Federal Court of Appeal  Cour d'appel fédérale

Date: 20180404

Docket: A-121-17

Citation: 2018 FCA 67

CORAM: **NADON J.A.**
BOIVIN J.A.
GLEASON J.A.

BETWEEN:

AERONAUTIC DEVELOPMENT CORPORATION

Appellant

and

HER MAJESTY THE QUEEN

Respondent

Heard at Montréal, Quebec, on December 4, 2017.

Judgment delivered at Ottawa, Ontario, on April 4, 2018.

REASONS FOR JUDGMENT BY: GLEASON J.A.

CONCURRED IN BY: NADON J.A.
BOIVIN J.A.

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REASONS FOR JUDGMENT

GLEASON J.A.

[1] This appeal concerns the way in which *de facto* control is to be assessed for purposes of subsection 256(5.1) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) (the ITA) and the scope of the Tax Court of Canada's ability to consider legal issues that were not pled with full specificity by the Minister of National Revenue in the Reply filed with the Tax Court.

[2] These issues arise in the context of an appeal by Aeronautic Development Corporation (ADC) from the judgment of the Tax Court of Canada (per Hogan, J.) in *Aeronautic Development Corporation v. The Queen*, 2017 TCC 39, [2017] 4 C.T.C. 2140 in which the Tax Court dismissed ADC's appeal with respect to its 2009, 2010 and 2011 income tax assessments.

[3] ADC had claimed refundable scientific research and experimental development investment tax credits at the rate of 35% in respect of expenditures it incurred in each of these taxation years. Its entitlement to the credits turned on whether it was a "Canadian-controlled private corporation" (CCPC), as defined in subsection 125(7) of the ITA, during the years in question. The Minister of National Revenue determined that ADC was not a CCPC during these years and therefore assessed ADC on the basis that it was not entitled to the refundable investment tax credits. The Tax Court agreed that ADC was not a CCPC and accordingly dismissed ADC's appeal of the assessments.

[4] While I do not agree with the Tax Court's reasoning in some respects, as is more fully discussed below, I believe that it did not make a reviewable error in determining that ADC was not a CCPC. I would therefore dismiss this appeal, with costs.

I. Background

[5] It is necessary to briefly review the factual background to ADC's appeal to put these issues into context.

[6] The principal behind ADC is Mr. Richard Silva, an American citizen and, at all material times, an American resident. Mr. Silva is an engineer and architect, with considerable experience in aeronautics. Some years ago, he invested in a Canadian company that hoped to develop and market a small aircraft, called the Seawind. That company declared bankruptcy, and Mr. Silva acquired the intellectual property rights to the Seawind. He wished to further develop the aircraft and to have it certified by the applicable regulatory authorities. He says that he was approached by Investissement Quebec and Industry Canada to carry out the certification work and the subsequent production of the Seawind in Quebec and that he was advised by both agencies that he would be eligible for the refundable investment tax credits if the development work were carried out in Canada by a CCPC.

[7] Mr. Silva sought the advice of a major accounting firm to create a corporate structure that would qualify for the refundable investment tax credits. A Canadian corporation was set up, called Flight Dynamics Corporation (FDC), in which Mr. Silva was a minority shareholder. FDC commenced the development work associated with the Seawind, but it also ran into financial difficulties and declared bankruptcy. In 2009, Mr. Silva acquired FDC's assets to continue the development work related to obtaining certification for the Seawind.

[8] In order to carry out this work, Mr. Silva caused ADC to be incorporated as a Nova Scotia corporation in April of 2009. Seawind Corp., a U.S. corporation controlled by Mr. Silva, was initially the sole shareholder of ADC.

[9] Shortly following its incorporation, and when it was still wholly owned by Seawind Corp., ADC entered into a development agreement with Seawind Corp. to complete the prototyping and certification of the Seawind on a cost-plus basis. Mr. Silva set the terms of the development agreement. It provided in relevant part as follows:

- all intellectual property rights associated with the work to be carried out by ADC were to be the property of Mr. Silva and Seawind Corp.;
- all of ADC's prototyping and certification expenses (net of the refundable investment tax credits received by it) would be reimbursed by Seawind Corp.;
- ADC would remit the refundable investment tax credits it received to Seawind Corp.;
- the material, equipment and tools acquired by ADC and funded by Seawind Corp. were to be transferred to Seawind Corp. on completion of the certification work; and
- ADC was to be paid a mark-up of 5% over its expenses, to be used to finance its certification expenses. (However, at Mr. Silva's direction, these amounts were never paid).

[10] The development agreement was for an initial term of 15 months. ADC did not seek to renegotiate the development agreement and the parties continued to operate in conformity with the majority of its provisions.

[11] Approximately four months after the development agreement was signed, ADC issued additional common shares to one of its employees and to Canadian corporations controlled by

three of its employees. This resulted in Seawind Corp. owning only 46% of the issued common shares to which voting rights attached.

[12] ADC operated out of a hangar at the airport in St-Jean-sur-Richelieu, Quebec, leased by another corporation controlled by Mr. Silva. That corporation was slated to manufacture the Seawind after it was certified. ADC did not sign a lease for use of these premises and paid no rent for them. Between 2009 and 2011, ADC's sole client was Seawind Corp. Over this period, Mr. Silva travelled regularly to the hangar and oversaw the work carried out by ADC.

[13] Several newsletters that were written by Mr. Silva and that were filed with the Tax Court, on consent, gave the impression that the activities associated with the development of the Seawind (including those of ADC) were carried out by Mr. Silva's integrated wholly-owned organization.

[14] ADC had nominal share capital and recorded the full amount of the refundable investment tax credits on its balance sheets in the relevant taxation years, but failed to show the offsetting liability to Seawind Corp. The amount of the claimed credits exceeded ADC's retained earnings. Its operations were therefore generating deficits. In addition, notes to some of its financial statements highlighted that ADC was economically dependent on Seawind Corp. Indeed, when the latter company ceased providing financing, ADC ceased operations.

[15] In the Reply filed with the Tax Court, the Minister set out the assumptions of fact the Minister relied on as well as the legal bases asserted in support of the assessments. The majority

of the above-noted facts were set out in the Reply. As for the legal arguments, the Reply merely listed the relevant provisions in the ITA and provided a brief summary of the Minister's position. More specifically, the Reply noted that the Minister asserted that Mr. Silva and Seawind Corp. had direct or indirect influence that, if exercised, would result in control in fact of ADC in such a fashion that it was controlled directly or indirectly by them and, thus, that ADC was not a CCPC, within the meaning of the relevant provisions in the ITA. However, the Minister did not specifically outline the position that ADC was not dealing at arm's length with Mr. Silva and Seawind Corp.

[16] Despite this, counsel for ADC made oral submissions before the Tax Court on the issue of whether ADC was dealing at arm's length with Mr. Silva and Seawind Corp. These submissions were largely made in response to questions from the Tax Court judge. Counsel for ADC conceded during the argument before us that he was aware of the need to address this issue before the Tax Court due to the requirements of the relevant provisions in the ITA, which, in the circumstances of this case, link the definition of control to the presence of an arm's length relationship.

II. The Relevant Statutory Provisions

[17] It is useful to next set out the ITA provisions that are relevant to this appeal.

[18] Subsection 248(1) of the ITA provides that a CCPC has the meaning ascribed in subsection 125(7) of the ITA. Paragraph (*a*) of the CCPC definition in subsection 125(7) of the ITA defines a CCPC, in relevant part, as meaning, a private corporation other than "a

corporation controlled, directly or indirectly in any manner whatever, by one or more non-resident persons […]".

[19] The parties concur that, prior to August 2009, ADC was under the *de jure* control of Seawind Corp., due to the latter corporation's ownership of all of ADC's then issued and outstanding shares. It is also common ground that, since Seawind Corp. was not a Canadian corporation, ADC was not a CCPC prior to August 2009.

[20] The notion of d*e facto* control is provided for in subsection 256(5.1) of the ITA. At all times relevant to this appeal, that subsection provided:

256 (5.1) For the purposes of the Act, where the expression "controlled directly or indirectly in any manner whatever," is used, a corporation shall be considered to be so controlled by another corporation, person or group of persons (in this subsection referred to as the "controller") at any time where, at that time, the controller has any direct or indirect influence that, if exercised, would result in control in fact of the corporation, except that, where the corporation and the controller are dealing with each other at arm's length and the influence is derived from a franchise, licence, lease, distribution, supply or management agreement or other similar agreement or arrangement, the main purpose of which is to govern the relationship between the corporation and the controller regarding the manner in which a business carried on by the corporation is to be conducted, the corporation	256 (5.1) Pour l'application de la présente loi, lorsque l'expression « contrôlée, directement ou indirectement, de quelque manière que ce soit, » est utilisée, une société est considérée comme ainsi contrôlée par une autre société, une personne ou un groupe de personnes — appelé « entité dominante » au présent paragraphe — à un moment donné si, à ce moment, l'entité dominante a une influence directe ou indirecte dont l'exercice entraînerait le contrôle de fait de la société. Toutefois, si cette influence découle d'un contrat de concession, d'une licence, d'un bail, d'un contrat de commercialisation, d'approvisionnement ou de gestion ou d'une convention semblable — la société et l'entité dominante n'ayant entre elles aucun lien de dépendance — dont l'objet principal consiste à déterminer les liens qui unissent la société et l'entité dominante en ce qui concerne la façon de mener une

shall not be considered to be controlled, directly or indirectly in any manner whatever, by the controller by reason only of that agreement or arrangement.	entreprise exploitée par la société, celle-ci n'est pas considérée comme contrôlée, directement ou indirectement, de quelque manière que ce soit, par l'entité dominante du seul fait qu'une telle convention existe.

[21] This provision may be summarized as follows:

1. A corporation is considered to be controlled in fact by another person (the controller) if, at the time control is asserted to have existed, the controller has any direct or indirect influence that, if exercised, would result in control in fact of the corporation;

2. Unless the corporation and the controller are dealing at arm's length; and

3. Also unless such influence is derived from a franchise, licence, lease, distribution, supply or management agreement or other similar agreement or arrangement, the main purpose of which is to govern the relationship between the corporation and the controller regarding the manner in which a business carried on by the corporation is to be conducted.

[22] As is more fully discussed below, in the recent decision in *McGillivray Restaurant Ltd. v. Canada*, 2016 FCA 99, 483 N.R. 23 (*McGillivray*), this Court interpreted what is meant by "any direct or indirect influence that, if exercised, would result in control in fact of the corporation" in a restrictive fashion as requiring there be a legal – as opposed to a merely factual – basis for the requisite influence. In response to this decision, Parliament enacted subsection 256(5.11) of the ITA, for taxation years that begin after March 21, 2017. The new subsection provides:

256 (5.11) For the purposes of the	256 (5.11) Pour l'application de la

Act, the determination of whether a taxpayer has, in respect of a corporation, any direct or indirect influence that, if exercised, would result in control in fact of the corporation, shall	présente loi, lorsqu'il s'agit de déterminer si un contribuable a, relativement à une société, une influence directe ou indirecte dont l'exercice entraînerait le contrôle de fait de la société :
(*a*) take into consideration all factors that are relevant in the circumstances; and	*a*) il est tenu compte de la totalité des critères qui sont applicables dans les circonstances;
(*b*) not be limited to, and the relevant factors need not include, whether the taxpayer has a legally enforceable right or ability to effect a change in the board of directors of the corporation, or its powers, or to exercise influence over the shareholder or shareholders who have that right or ability.	*b*) il n'est pas tenu compte uniquement de la question — qui n'a pas à être l'un des critères applicables à la détermination — de savoir si le contribuable a un droit ayant force exécutoire, ou la capacité, de faire modifier le conseil d'administration de la société ou les pouvoirs de celui-ci ou d'exercer une influence sur l'actionnaire ou les actionnaires qui ont ce droit ou cette capacité.

[23] Finally, subsection 251(1) of the ITA sets out the circumstances where parties are deemed not to deal with each other at arm's length. The portion of the provision that is relevant to this appeal is paragraph 251(1)(*c*), which provides that "it is a question of fact whether persons not related to each other are, at a particular time, dealing with each other at arm's length".

III. The Decision of this Court in *McGillivray*

[24] A proper understanding of what was decided in *McGillivray* is central to the disposition of this appeal and to an understanding of the Tax Court's reasons. It is therefore necessary to review the holding in *McGillivray* in some detail.

[25] In *McGillivray*, Ryer, J.A. wrote for this Court and commenced his analysis of subsection 256(5.1) of the ITA by noting that, prior to the introduction of this provision, the notion of control, for purposes of assessing who controlled a corporation for income tax purposes, "was thought of as *de jure* control" (at para. 30). He then went on to state that such *de jure* control was defined by the Supreme Court of Canada in *Duha Printers (Western) Ltd. v. Canada*, [1998] 1 S.C.R. 795, 159 D.L.R. (4th) 457 as "the ability of the owners of the majority of the voting power in the corporation that would enable [them] to elect directors of the corporation and accordingly to enjoy effective control of the corporation" (at para. 31).

[26] The Court next moved to consider the attributes of *de facto* control, for purposes of subsection 256(5.1) of the ITA, and noted that "there are a broader range of attributes – beyond voting power determined in the context of constating documents and share registers – that must be considered to determine whether the requirements of subsection 256(5.1) have been met" (at para. 33). The Court then posed the question as to whether the requisite influence to meet the definition of *de facto* control in 256(5.1) of the ITA must arise out of a legally binding arrangement or if it is sufficient that it arises from other kinds of influences, such as operational control.

[27] The Court opted for the former and held that subsection 256(5.1) of the ITA requires there be legally binding arrangement(s) as the source of the *de facto* control. Ryer, J.A. wrote in this regard at paragraphs 48 and 50:

> […] in my view, a factor that does not include a legally enforceable right and ability to effect a change to the board of directors or its powers, or to exercise

> influence over the shareholder or shareholders who have that right and ability, ought not to be considered as having the potential to establish *de facto* control.
>
> […]
>
> An interpretation of subsection 256(5.1) that encompasses "operational" control would import a degree of subjectivity into the *de facto* analysis that, in my view, would lead to unpredictability, rather than predictability, as mandated by the *Canada Trustco* interpretative approach.

IV. The Reasons of the Tax Court

[28] With this background in mind, it is now possible to review the reasons given by the Tax Court in the present case.

[29] After setting out the relevant facts and statutory provisions, the Tax Court quoted from *McGillivray* and held that the requisite influence to establish *de facto* control, within the meaning of subsection 256(5.1) of the ITA, could arise from commercial agreements and arrangements (or otherwise the exception in subsection 256(5.1) would make no sense). The Court then went on to state in paragraph 46:

> For the courts to conclude that the controller has control in fact, I believe that the evidence must show that the controller has the ability to affect the economic interest of the voting shareholders in a manner that allows the controller to impose his or her will on them, should he or she decide to do so. The evidence must allow the Court to discern that it would be unlikely that the shareholders would exercise their voting rights independently of the controller's wishes.

[30] In so stating, the Tax Court set out what is essentially a test for operational control. It then proceeded to apply this test and found that Mr. Silva and Seawind Corp. exercised *de facto* control over ADC from August 2009 to December 31, 2011 in light of the facts, including that:

- ADC had nominal share capital;
- ADC was dependent on the cash flow provided by Seawind Corp. under the development agreement;
- the terms of the development agreement were dictated by Mr. Silva and were lop-sided in favour of Seawind Corp.;
- ADC operated at a deficit in the taxation years in question;
- when Seawind Corp. ceased providing financing, ADC suspended its operations;
- ADC did not own the intellectual property rights resulting from the development and certification work it carried on;
- if the Seawind aircraft were certified, it was to be manufactured by another company controlled by Mr. Silva;
- ADC was not able to obtain financing elsewhere and offered no potential for earnings growth to justify its employees' investment in it;
- ADC did not own the hangar where it operated and all intellectual property rights belonged to Seawind Corp. or Mr. Silva;

- some of ADC's financial statements highlighted that it was economically dependent on Seawind Corp.;

- ADC's employees who invested in ADC were dependent on its financial viability and, in light of the "virtual stranglehold" Mr. Silva and Seawind Corp. had over ADC, the other shareholders could have been influenced by Mr. Silva, if he had chosen to exert his influence; and

- Certain newsletters written by Mr. Silva gave the impression that the activities associated with the development of the Seawind (including those of ADC) were carried out by his integrated wholly owned organization (reasons, paras. 49-60).

[31] Based on all of the foregoing, the Tax Court concluded that Seawind Corp. and Mr. Silva had direct or indirect influence that, if exercised, would result in the control in fact of ADC in such a fashion that it was controlled directly or indirectly by them within the meaning of subsection 256(5.1) of the ITA.

[32] The Tax Court then moved to consider what it termed ADC's "last line of defence", namely, the argument that the only basis for *de facto* control that could be considered was the development agreement that ADC asserted fell within the exception set out in subsection 256(5.1) of the ITA. The Tax Court held that this exception did not apply for several reasons.

[33] First, it noted that when the development agreement was entered into, Seawind Corp. and ADC were related persons by virtue of subparagraph 251(2)(*b*)(ii) of the ITA, which states that related persons include a corporation and "a person who is a member of a related group that controls the corporation". Accordingly, ADC and Seawind Corp. were deemed not to be dealing at arm's length by virtue of paragraph 251(1)(*a*) of the ITA, which deems related persons to not deal with each other at arm's length.

[34] Second, the Tax Court found that the facts pointed to non-arm's length dealings between ADC, Seawind Corp. and Mr. Silva. The Tax Court highlighted in this regard:

- the role exerted by Mr. Silva in setting the terms of the development agreement;

- the fact that ADC did not seek to renegotiate it after the expiry of the initial term, even though it was operating at a deficit;

- Mr. Silva's unilateral decision to not pay the 5% mark-up to ADC that the development agreement called for; and

- the fact that ADC operated out of a hangar leased by another corporation owned by Mr. Silva, but signed no lease and paid no rent for the space.

[35] The Tax Court went on to state as follows:

> 68. […] I suspect Mr. Silva did not require the Appellant to enter into a formal lease because the Appellant was economically dependent on Seawind Corp., a corporation wholly owned by Mr. Silva. Seawind Corp. would have had to fund

> the lease payments under the terms and conditions of the Development Agreement. This would have been tantamount to Mr. Silva paying rent to himself.
>
> 69. The absence of a lease, however, suggests that the parties envisaged that the Appellant would not operate independently of Seawind Corp. and Mr. Silva. If the Appellant had expected to do so, I believe it would have insisted on a lease to avoid being evicted from its place of business when it secured other business. I suspect that Mr. Silva would also have insisted on a lease based on normal commercial terms. Otherwise, the Canadian Resident Shareholders would have benefited from the rent free arrangement if the Appellant secured new clients. The absence of a lease suggests that the parties were not dealing at arm's length.

[36] The Tax Court thus concluded that ADC was not a CCPC during the relevant taxation years and dismissed ADC's appeal.

V. Issues

[37] Before us, ADC makes several arguments.

[38] First, it submits that the Tax Court erred in failing to follow *McGillivray* and in effectively finding operational control to be sufficient for a finding of *de facto* control under subsection 256(5.1) of the ITA.

[39] Second, ADC says that the sole basis upon which the Tax Court could have grounded a finding of *de facto* control was the development agreement, as this is the only legal – as opposed to factual – underpinning for a finding of the requisite influence sufficient to meet the requirements of subsection 256(5.1) of the ITA.

[40] Third, ADC says that the development agreement is a supply agreement, as it claims the Minister conceded through the auditor's testimony. ADC thus says that the development agreement meets the first part of the exception set out in subsection 256(5.1) of the ITA.

[41] Fourth, ADC asserts that the Tax Court erred in finding that the second requirement for the exception set out in subsection 256(5.1) of the ITA – namely arm's length dealing – was absent. ADC advances several reasons in support of its assertion that the Tax Court erred in finding there to have been non-arm's length dealings between ADC, Seawind Corp. and Mr. Silva.

[42] First, it says that it was not open to the Tax Court to consider this issue at all as it had not been pleaded by the Minister.

[43] Second, ADC asserts that the Tax Court erred in considering whether ADC and Seawind Corp. were related corporations when the development agreement was signed as this occurred prior to the relevant time. ADC more specifically asserts that subsection 256(5.1) of the ITA requires that the facts on which *de facto* control is asserted must exist at the point in time when such control is alleged to exist, which was after August of 2009 in this case. It thus says the status of ADC and Seawind Corp. several months before that date is irrelevant.

[44] Third, ADC submits that the Tax Court erred in finding Mr. Silva's role in defining the terms of the development agreement to be relevant to the issue of whether there were non-arm's length dealings. It argues that this finding "would mean that anytime a consumer enters into a

contract the terms of which are pre-determined by a party, they would automatically not be dealing at arm's length for tax purposes [which] would be legally incorrect and […] illusory" (ADC's Memorandum of Fact and Law at para. 69).

[45] Finally, ADC says that the reasons offered by the Tax Court in paragraphs 68 and 69, quoted above, are purely speculative and thus cannot provide a basis for the Tax Court's conclusion.

VI. Analysis

[46] In assessing these arguments, it is first necessary to ascertain whether the asserted errors are errors of law, fact or mixed fact and law as the standard of review this Court is to apply is that set out in *Housen v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235 (*Housen)*. This standard provides that errors of law are reviewed for correctness whereas errors of fact or of mixed fact and law from which a legal issue cannot be extricated are reviewed under the more exacting standard of palpable and overriding error: *Housen,* at paras. 8, 27-28; *Truong v. Canada,* 2018 FCA 6 at para. 9.

[47] Only two of the various arguments raised by ADC involve issues of law. More specifically, the assertion that the Tax Court improperly interpreted *McGillivray* and found there to be *de facto* control based on operational control raises an issue of law. Likewise, ADC's argument regarding the temporal limitations contained in subsection 256(5.1) of the ITA also raises an issue of law. All of ADC's remaining arguments that it is necessary to consider involve either issues of fact or of mixed fact and law from which a legal issue cannot be extricated.

[48] Turning, first, to the legal errors alleged, I agree with ADC that the Tax Court erred in its interpretation of subsection 256(5.1) of the ITA in the two ways ADC asserts.

[49] As already noted, in *McGillivray*, which is the most recent authority on the point, this Court determined that operational control is insufficient to constitute *de facto* control under subsection 256(5.1) of the ITA and held that, instead, there must be some legally-enforceable arrangement or arrangements that give rise to such control. The development agreement undoubtedly does constitute such an arrangement.

[50] However, in the instant case, the Tax Court went well beyond relying on the terms of the development agreement in considering what circumstances gave rise to *de facto* control and instead considered such issues as ADC's financial position, the other shareholders' dependence on the viability of ADC and representations made by Mr. Silva in newsletters regarding the integration of ADC with his other companies. While these other factors are indicative of operational control, they are not the result of a legally-enforceable arrangement. I thus conclude that the Tax Court erred in premising its *de facto* control decision in part on factors that *McGillivray* determined to be irrelevant under subsection 256(5.1) of the ITA.

[51] I also agree with ADC that the Tax Court erred in looking to the fact that ADC and Seawind Corp. were related before August 2009 to be a relevant factor in assessing whether they were operating at arm's length after that date within the meaning of subsection 256(5.1) of the ITA. That provision makes it clear that the time for assessing whether there is an arm's length

relationship for the purposes of the subsection is during the period of time *de facto* control is alleged to exist. The relevant portion of subsection 256(5.1) states in this regard that:

[…] a corporation shall be considered to be so controlled by another corporation, person or group of persons (in this subsection referred to as the "controller") at **any time where**, **at that time,** the controller has any direct or indirect influence that, if exercised, would result in control in fact of the corporation, except that, where the corporation and the controller **are** dealing with each other at arm's length […]. [emphasis added]	[…] une société est considérée comme ainsi contrôlée par une autre société, une personne ou un groupe de personnes — appelé « entité dominante » au présent paragraphe — **à un moment donné si**, **à ce moment**, l'entité dominante **a** une influence directe ou indirecte dont l'exercice entraînerait le contrôle de fait de la société. Toutefois, si cette influence **découle** d'un contrat de concession […] la société et l'entité dominante **n'ayant** entre elles aucun lien de dépendance […]. [mon emphase]

The Tax Court therefore erred in considering the fact that the two companies were related and not dealing with each other at arm's length before the relevant period during which *de facto* control was alleged to have existed.

[52] Despite these two errors, I see no basis for interfering with the Tax Court's decision as these two errors are immaterial to the result reached. As noted, and as indeed conceded by ADC, the development agreement constitutes a legally-enforceable arrangement capable of establishing *de facto* control under subsection 256(5.1) of the ITA in the circumstances of this case. I also agree with ADC that the development agreement is a supply agreement within the meaning of subsection 256(5.1).

[53] Thus, the issue becomes whether the exception set out in the subsection pertains. Contrary to what is asserted by ADC, I believe that it was open to the Tax Court to consider

whether ADC was operating at arm's length from Seawind Corp. and Mr. Silva at the relevant time. Indeed, ADC's reliance on the exception in subsection 256(5.1) of the ITA put the arm's length issue into play.

[54] ADC was not taken by surprise by the arm's length issue and its counsel anticipated that it would need to address it. Further, counsel for ADC at no time asserted that the issue was beyond those it was appropriate for the Tax Court to consider in light of the nature of the Minister's Reply and instead made submissions on the arm's length issue in response to questions posed by the Tax Court. Thus, even if there had been grounds to object to this issue's being raised by the Tax Court, they were waived by counsel when he made submissions on the point.

[55] The rules governing the nature of pleadings required by the Minister in his or her Reply in income tax cases are premised on the need for fairness to ensure that a taxpayer is not unfairly taken by surprize. This has been highlighted by this Court in those cases where it found the raising of new issues by a Tax Court judge to be improper. For example, this Court has found it is a breach of procedural fairness for a Tax Court judge, in upholding an assessment of the Minister, to rely on provisions of the *Act* that had not been pleaded by the Crown and that did not form part of the theory of the case: see, for example, *Heron Bay Investments Ltd. v. Canada*, 2010 FCA 203 at para.39, 405 N.R. 73; *Pedwell v. Canada*, [2000] 4 .F.C. 616 at paras. 16-17, 257 N.R. 148.

[56] Similar concerns simply do not arise in the present case as ADC was very much alive to the need to address the arm's length issue, which formed part of its defence to the Crown's claim of *de facto* control. It also made submissions on the issue, without objection. Thus, contrary to what ADC asserts, it was open to the Tax Court to consider the issue of whether ADC, Mr. Silva and Seawind Corp. were dealing with each other at arm's length.

[57] I then turn to the final issue, namely, whether the Tax Court made a reviewable error in concluding that ADC, Mr. Silva and Seawind Corp. were not dealing with each other at arm's length during the relevant period. In my view, the Tax Court did not so err as the various factors relied on by the Tax Court (other than the status of the two companies before August 2009) provided more than ample basis for concluding that there was not an arm's length relationship.

[58] Contrary to what ADC asserts, I do not think there is a hard and fast rule that one cannot have regard to the role of a putative controller in setting the terms of a supply agreement in assessing the non-arm's length nature of a relationship. Under paragraph 251(1)(*c*) of the ITA, the requisite inquiry is entirely factual, and the ability to set the terms of the supply agreement must accordingly be considered in context. In the context of the instant case and in light of ADC's near-total economic dependence on Seawind Corp., the fact that the owner of the latter company dictated (and was able to dictate) the terms of the relationship between the two companies is a very relevant factor in determining whether the three were dealing at arm's length. Even more telling was Mr. Silva's ability to make the two companies disregard the terms of the development agreement – as he decided to do when he unilaterally decided that the 5% mark-up would not be paid to ADC.

[59] As for the other facts relied on by the Tax Court, it would be difficult to imagine a stronger indicator of a non-arm's length relationship than the fact that a company is allowed to operate out of another's facility for free, without a lease. Contrary to what ADC asserts, the comments made by the Tax Court in paragraphs 68 and 69 of its reasons are not pure speculation but, rather, merely an elucidation of the implications of such a rent-free arrangement.

[60] Thus, while I do not agree with all of the Tax Court's reasoning, I believe that it did not err in concluding that ADC was not a CCPC during the relevant taxation years. Accordingly, there is no basis to interfere with its decision and I would therefore dismiss this appeal, with costs.

"Mary J.L. Gleason"
J.A.

"I agree.
M. Nadon J.A."

"I agree.
Richard Boivin J.A."

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

DOCKET:	A-121-17
STYLE OF CAUSE:	AERONAUTIC DEVELOPMENT CORPORATION v. HER MAJESTY THE QUEEN
PLACE OF HEARING:	MONTRÉAL, QUEBEC
DATE OF HEARING:	DECEMBER 4, 2017
REASONS FOR JUDGMENT BY:	GLEASON J.A.
CONCURRED IN BY:	NADON J.A. BOIVIN J.A.
DATED:	APRIL 4, 2018

APPEARANCES:

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Ian Demers	FOR THE RESPONDENT

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