the net management fee calculated according to Step 1.

3. The Funds then made special Management Fee Distributions to the Large Investors out of trust income or trust capital.

[20] The Appellant sought and received an advance income tax ruling to ensure that this proposed new arrangement would not result in double taxation under the *ITA* (the "Ruling"). The Ruling confirmed the CRA's view that these special Management Fee Distributions from the Funds to the Large Investors should be treated as trust distributions out of the mutual trust funds. Pursuant to subsection 104(6) of the *ITA*, the Funds would be entitled to deduct those payments.

[21] For income tax purposes, Management Fee Distributions were to be treated as trust distributions by the Funds and the Large Investors. Although this Ruling

dealt only with subsection 104(7.1) of the *ITA* and the Appellant did not obtain a ruling with respect to potential GST implications, the fee arrangements at issue in these appeals are those that are the subject matter of the Ruling.

[22] The new arrangements were implemented through the following documentary changes:

1. The Declaration of Trust for a Fund was amended to (a) define "Management Fee Distributions" as a special subset of distributions available only to Large Investors and (b) require the Trustee of the Fund to make such distributions to Large Investors. (Joint Document Brief, Volume 1, Tab 5, Second Amendment to Declaration of Trust, paragraphs 2.1, 2.2 and 2.4).

2. The Management Agreement, between the Manager and the Fund, was amended to provide that the Manager may reduce the management fees at an annual rate, which is less than that rate otherwise paid by the Funds under a Management Agreement in respect of a particular unitholder, on condition that the amount of the reduction is distributed to that unitholder by the Fund (Joint Document Brief, Volume 1, Tab 6, Amendment to Management Agreement).

The Appellant's Position

[23] The management fee paid by the Funds to the Appellant/Manager was the net management fee of "Factor A" (the maximum stated management fee that could be charged according to the Offering Documents) minus "Factor B" (the fee reduction amount offered to eligible Large Investors). This reduced amount was the sole consideration for the Appellant's single supply of management services. The Management Fee Distributions were a separate transaction occurring between the Funds and the Large Investors and were distributions of trust income or realized capital gains of the Funds to the Large Investors. The Appellant's fee was reduced at the point of sale and there were no subsequent adjustments or rebates that were paid. Consequently, the distributions were a separate supply and did not form part of the consideration provided to the Appellant for the supply of management services. All of the documentation, together with the amendments, the conduct of the parties, the surrounding commercial realities and circumstances support the objective intention of the parties that the management fee was reduced at the point of sale to Large Investors at a rate that matched the rate a Large

Investor could have obtained by hiring an investment manager directly. At the same time, the objective intention of the parties was to avoid a payment of funds from a Manager to an investor, either directly or indirectly, so as to prevent potential double taxation caused by the application of subsection 12(2.1) of the *ITA*.

[24] Appellant Counsel also relied on internal accounting documents and tax returns respecting the payment of fees and interpretation of the contracts.

[25] In the alternative, the Appellant argued that, if this Court concluded that the Management Agreement contained a guarantee or condition that was partial consideration for the supply of management services, the Minister did not plead an assumption relating to the value of that condition or guarantee, which then places the onus on the Minister and not the Appellant. However, the Appellant contends that the Respondent adduced no evidence at the hearing respecting this issue.

The Respondent's Position

[26] The Respondent argued that the Management Fee Distributions to the Large Investors did not represent a price adjustment for the management services that the Appellant offered and, therefore, did not reduce the value of the consideration payable by the Funds for the supply of the management services. There was no reduction in the total amount payable by the trust funds under the Management Agreement. The Funds paid the full management fee but to two different parties.

> 61. … The only change was that instead of being required to pay the total amount payable (i.e. the gross management fee) directly to the appellant (i.e. the supplier), the Trust was now required (or at least permitted) to instead pay one component of the gross management fee to particular investors (identified by the appellant) in the form of management fee distributions.
>
> (Respondent's Written Submissions, paragraph 61)

The second portion of the fee that was paid to the Large Investors at the Appellant's direction was therefore part of the value of the consideration for the management services and upon which GST should have been remitted.

[27] The Respondent submitted that, as long as there is a direct link or connection between the amount payable and the supply that is made, then the amount will be consideration for that supply.

[28] In determining the value of the consideration, both the legal and the "economic reality" of the transactions should be considered. The economic reality of the transactions is that the Funds were in no better position as a result of the management fee reductions. From the perspective of the Funds, there was no difference between the periods before and after 1995 when changes were made. Instead of paying the full fee to the Appellant/Manager for the supply of management services, the Funds now make two payments, one to the Appellant and the remainder to the Large Investors. The economic reality is that the Funds have no additional money in their coffers. According to the Respondent, the legal reality is that the Appellant negotiated agreements with the Large Investors and agreed to cause the Funds to make these payments of Management Fee Distributions in exchange for the investors agreeing to invest in the Funds. It was the Appellant that owed an obligation to the Large Investors equal to the amount of these distributions. Had the Funds not paid the distributions, the Large Investors would have a legal right against the Appellant/Manager for recovery of any unpaid amounts. The Appellant would then have legal rights against the Funds in respect to their obligation to pay the distributions.

[29] As a result, there is both a legal and an economic link or connection between the unreduced gross management fee and the supply of management services to the Funds. The Funds were liable to pay gross fees pursuant to the Management Agreement, provided the Appellant fulfilled its managerial responsibilities. However, the Appellant and the Funds agreed that, instead of the Funds paying the gross management fees, the Appellant would receive part of those fees in cash and the Funds would accept an obligation or condition imposed upon them to pay the negotiated reduced amounts to the Large Investors. This obligation had a value equal to the amounts negotiated between the Appellant and the Large Investors.

[30] In response to the adequacy of the pleadings issue raised by the Appellant, the Respondent contended that the Reply to the Notice of Appeal sets out that the benefit of the negotiated reduction went, not to the Funds, but to the Large Investors with whom the managers negotiated a special deal. The Reply assumed that the Funds did not receive those negotiated amounts nor any benefit from that arrangement and that the management fee was never reduced.

Analysis

A. The Legislative Framework and Jurisprudence

[31] Subsection 165(1) of the *ETA* is the charging provision. It provides that tax shall be paid on the value of the consideration for a taxable supply. In these appeals, the taxable supply is the management services provided by the Appellant to the Funds and the Appellant agreed those services are taxable supplies for GST purposes. The recipient of the supply is the Funds. The issue arises in respect to a valuation of the consideration for those services. According to the wording of subsection 165(1), the consideration must be "for the supply". This means there must be a link or connection between the consideration and the supply itself. Subsection 123(1) of the *ETA* provides the following definition of "consideration":

> "consideration" includes any amount that is payable for a supply by operation of law;

The Technical Notes that accompanied the introduction of this definition explained the purpose behind the inclusion of the phrase "by operation of law" in the definition:

> … [In] some circumstances, amounts can become payable for a supply by operation of law in the absence of a contract. … This would address, for example, situations where services are rendered to a person without having been contracted for and the person is required, by law, to pay fair value for the services received. … [Emphasis added]
>
> (Explanatory Notes to Legislation Relating to the Goods and Services Tax, Department of Finance: February 1993)

[32] The inclusion of the phrase "by operation of law" is intended to encompass those relationships which may not be contractual in nature but that are nonetheless governed by common law doctrine or statute. The explanation, contained in the Technical Notes, mirrors the definition provided by the Federal Court of Appeal in *Commission Scolaire des Chênes v Canada* (2001 FCA 264, [2001] FCJ No. 1559, at paragraphs 18 and 19).

[33] The Federal Court of Appeal, in its reasons in *Commission Scolaire des Chênes*, concluded that two factors will be required in order for consideration to have been paid for a supply:

> 18. Consideration under the Act is easily discernable when the obligation to pay arises under a contract. …
>
> 19. Under the Act, in order for a payment to constitute consideration, it must have been made pursuant to a legal obligation (contractual or otherwise) and must

> be closely enough linked to a supply that it may be regarded as having been made "for" that supply (see the definition of the term "consideration" in section 123). That is why a direct link is required.

The Federal Court of Appeal noted that a payment made pursuant to the terms of a contract will always meet the definition of consideration. However, where a payment is made outside the contract, an analysis will be required to determine whether a direct link exists between the payment and the supply. At paragraph 20 of *Commission Scolaire des Chênes*, the Court concluded:

> 20. … [W]hen the payment is made otherwise than under a contract, the purpose of the payment and the circumstances in which it is made must be carefully analyzed to determine whether there is a direct link with the supply; a payment will constitute consideration only where it is made "for" or in return for that supply.

[34] In *County of Lethbridge v The Queen*, 2005 TCC 809, [2006] TCJ No. 56, Justice Bell confirmed that the definition of consideration for the purposes of the *ETA* includes any amount that would be consideration under common law:

> 95. … In *Dunlop Pneumatic Tyre Co. Ltd. v Selfridge & Co. Ltd.*[1915] AC 847 at 855, HL, Lord Dunedin wrote:
>
> > I am content to adopt from a work of Sir Frederick Pollock … the following words as to consideration:
> >
> > > An act or forbearance of one party, or the promise thereof, is the price for which the promise of the other is bought, and the promise thus given for value is enforceable.

At paragraph 100, Justice Bell went on to state:

> 100. … The test to be applied is not whether there is a "direct link". This rhapsodic venture into a mire of possibilities is foreign to the common law concept of contractual consideration. The test in this case is whether there was "consideration" as that term, both under the definition in the *Act*, and under common law, exists.

[35] As a result of the foregoing comments, much of the Respondent's submissions on "direct link" between the payments and the related caselaw were unnecessary. Pursuant to *Commission Scolaire des Chênes* and the common law definition of consideration, all that would be required for the Management Fee

Distributions to constitute consideration for the taxable supply of management services would be a contractual obligation.

[36] The *ETA* also provides a definition, in subsection 153(1), for the value of the consideration for a supply as follows:

> **153. (1) Value of consideration** – Subject to this Division, the value of the consideration, or any part thereof, for a supply shall, for the purposes of this Part, be deemed to be equal to
>
> > (a) where the consideration or that part is expressed in money, the amount of the money; and
> >
> > (b) where the consideration or that part is other than money, the fair market value of the consideration or that part at the time the supply was made.

[37] The Appellant contended that, pursuant to subsection 153(1), the only supply was for a dollar amount under the Management Agreement. In respect to the Respondent's argument that there was additional consideration that was not cash and was in the form of a legal obligation to pay Management Fee Distributions to Large Investors, the Appellant argued that the Respondent must address what the fair market value of that non-cash consideration would be. Appellant Counsel submitted that the Respondent did not adduce evidence respecting fair market value. The Appellant's position was that the legal obligation to pay Management Fee Distributions to Large Investors is found in the Declaration of Trust. The Management Agreement, according to the Appellant, contains a guarantee that the Funds will comply with their obligation under the Declaration of Trust. However, when viewed within the context of the factual matrix umbrella, this guarantee is not consideration for the management services that the Appellant provided and, even if the Court determines that it was, the Respondent has not established the value of the guarantee.

[38] The Respondent argued that it is the Management Agreement that creates a legal obligation to pay the Management Fee Distributions to the Large Investors on the Appellant's behalf but that it is the Appellant that has the obligation to pay the distributions to the Large Investors. Under the Management Agreement, when the Funds agreed to accept this obligation, something of value is being provided to the Appellant (Respondent's Written Submissions, paragraph 62). The value of the obligation, being consideration for the management services, is equal to the Management Fee Distributions, according to the Respondent's position.

[39] The first step in these appeals is to interpret the contracts and relevant documentation in order to determine the true nature of the legal obligations that were created. If I determine that the only consideration for the management services was the cash amount of the Appellant's reduced fee, that ends the matter. If, however, I conclude that the Funds had a legal obligation to pay amounts in addition to the reduced fee for the Appellant's services, then the next step will be a determination of the fair market value of that legal obligation or condition to the Appellant.

B. The Factual Matrix/Contractual Interpretation and the Recent SCC Decision in *Sattva Capital Corp. v Creston Moly Corp.*, 2014 SCC 53, ("*Sattva*")

[40] The importance of and the role that the relevant factual matrix has in the interpretation of contracts is well established in Canadian jurisprudence and, in particular, tax matters. Subsequent to the hearing of these appeals, the Supreme Court of Canada, on August 1, 2014, released a decision in *Sattva* dealing with the principles of contractual interpretation. Since this has a direct bearing on the issue before me, that is, the determination of the value of the consideration that the Appellant received from the Funds for the supply of management services, I requested that the parties provide further written submissions in respect to the impact of the *Sattva* decision.

[41] Overall, the reasons rendered by Mr. Justice Marshall Rothstein and the principles enunciated respecting contractual interpretation are consistent with prior jurisprudence. While *Sattva* clarifies the basic existing principles of contractual interpretation, it does not change the relevant law, nor my view of the issue before me, based on the already existing jurisprudence. In *Sattva*, Justice Rothstein endorsed a practical, common-sense approach to the interpretation of contracts not dominated by technical rules of construction. A determination of the intent of the parties and the scope of their understanding should be the Court's overriding concern and the present-day approach that should be applied. To this end, a contract should be read as a whole, giving the words it employs their ordinary and grammatical meaning, consistent with the surrounding circumstances known to the parties at the time the contract was formed – often referred to as the "factual matrix". At paragraph 47, Justice Rothstein describes this approach as follows:

> [47] Regarding the first development, the interpretation of contracts has evolved towards a practical, common-sense approach not dominated by technical rules of construction. The overriding concern is to determine "the intent of the parties and the scope of their understanding" (*Jesuit Fathers of Upper Canada v.*

> *Guardian Insurance Co. of Canada*, 2006 SCC 21, [2006] 1 S.C.R. 744, at para. 27 *per* LeBel J.; see also *Tercon Contractors Ltd. v. British Columbia (Transportation and Highways)*, 2010 SCC 4, [2010] 1 S.C.R. 69, at paras. 64-65 *per* Cromwell J.). To do so, a decision-maker must read the contract as a whole, giving the words used their ordinary and grammatical meaning, consistent with the surrounding circumstances known to the parties at the time of formation of the contract. Consideration of the surrounding circumstances recognizes that ascertaining contractual intention can be difficult when looking at words on their own, because words alone do not have an immutable or absolute meaning:
>
> > No contracts are made in a vacuum: there is always a setting in which they have to be placed. . . . In a commercial contract it is certainly right that the court should know the commercial purpose of the contract and this in turn presupposes knowledge of the genesis of the transaction, the background, the context, the market in which the parties are operating.
> >
> > (*Reardon Smith Line*, at p. 574, *per* Lord Wilberforce)

[42] Consequently, the Court must consider the commercial purpose, background and context of the transaction as well as the market in which the parties to a contract are operating. This goes back to the very basics of contract interpretation principles: contracts are never made in a vacuum.

[43] Words alone do not have an immutable or absolute meaning. Rather, their meaning should be considered against the backdrop of relevant contextual factors, including the purpose of the agreement and the nature of the relationship between the parties that is created by the contract. At paragraph 48 of *Sattva*, Justice Rothstein reproduced the following passage by Lord Hoffman in *Investors Compensation Scheme Ltd. v West Bromwich Building Society*, [1998] 1 All ER 98 (H.L.) as follows:

> [48] …
>
> > The meaning which a document (or any other utterance) would convey to a reasonable man is not the same thing as the meaning of its words. The meaning of words is a matter of dictionaries and grammars; the meaning of the document is what the parties using those words against the relevant background would reasonably have been understood to mean. [p. 115]

[44] However, as Justice Rothstein concludes in *Sattva*, although surrounding circumstances will be a relevant consideration to contractual interpretation, they cannot be allowed to overwhelm the words contained in a contract. This principle

would logically follow from the principle of giving words their ordinary and grammatical meaning, consistent with surrounding circumstances at the time of the contract formation. Otherwise, words in a contract would not be given their ordinary and grammatical meaning. In other words, courts cannot use surrounding circumstances to deviate from the text such that a new agreement is created. Specifically, Justice Rothstein had the following to say in respect to what a court can consider when interpreting a contract:

> [57] While the surrounding circumstances will be considered in interpreting the terms of a contract, they must never be allowed to overwhelm the words of that agreement (*Hayes Forest Services*, at para. 14; and *Hall*, at p. 30). The goal of examining such evidence is to deepen a decision-maker's understanding of the mutual and objective intentions of the parties as expressed in the words of the contract. The interpretation of a written contractual provision must always be grounded in the text and read in light of the entire contract (*Hall*, at pp. 15 and 30-32). While the surrounding circumstances are relied upon in the interpretive process, courts cannot use them to deviate from the text such that the court effectively creates a new agreement (*Glaswegian Enterprises Inc. v. B.C. Tel Mobility Cellular Inc.* (1997), 101 B.C.A.C. 62).

[45] As emphasized by Justice Rothstein at paragraph 58 of his reasons, evidence respecting surrounding circumstances will necessarily vary from case to case and will be limited to the objective evidence of the background facts at the time of formation and execution of the contract. This requires a court to look at the knowledge that the parties possessed or ought to have possessed, again, prior to and at the time of the contract formation. As noted in *Sattva*, considering surrounding circumstances, as an interpretative aid, does not offend the parol evidence rule, which excludes evidence of the parties' subjective intentions and precludes considering evidence outside the words of the contract that would result in varying the contract in some manner. Absent ambiguity, the Court cannot consider the subjective intention of the parties to a contract nor their actions subsequent to contract formation. Although the Appellant relied on subsequent accounting documents and tax returns to support its position, since there is no ambiguity present in the documentation, I have placed no reliance on this portion of the Appellant's submissions.

The Appellant's Position after *Sattva*

[46] The Appellant's position is that its proposed interpretation of the agreements between the parties is further supported by the reasons in *Sattva*. The objective intention of the parties was to implement the transaction described in the ATR-65

and the Ruling in order to avoid the impact of double income taxation. It could not therefore be the objective intent of the parties to increase GST payable, in respect to the management services, by implementing the Respondent's complicated, multi-step arrangements (Appellant's Written Submissions on *Sattva*, at paragraph 18). The language, contained in the Management Agreements, that refers to the conditionality of the management fee discount, should not be interpreted to mean that the Funds had to "earn" the discount by making a separate supply each time that a discount would be applied (Appellant's Written Submissions on *Sattva*, paragraph 19). Essentially, this would thwart the parties' commercial goals and lead to inconsistencies with the Fund's treatment of the payment of the Management Fee Distributions as trust distributions (Appellant's Written Submissions on *Sattva*, paragraph 19(a) and (b)). Instead, the conditionality of the discount addressed concerns of differential entitlement to income or capital between beneficiaries of a trust, contrary to subsection 104(7.1) of the *ITA*. It also ensured the integrity of the new arrangement by preventing other investors from challenging these arrangements because the fee reductions were not being used to pay distributions to all of the investors in the Fund (Appellant's Written Submissions on *Sattva*, paragraph 20(a) and (b)). The language, contained in the confirmation letters from the Funds to the Large Investors, merely confirms that the Large Investors would receive Management Fee Distributions from the Funds. It was not an agreement by the Appellant to make the distribution itself to the Large Investors (Appellant's Written Submissions on *Sattva*, paragraph 21).

The Respondent's Position after *Sattva*

[47] The Funds were distinct from the Large Investors, to whom the Appellant directed the Funds to pay the distributions (Respondent's Written Submissions on *Sattva*, paragraph 9). The Funds were liable under the Management Agreements to pay consideration for the supply of management services by the Appellant, as they were the recipients of the Appellant's taxable supply (Respondent's Written Submissions on *Sattva*, paragraph 10).

[48] The Funds did not realize any savings from the management fee reduction that was negotiated between the Appellant and the Large Investors. The fee distributions were amounts payable by the Funds under the amended Management Agreements, in addition to the cash amounts paid by the Funds to the Appellant/Manager (Respondent's Written Submissions on *Sattva*, paragraphs 11 and 12). Consideration is much broader in scope in these circumstances and is not limited to cash paid by the recipient to the supplier (Respondent's Written Submissions on *Sattva*, paragraphs 13, 27 and 29). Consequently, this Court should

interpret the word "consideration" to include the Management Fee Distributions payable by the Funds to the Large Investors.

[49] The Appellant did not want the Funds to realize any savings which would, in turn, benefit all unitholders and did not want to reduce its management fees for all investors. For accounting and financial statement purposes, the Funds recorded the distributions payable to the Large Investors as a liability and recorded distributions paid to these investors as an expense (Respondent's Written Submissions on *Sattva*, paragraph 14). These surrounding circumstances support the Respondent's position that the amounts payable by the Funds for the supply of management services were not reduced.

[50] If a supplier, in its discretion, reduces the amount payable by the recipient solely on the condition that the recipient should pay the difference to another party, the supplier has not reduced the amount that the recipient is paying for the supply (Respondent's Written Submissions on *Sattva*, paragraph 16). The Appellant's subjectively held belief that the consideration paid by the Funds for GST/HST purposes was less than the "gross" management fee is irrelevant (Respondent's Written Submissions on *Sattva*, paragraph 20). The Supreme Court of Canada has held that nothing in the *ETA* requires that a supply have only one recipient (*Calgary (City) v The Queen*, 2012 SCC 20, [2012] 1 SCR and *United Parcel Service Canada Ltd. v The Queen*, [2009] 1 SCR 657). The Appellant's interpretation of the word "consideration" would import limitations into the definition where none were intended by Parliament (Respondent's Written Submissions on *Sattva*, paragraphs 23 to 29).

[51] The purpose of these fee arrangements was to accord preferential treatment to a select group of investors. The Funds always remained liable to pay the total "gross" management fees to the Appellant, partly through cash payments directly to the Appellant and partly through payments of special distributions to the Large Investors. This interpretation is in accordance with the practical, common-sense approach adopted in *Sattva* (Respondent's Written Submissions on *Sattva*, paragraphs 30 and 31).

[52] One point arising out of the parties' further submissions on the *Sattva* decision requires comment: The Respondent's argument that, from a practical, common-sense approach, the consideration paid by the Funds has not been reduced simply because the Appellant (the supplier) has reduced the amount payable by the Funds (the recipient) based solely on the condition that the Funds pay the

difference to another party (Respondent's Written Submissions on *Sattva*, paragraphs 12 to 16).

[53] Put simply, the Respondent is saying that the Funds must pay the Management Fee Distributions to either the Large Investors or to the Appellant/Manager. Either way, the Funds will be paying the full amount and, therefore, the consideration that is payable by the Funds has not been reduced. It remains the "gross" management fees prior to the fee reduction. This is predicated upon the view that it is the Manager that owes the special distributions to the Large Investors. The Appellant referred to this as the "… directed payment theory [which] really raises the question of conduit or trust or something …" (Appellant's Reply Submissions, Transcript, Volume 3, page 450). This reference to "or something" that Appellant Counsel referenced I infer to be an agency relationship when he uses the term "conduit" in the same sentence. Agency was never argued except for this passing reference. Because I have concluded that, according to my interpretation of the contracts, it was the Funds, and not the Appellant, that had the legal obligation to pay the Large Investors under the terms of the Declaration of Trust, I do not have to address the agency/conduit reference.

[54] The Funds enjoyed a benefit arising from their access to the fee reduction during the time lapse between the payment of the net management fee to the Appellant and Management Fee Distributions to the Large Investors. The Funds paid a net management fee to the Appellant weekly and at the end of the month, while the amount of the reduction of the management fee was paid to the Large Investors as special distributions monthly or quarterly. Contrary to the Respondent's assumption that the trusts did not receive the negotiated amounts, nor the benefit of the negotiated amounts (Reply to the Notice of Appeal, assumption (t)), the Funds did receive a benefit because they had access to those amounts for investment purposes for varying periods of time. Although the evidence did not address exactly how long the Funds had access to each Large Investor's fee reduction, there clearly was a time lapse between the time of the negotiated fee reduction and the eventual distributions to those investors. In those time periods, the Funds enjoyed the benefit of additional assets, alleviating the potential application of subsection 104(7.1) so that there could be no argument that the distributions created different entitlements to Fund assets as between beneficiaries of the trust funds.

[55] Even if I accepted the Respondent's argument that the special distributions constitute consideration to the Appellant, these amounts must be reduced by some value assigned to the benefit. On this basis alone, the Minister's assumption, that

"the funds paid the full amount of the management fees originally agreed upon and did not receive a rebate of, or reduction in, those fees" is demolished. The benefit would be the amount of the return in respect to that fee reduction during whatever time period the Funds had access to the negotiated amount of the fee reduction.

[56] The Appellant's approach to contractual interpretation, which is at the heart of the issue in these appeals, is supported by an abundance of jurisprudence, including the most recent Supreme Court of Canada decision in *Sattva*. Where contracts are in written form, as in these appeals, there is a presumption that the parties chose the words that would reflect their intention and the resulting bargain they struck. The objective for the Court is to examine the factual matrix or surrounding circumstances in order to determine what the parties intended by the words they chose to use in the contract. So the actual text of the agreement, together with the context of the circumstances in which the parties bargained, will be integral to the proper approach to contractual interpretation. The surrounding circumstances will include an examination of the purpose of the contract, the knowledge that the parties had at the time or which should have been available to them when they were bargaining and at the date of the contract formation, together with an examination of the industry standards, the market and the commercial reality within which the parties were operating.

[57] I am being asked to determine the value of the consideration in respect to the Appellant's supply of management services to the Funds. The parties are in disagreement over which payments constitute consideration as set out in a number of agreements, including several amendments to some of those agreements. In these circumstances, it is imperative that I take all of those surrounding circumstances into consideration in determining the existing legal rights among the Manager, the Funds and the unitholders in arriving at a determination of the value of the consideration and a proper characterization of the Management Fee Distributions. In fact, that is exactly what *Sattva* instructs me to do.

[58] The Respondent's proposed interpretation of clauses in several key documents is at odds with the approach adopted in *Sattva* and in prior jurisprudence.

[59] The three documents, that are central to a determination of the issue, are:

(a) the confirmation correspondence, dated October 2, 1995, forwarded by the Appellant/Manager to the Large Investors;

(b) the Amendment to the Declaration of Trust; and

(c) the Amendment to the Management Agreement.

Although there were a number of different amendments and contracts relating to the various funds and time periods, the parties focussed on one set of documents as representative of the entire group.

The Correspondence to the Large Investors (the Confirmation Letter)

[60] Much of this document involves the marketing and intellectual property rights which are not relevant to the issues before me. The relevant portion relating to Management Fee Distributions states:

> […] For greater certainty, we acknowledge that, as a holder of units of the Mutual Funds, subject to regulatory approval, commencing October 1, 1995, you will be entitled to Management Fee Distributions (as described and on the terms set out in the Prospectus), in respect of the units of each Mutual Fund held by you to which such distributions are available, required to achieve the effective annual management fee, per fund, set out below:
>
> | **Net Asset Value (per fund)** | **Fee** |
> |---|---|
> | up to $1 million | 0.95% |
> | from greater than $1 million to $3 million | 0.85% |
> | from greater than $3 million to $5 million | 0.75% |
> | from greater than $5 million to $10 million | 0.70% |
> | greater than $10 million | 0.65% |
>
> provided that, you agree not to sell contracts of insurance which derive their performance from the Mutual Funds to individuals or groups comprised of less than ten members.
>
> As is set out in the Prospectus, although there are currently no plans to terminate the Management Fee Distributions, we reserve the right to discontinue or change the Management Fee Distributions at any time.
>
> […]

(Joint Document Brief, Volume 1, Tab 7, pages 1 to 2)

[61] The Respondent's position is that an agreement existed between the Appellant/Manager and the Large Investors pursuant to which the Appellant had a legal obligation to cause the Funds to pay the Management Fee Distributions to the Large Investors. Respondent Counsel, at page 383 of the Transcript (the oral submissions) submitted that where the Funds made distributions, there was a separate or "side agreement" or arrangement between the Appellant and the Large Investors which would confirm the amount of the distributions that the Large Investors would receive and how it would be calculated. Respondent Counsel argued that it was the Appellant/Manager that had the sole discretion to determine when an investor would receive a distribution and what that amount would be. The Appellant also reserved the right to discontinue or change the distributions at any time.

[62] These so-called "side agreements" referred to by the Respondent do not create legal obligations for the Appellant to pay any amount to the Large Investors. The Appellant's discretion was the ability to negotiate directly with the Large Investors for a reduced management fee as a means of attracting them to invest in the Funds. The legal obligation to pay distributions to the Large Investors is created pursuant to the Declaration of Trust instruments which are meant to govern the legal relationship between the Funds and the investors. The contents of this correspondence do not create any legal obligation for the Appellant to pay any amounts, either Management Fee Distributions or any other type of payment, to the Large Investors. The correspondence establishes two things: first, the Large Investors will be entitled to Management Fee Distributions by virtue of being unitholders in the Funds; and second, the entitlement to those distributions originates and flows from the terms contained in the Offering Documents.

<u>The Amendment to the Declaration of Trust</u>

[63] The Declaration of Trust amended section 4.03 to include the following provision:

> 2.3 […]
>
> Section 4.03 is amended by adding the following subsection (f) to that section:
>
> (f) In the event that the Manager has decided to reduce the management fee it charges to the Trust in respect of a Unitholder with substantial holdings in the Trust and who satisfies any other criteria established by the Manager

> from time to time, the amount of the reduction shall be credited daily to such Unitholder, and shall be distributed to such Unitholder and automatically reinvested in Units on such day or days in a taxation year determined by the Trustee from time to time (a "Management Fee Distribution"), except as set forth below. …

(Joint Document Brief, Volume 1, Tab 5, pages 2 to 3)

[64] It is apparent from this wording that the obligation, for the Funds to pay Management Fee Distributions to Large Investors, is created by the Declaration of Trust. The legal obligation or liability to pay these special distributions arises through the wording employed by the Declaration of Trust and not the Management Agreement. The Large Investors were entitled to receive distributions as unitholders in the Funds. The Declarations of Trust establish these special Management Fee Distributions as a subset of the ordinary trust distributions which the Funds are required to make. It is the trustee that holds the assets of a trust pursuant to the terms contained in the Declaration of Trust. The special distributions are not consideration for the Appellant's supply of management services to the Funds because they are being paid from the Funds, which are separate legal entities, to trust beneficiaries as trust distributions.

[65] The Respondent's position is clearly evident in the assumptions of fact set out at (t), (u), (v) and (w) of the Reply to the Notice of Appeal:

> (t) the mutual fund corporations and trusts did not receive the negotiated amounts, nor the benefit of the negotiated amounts;
>
> (u) the negotiated amounts did not relate to the original supply of investment management services to the mutual fund trusts or corporations by the manager;
>
> (v) the manager charged the mutual fund trusts and corporations the full amount of the management fees originally agreed upon;
>
> (w) the funds paid the full amount of the management fees originally agreed upon and did not receive a rebate of, or reduction in, those fees;

[66] The Respondent has assumed that the special distributions were paid to the Large Investor from the Appellant's fees, that the Appellant charged full fees to the Funds and that the Appellant then made payments of the reduced amounts to the Large Investors. However, Mr. Warren's evidence, which was not challenged on cross-examination, was that the Appellant/Manager did not make payments to the investors. There is no evidence, oral or documentary, that could support the

Respondent's assumption that the Appellant received the full fee and returned a portion to the investor. The documents support the conclusion that the money never left the trust vehicle except pursuant to the terms of the applicable agreements.

[67] Paragraph 4.03(f) of the Second Amendment to the Trust Declaration further clarifies that it was the Trustee of the Funds who determined the day or days in a taxation year when the amounts of the reduction, which were generally reinvested in units of the Funds, were to be distributed to the unitholders. It also specifies other key points concerning distribution including:

(a) how the amount of the Management Fee Distributions was to be determined;

(b) when they were to be paid; and

(c) that they were to be paid first out of net income and then out of net realized capital gains.

[68] Article VI, "Determination and Distribution of Net Income and Net Capital Gains", of the Master Declaration of Trust confirms that there were limitations associated with the discretion to pay distributions and that it was the Trustee, not the Appellant, that possessed that discretionary power. In particular, section 6.3, at paragraph (a) states:

> SECTION 6.3 Unitholder Entitlement for Tax Purposes
>
> (a) Subject as hereinafter provided and subject to Article XI, the Trustee shall have the sole discretion to determine if any distribution or distributions of the property or assets of a Fund are to be made, the time or times of such distributions and the record date or dates for the purposes of determining Unitholders entitled to receive distributions. …

(Joint Document Brief, Volume 7, Tab 164, page 19)

The Amendment to the Management Agreement

[69] The Management Agreement was amended as a consequence of the Ruling obtained in 1995 to include the following provision:

> 11. The Manager may from time to time reduce the management fee otherwise payable to the Manager hereunder by an amount equal to the aggregate of the amounts agreed to with certain unitholders on the condition that the Fund distribute to each particular unitholder that portion of the amount of such reduction agreed to with such unitholder. (Emphasis added)
>
> (Example provided of the Americas RRSP Fund, Joint Document Brief, Volume 1, Tab 19, page 000675)

[70] The Respondent's argument was that the phrase "on the condition that" is the source of the legal obligation for the Funds to pay the Management Fee Distributions to the Large Investors. The Respondent contended that, pursuant to this agreement, the Funds are assuming the Appellant's legal obligation to pay the reduced amounts to the Large Investors as consideration for the management services. The value of that consideration, Respondent Counsel argued, is equal to the Appellant's obligation to the Large Investors. In support of this position, the Respondent relied on the reasons in *Roberge Transport Inc. v The Queen*, 2010 TCC 155, [2010] TCJ No. 100, where it was held that an agreement to incur an expense is the consideration or part of the consideration for the purposes of the *ITA*.

[71] The Appellant argued that *Roberge* has no application to the issues before me because the Appellant was under no contractual obligation to pay any amounts to the Large Investors. The Funds were not reimbursing an expense or incurring an expense on the Appellant's behalf and this is evident in the documentation. Appellant Counsel also argued that the Manager was permitted to reduce the management fees that it charged the Funds as a result of the 1995 amendments that were implemented. As a result of this point of sale reduction to the management fees, the Funds had the benefit of, and earned income on, the remaining portion for the period between the payment of the cash fees and the quarterly management distributions. This enabled the Funds to make distributions to all of the trust beneficiaries in the Funds. Finally, the Appellant noted that the guarantee cannot be equated to a direction or diversion of the management fees payable from the Appellant to the Large Investors because its presence in the documents is to ensure compliance with the terms of the advance tax Ruling and to ensure that the retail investor beneficiaries, as unitholders within the Funds, could not challenge those special Management Fee Distributions.

[72] With respect to the Management Agreement, I conclude that there is sufficient evidence to infer that the objective intent of the parties was to avoid the application of subsection 12(2.1) by eliminating any payment of an inducement,

directly or indirectly, between the Appellant and the Large Investors, while at the same time avoiding the application of subsection 104(7.1) which could attract double taxation. The numerous documents that are before me must be interpreted from the perspective of this goal that the parties were attempting to achieve, amid concerns as well that had been communicated to them from the OSC. To prevent these rules from being triggered, it was the objective intention of the parties to ensure that the Management Fee Distributions would be separate from the fees that the Appellant charged the Funds for its management services. Consequently, to achieve these goals, there could be no payment from the Appellant to the Large Investors. In doing so, the transactions adhered to the terms of the advance tax Ruling. From this, one should not conclude that the income tax treatment of the payments will have any direct bearing on my conclusions respecting the GST consequences in respect to these payments. However, the Ruling and the ATR-65 (which described the income tax rulings that CRA had provided to others in the industry) form part of the factual matrix which must be reviewed in the contractual interpretation of the documents before me. They are instructive of the commercial environment in which the parties were operating at the time and of their objective intent, as revealed through their efforts to achieve a particular income tax result. The Ruling and the ATR-65 described transactions in which the income tax consequences would be consistent with a Manager charging the Funds reduced fees provided the Funds used the savings to pay special distributions to certain investors.

[73] The Appellant's primary concern in requesting the income tax Ruling was to structure transactions so that subsection 104(7.1) would not be engaged where entitlements from the Funds could be different as between the Large Investors and the general retail investors. The new arrangements that were implemented, subsequent to the Ruling, were meant to address the potential application of subsection 12(2.1) of the *ITA* and the resulting double-taxation scenario concerning both the Funds and the investors.

[74] The evidence adduced by the Appellant established that the Appellant did, in fact, reduce its rate in respect to the management services it was providing to the Funds and that this reduction occurred at the point of sale. The fee charged by the Appellant to the Funds and, in turn, the amount that the Funds were obligated to pay the Appellant for the management services was equal to the reduced or net fee and, therefore, GST would be applicable on this amount.

[75] The Appellant's proposed interpretation of the documentary evidence accords with the approach in *Sattva*. The Respondent's propositions simply do not.

Sattva instructs us to interpret the documents generally, as well as the contentious provisions within them, from a global perspective. That includes moving beyond the words and phrases themselves to a review of the contracts as a whole. At the same time, I must give the words used within the documents their ordinary and grammatical meaning but consistent with and against the backdrop of the surrounding circumstances applicable to the facts and the knowledge that the parties had, or ought to have had, during the period when the contracts were being formulated.

[76] The objective intent of the parties is connected to market events that were occurring prior to 1995 and the requirement to ensure that the Large Investors benefited from the negotiated lower rate that the Appellant had the discretion to offer. As a result, and in accordance with the transactions described in the income tax Ruling as well as the ATR-65, the Offering Documents, including the Declaration of Trust, the Prospectus and the AIF, were amended specifically to ensure that the Large Investors would receive the special Management Fee Distributions as trust distributions from the Funds and that those distributions would not be challenged.

[77] According to the reasons in *Sattva*, the factual matrix includes objective evidence of background facts that were known to, or within the knowledge of, both parties when the contract was formed. Of course, this does not extend to a consideration of the subjective intent of the parties, which is viewed as inadmissible. The parties in the present case intended to implement transactions described in the ATR-65 and the Ruling so that any prospect of double taxation could be avoided, as it would have applied to the pre-1995 arrangements under which the parties originally operated. Although a subjectively held belief, on its own, that certain actions should be taken in order to avoid the possibility of double taxation, will never influence a court on the tax treatment that ought to result, actual content, expressed in the wording of the relevant documents, can be assessed in order to assist in ascertaining the objective intent of the parties at the time of formation of the agreement, in light of all of the existing surrounding circumstances.

[78] At the end of the day, the totality of the surrounding circumstances will be relevant where they are used by a court to assist in the interpretation of the contract viewed as a whole while giving the words contained therein their ordinary and grammatical meaning consistent with the surrounding circumstances as presented in the evidence. Since the court’s findings will often be fact specific, it is essential that the court have knowledge of the relevant circumstances as they existed in the

commercial market and, generally, the external factors that came to bear on the parties taking specific actions – all of which merely assist the court in drawing the proper conclusions respecting the objective intent of the parties, as they chose to express them, in the body of a contract.

[79] I consider that the Ruling and the ATR-65 may be considered in these appeals as they are a necessary piece of the overall puzzle as to why the parties embarked on a course of action and why amendments were implemented in 1995. Although *Sattva* does not provide guidelines as to how subjective intent is to be distinguished from objective intent and although the line between what is subjective intention and what is not is not a particularly well-delineated line, applying a generous dose of common sense to the facts before me, I conclude that I must consider them in looking at the contracts as they are framed within the factual matrix. In doing so, I am cognizant that neither the Ruling nor the ATR-65 may be incorrectly used to create a new contract between the parties. My consideration of these two documents is confined to assigning them their respective roles within the surrounding circumstances in order that they may assist me in reaching the proper interpretation of the contracts before this Court.

[80] When I look at the 'big picture' here, that is, the evidence of David Warren and all of the documents before me in light of the surrounding circumstances at the time, including: the commercial realities in which the parties contracted, the business challenges concerning the application of various provisions of the *ITA* that could have produced unwanted and inequitable tax treatment, the duties owed to the investors and the necessity of dealing with the concerns of the OSC, the correct conclusions, from both a legal and commercial perspective, are that:

(a) the Appellant's management fees were discounted at the point of sale;

(b) the net management fee is, in fact, only that reduced amount;

(c) the Large Investors received the special distributions from the Funds as unitholders in the trusts; and

(d) the Appellant/Manager had no obligation, legal or otherwise, to pay distributions to the Large Investors.

The Assumptions of Fact Contained in the Reply to the Notice of Appeal

[81] Although the Respondent's argument, that the guarantee or condition for the Funds to pay the Large Investors was a form of consideration, may have had some merit if framed differently in the pleadings, the Respondent did not adduce any evidence respecting the value of this liability. It was evident that the value of this liability may not necessarily be equal to the amount of the Management Fee Distributions. The Respondent, therefore, cannot place reliance on the reasoning in *Roberge*, given the absence of any legal obligation for the Appellant to pay any amounts to the Large Investors, in order to argue that the value of the guarantee is equivalent to the exact amount of the Management Fee Distributions.

[82] The *ITA* provides that the value of non-monetary consideration will be its fair market value. Ordinarily, the Appellant would bear the onus to rebut an assumption respecting fair market value of the guarantee or condition respecting the special distributions. However, in these appeals, the Reply contains no assumptions whatsoever respecting the Minister's position on this theory. At assumptions (v) and (w), the Minister assumed that the Appellant charged the Funds "the full amount" of the management fees, without reduction or benefit or rebate. (Assumption (v) also referenced mutual fund corporations – an indication the Minister has failed to distinguish the basic differences between the legal arrangements applicable to mutual fund corporations and trusts.)

[83] The Minister also assumed that it was the Appellant that paid the special distributions to the Large Investors (assumptions (r) and (s)). The Appellant has demolished these assumptions as there is no basis at all in the evidence before me that could give any credence to these assumed facts.

[84] Paragraph 9 of the Reply to the Notice of Appeal, although not an assumption of fact, states the Minister's assessing position as follows:

> 9. The Minister determined that the appellant was required to collect GST from the mutual fund trusts (the "fund trusts") calculated on the total management fees payable by the fund trusts to the appellant. The distribution of fund units or other amounts to certain investors (which the appellant has termed "Management Fee Rebates" or "Management Fee Distributions") did not reduce the management fees payable by the fund trusts to the appellant. In computing net tax for the reporting periods under appeal, the appellant was required to include the full amount of GST collectible from the fund trusts.

This is consistent with the other referenced assumptions that the guarantee or obligation for the Funds to pay the Management Fee Distributions to the Large Investors had no value. It is not surprising, then, that there was no assumption pleaded that addresses the value of the obligation assumed by the Funds. Assumptions must be clearly worded and precise so that an appellant can know the case it will have to meet. Where none of the over two dozen assumptions address this matter even indirectly, the onus is with the Respondent to bring forward evidence of the value of the guarantee or obligation. The Respondent's position, based on *Roberge*, is that the value of the guarantee is the full amount of the Management Fee Distributions paid to the Large Investors based on the purported existence of a legal obligation on the Appellant's part to pay special distributions to the Large Investors. That purported legal obligation never existed between those parties. Consequently, the Respondent has failed to establish the value of the guarantee.

Conclusion

[85] Management Fee Distributions paid by the Funds to the Large Investors were not consideration for the Appellant's supply of management services to the Funds. They were a separate payment made pursuant to the trust declarations governing the relationship between the Funds and the Large Investors. The Appellant, as Manager of the Funds, negotiated a reduced fee with the Large Investors and the Funds paid the money to the Appellant weekly and at the end of each month. That reduced fee was the amount that was charged by the Manager to the Funds and it is the only transaction which is subject to GST. The "cash fees" were the only consideration for the supply of management services that the Appellant was providing to the Funds. No other consideration was paid or payable. The proper interpretation of the legal documents relating to the relevant transactions, when taking into consideration the surrounding circumstances that existed when the contracts were formed, together with the conduct of the parties, is that the Appellant has properly charged, collected and remitted applicable GST based on the correct value of the consideration, which was the reduced amount of management fees charged to the Funds. This is consistent with my interpretation of the Management Agreement between the Funds and the Appellant as well as the Offering Documents.

[86] The appeals are allowed, with costs to the Appellant.

Signed at Ottawa, Canada, this 23rd day of December 2014.

"Diane Campbell"

Campbell J.

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