Nor are we convinced that there is any policy basis that would support this view. There is no question that in the *Anchor Pointe* case, both the new basis and the original basis of reassessment deal with the same subject matter—the claim for the CEE allowance. But consider this situation. The minister reassesses disallowing certain business expenses. Upon the filing of a notice of objection, the minister agrees that these expenses are properly deductible. However, during the review, the minister decides that a capital gain unconnected to the business expenses reported by the taxpayer should have been assessed as income from an adventure in the nature of trade. Clearly this would be an entirely new and distinct basis of assessing and not simply a new argument to support the assessment. Could the minister continue to uphold the reassessment on this totally different basis? It appears that Judge Rip thinks he could.

We suspect that, notwithstanding subsection 152(9), this issue will be the subject of further debate. Judge Rip specifically declined to comment on the distinction between the word "argument" and the word "basis," and whether or not new subsection 152(9) trumps the Supreme Court's position articulated in the *Continental Bank* decision. That is left to another day—perhaps when the *Anchor Pointe* case proceeds to an actual hearing. In our view, the issue is important because it concerns the integrity of the limitation periods under the Act.

Richard Thomas

## "CAPITAL" CONFUSION: THE EVOLVING TAX CHARACTERIZATION OF MERGER COSTS

BJ Services Company Canada v. The Queen
(November 15, 2002), docket no. 2001-1753-GST-G

International Colin Energy Corporation v. The Queen
2002 DTC 2185

**KEYWORDS:** ACQUISITIONS AND MERGERS ■ TAKEOVER BIDS ■ COSTS ■ REORGANIZATION

As waves of consolidation have swept through business sectors as diverse as resource development and professional services, organizational structuring has become an ever-present concern for the officers and directors of public companies. During the first three quarters of 2002 alone, 741 public mergers and acquisitions were consummated in Canada, with a combined value of $74.5 billion.[34]

Traditionally, the costs incurred by companies that become the subject of a takeover bid or a merger, such as legal, accounting, and financial advisory fees and circular costs ("merger costs"), have been characterized by the CCRA either as expenditures that are outside the scope of the deductions afforded by section 9 and

34 R. Ferguson, "Bay St. Sharks Not Biting," *The Toronto Star*, December 26, 2002.

paragraph 18(1)(a)[35] or as capital expenditures under paragraph 18(1)(b) of the Act. Frequently, the CCRA has been prepared to treat these costs as "eligible capital expenditures," with the less than appealing prospect that such expenditures will be recognized over a relatively lengthy period.[36] Similarly, for the purposes of the goods and services tax (GST) levied under part IX of the Excise Tax Act,[37] the CCRA has asserted that GST registrants are not necessarily permitted to claim input tax credits (ITCs) for GST paid in respect of merger costs.

The CCRA, however, sustained a potentially significant setback in two recent decisions of the Tax Court of Canada, *BJ Services Company Canada v. The Queen* and *International Colin Energy Corporation v. The Queen* ("*ICEC*"). These cases address the treatment of merger costs from a GST and an income tax perspective respectively.

## BJ Services

The facts in *BJ Services* are relatively straightforward and are summarized below.

### The Nowsco Share Acquisition

Nowsco Well Service Ltd. ("Nowsco") was a publicly traded, Calgary-based corporation that carried on the business of providing well stimulation and pipeline services in the oil and gas industry. On April 1, 1996, Nowsco was approached (with apparently little, if any, solicitation on its part) by representatives of a competitor, BJ Services Company ("BJ"), in the hopes of negotiating a "friendly merger" ("the initial proposal").

In response to the initial proposal and consistent with generally accepted public market practices,[38] the directors of Nowsco convened an urgent meeting at which an independent "special committee," consisting of three independent board members, was formed to deal with the proposal. At the meeting, the board was also advised of its duties and obligations with respect to the initial proposal, including

- a general duty to act honestly, in good faith, and in the best interest of the corporation in deciding whether to support or oppose the initial proposal;
- a fiduciary obligation to obtain the highest price for the corporation's shares; and
- an obligation to engage in an "auction" of the corporation's shares and to retain financial advisers to counsel the board on the valuation of the company when attempting to obtain the highest possible price for the corporation's shares.

35 On the grounds that these costs are not deductible under ordinary principles of commercial trading or are not incurred in the course of earning income from a business, but rather are incurred primarily for the benefit of shareholders.

36 Generally, section 14 of the Act allows for 75 percent of all "eligible capital expenditures" to be placed in a pool, 7 percent of the value of which may be deducted in a particular year.

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

38 As described by expert testimony that was accepted by the court.

On the basis of this advice, Nowsco retained RBC Dominion Securities Inc. as its Canadian financial adviser. Nowsco also retained Simmons & Company International, a US investment bank specializing in the oil service and equipment business, as its special financial adviser. Finally, the special committee retained its own legal advisers.

By April 19, 1996, the Canadian financial adviser and the special committee had advised the Nowsco board that, in their respective opinions, the initial proposal was "inadequate" and merited rejection. In the months that followed, the directors of Nowsco commenced negotiations with other potential corporate suitors, which resulted in a competing offer to purchase the shares of Nowsco.

On June 3, 1996, however, BJ Services Canada Inc. ("BJ Canada," a wholly owned subsidiary of BJ) submitted a second offer, amending the initial proposal by increasing the value of the offer and eliminating many of the conditions that had previously troubled the Nowsco board ("the amended offer"). The Nowsco board, in consultation with its financial advisers and the special committee, recommended acceptance of the amended offer. Several weeks later, the takeover was completed.

## Advisory Fees and Related GST in Dispute

The financial advisers and the legal advisers received significant fees for their services. GST was paid on the fees paid to the Canadian financial adviser and the legal advisers, and Nowsco claimed ITCs for equal amounts. No GST was paid on the amounts paid to the US financial adviser, and Nowsco did not self-assess GST on these fees.

The minister of national revenue took the position that GST applied to all of the fees and issued an assessment seeking (1) to deny the ITCs claimed in respect of most of the fees paid to the Canadian financial adviser, as well as the fees paid to the legal advisers (collectively, "the fees"); (2) to collect unremitted GST on the fees paid to the US financial adviser ("the US fees"); and (3) to levy interest and penalties.

## Judicial Analysis and Commentary

The Tax Court found in favour of the taxpayer on all counts. In grappling with Nowsco's eligibility to claim ITCs in respect of the GST paid on the fees, Judge Miller reduced the issue to whether the fees were incurred by Nowsco in the course of its "commercial activities." Judge Miller also reasoned that to the extent that the fees were found to have been incurred in the course of Nowsco's "commercial activities," Nowsco would not be required to self-assess GST on the US fees because the services performed by the US financial adviser would not be "imported taxable supplies" and therefore would not be subject to GST.

Subsection 169(1) of the ETA provides that a GST registrant is entitled to claim an ITC in respect of GST paid on supplies acquired or imported for consumption, use, or supply in the course of its commercial activities. Subsection 123(1) of the ETA defines "commercial activity" as "a business carried on by the person . . . except to the extent to which the business involves the making of exempt supplies."

On the basis of these definitions and the fact that Nowsco did not make any material "exempt supplies" in the course of its business, Judge Miller postulated that the only basis for denying Nowsco's ITC claims and subjecting the US fees to GST would arise where such fees could reasonably be viewed as "having a non-business or personal element that would remove them from [the scope of Nowsco's] commercial activity for purposes of section 169."[39] In analyzing this question, Judge Miller identified several factors that had to be considered. First, he examined the purposes for which the services provided by the financial advisers and the legal advisers were acquired.[40] He concluded that while the primary purpose of acquiring the services was to "maximize shareholder value," this purpose was not "devoid of any relationship to the making of taxable supplies" by the taxpayer.[41] In support of the linkage that he perceived to exist between activities undertaken to maximize shareholder value and the commercial success of a public corporation, Judge Miller observed:

> A company that does not behave as commercially expected will lose that corporate marketplace confidence, and suffer the financial consequences. Those consequences will go directly to the company's ability to sustain a profitable business. Had Nowsco's directors not responded in a textbook fashion . . . what would the consequences have been to the ongoing commerciality of the goods and service business? Chaos perhaps, uncertainty definitely—each of which would have negatively impacted on the ability of Nowsco to make its taxable supplies.[42]

In addition, Judge Miller suggested that even if the primary purpose for acquiring the services was exclusively related to providing benefits to shareholders, a secondary purpose existed, namely, the desire to maintain the "on-going viability and economic health of the company to provide its oilfield service."[43] In conclusion, Judge Miller found that both the primary and the secondary purposes for obtaining the services were sufficiently linked to Nowsco's business of producing taxable supplies that the services fell within the realm of its "commercial activity" for the purposes of section 169 of the ETA.

As a second and third line of analysis, Judge Miller also considered who benefited from the services and the context in which the services were acquired. He determined that the first of these supplementary considerations was of no assistance to the minister, by distinguishing between shareholder benefits that are "completely

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39 (November 15, 2002), docket no. 2001-1753-GST-G (TCC), reasons for judgment, at paragraph 35.

40 Judge Miller did not accept that ITC eligibility turned on whether there was a direct linkage between the advisers' services and the taxable supplies made by Nowsco in the ordinary course of its operations.

41 Supra note 39, reasons for judgment, at paragraph 41.

42 Ibid.

43 Ibid., at paragraph 40.

unrelated to the fortunes of the company" and those that are linked in some fashion to the company's success, and holding that only the former benefits are potentially excluded from the realm of the company's "commercial activity."

In examining the "context" in which the services were acquired, Judge Miller referred to the statutory and common law obligations of the Nowsco board as support for the requisite commercial activity linkage. Although this finding is consistent with the general principles articulated in the judgment, the fact that the services were acquired to satisfy the fiduciary obligations of a corporate board imposed by statute and the common law should, in and of itself, be dispositive of the "commercial activity" determination. Surely, efforts to comply with corporate and commercial laws are an element of the registrant's "commercial activity," under even the narrowest conception of the term.[44] We also note that, from an analytical standpoint, the "context of a supply," as an independent form of inquiry, is somewhat artificial and that to separate the "context of a supply" from the purpose of the registrant's having acquired it or the parties benefiting from it arguably lacks any practical value.[45]

In response to the submissions of the minister, Judge Miller also attempted to draw analogies between the concept of a "commercial activity" in the GST context and the principles of ordinary commercial trading in the income tax context, with particular reference to the decision in *Boulangerie St-Augustin Inc. v. The Queen*.[46] Although this line of reasoning did not appear to materially influence the outcome of the case, it is worthy of note. *Boulangerie* involved the deduction, under section 9 of the Act, of circular preparation and legal costs incurred by a corporate taxpayer that was the subject of three unsolicited takeover bids. While the minister's reasons on this point are not entirely clear, the minister presumably raised *Boulangerie* in an attempt to draw a distinction between so-called friendly takeover bids, where a board of directors plays a relatively passive role in responding to the bid as required under applicable securities laws, and hostile situations, where a board of directors vigorously pursues alternative transactions or engages in an "auction" of the company's shares.[47] The minister's attempts were unsuccessful in that, after finding that similarities existed between the concept of a "commercial activity" and the principles of ordinary commercial trading, Judge Miller accepted that the services acquired by

44 Interestingly, in a past technical interpretation, the CCRA acknowledged that GST paid on merger costs incurred to discharge obligations imposed by statute could qualify for an ITC to the extent that the registrant was otherwise engaged in commercial activities. See CCRA, Excise and GST/HST Rulings Directorate, document no. 8190/HQR00001796, January 27, 2000.

45 As an analytical matter, the context in which a particular supply is acquired necessarily informs the determination of both the purpose of the acquisition and the parties who benefit from the supply.

46 95 DTC 164; [1995] 2 CTC 2148 (TCC); aff'd. 97 DTC 5012 (FCA).

47 Interestingly, the court found such activities to be within the accepted realm of a director's statutory and common law duties.

Nowsco would have been deductible under section 9 of the Act.[48] This determination, coupled with the court's broad construction of the scope of a public company's business activities, may prove to be of assistance to taxpayers in future income tax cases, including the upcoming appeal by BJ Services of the minister's income tax assessment with respect to the Nowsco acquisition.[49]

### *Alternative Submissions*

The minister cited section 141.01 of the ETA as an alternative argument in support of a more restrictive construction of the phrase "in the course of commercial activity." Specifically, the minister suggested that section 141.01 of the ETA supported the general proposition that ITCs may be claimed in respect of a supply only in cases where the supply is acquired for the purpose of making a taxable supply for consideration. Judge Miller dismissed this contention on the basis of a contextual analysis of the section and the ETA as a whole. On the basis of the relevant jurisprudence and several releases from the Department of Finance, Judge Miller reasoned, correctly in our view, that section 141.01 of the ETA was designed solely as a mechanism to allocate the value of supplies acquired by a registrant in support of both exempt and commercial activities.

Judge Miller also dismissed the minister's contention that Nowsco was involved in providing a separate supply of information to its shareholders and that it was these activities that the services were acquired to support. Judge Miller went on to find that even if he were to rule that Nowsco was in the business of providing the separate supply of information, the supplies would not constitute exempt financial services.[50]

In concluding his judgment, Judge Miller pondered whether there was a policy basis for denying Nowsco's claim for ITCs in respect of the services. He proposed an interesting, although potentially unwieldy, construct, under which, to assess the eligibility of a registrant to claim an ITC in respect of a particular supply, one must

48 As a technical matter, in attempting to apply subsection 9(1) and paragraph 18(1)(a) separately, Judge Miller appears to have lost sight of recent jurisprudence that has suggested that paragraph 18(1)(a) is largely superfluous and that for an expense to be deductible under subsection 9(1), it must rightly have been incurred for the purpose of producing income. See, for example, *Symes v. The Queen et al.*, 94 DTC 6001; [1994] 1 CTC 40 (SCC). While there was previously a distinction between the test imposed under subsection 9(1) and the precursor to paragraph 18(1)(a) (which was a far more restrictive subsection), the current amended version of paragraph 18(1)(a) is largely repetitive of the test imposed under subsection 9(1).

Judge Miller also appears not to have considered or to have attempted to distinguish past cases in which the Tax Court has expressly concluded that the tests used to determine the deductibility of an expense under the Act are narrower than the test used to determine whether a supply was acquired in the course of a commercial activity. See, for example, *Hleck, Kanuka, Thuringer v. The Queen* (1994), 2 GTC 1034; [1994] GSTC 46 (TCC), cited with approval in *City of Regina v. The Queen*, 2001 GTC 447; [2001] GSTC 68 (TCC).

49 The appeal is scheduled to be heard on May 5, 2003.

50 Judge Miller ruled that the proffering of such advice, had it actually been made, would have rightly constituted a taxable supply.

ask whether the costs incurred by the registrant are "the types of costs the consumer would expect to have a company pass on?"[51] Judge Miller reasoned that the costs of obtaining the services were costs that a consumer would reasonably expect to be passed on in the form of higher prices. Thus, he concluded that were Nowsco's ITC claim to be denied, double taxation would result; that is, Nowsco would pay GST on the value of the services and pass on the cost of the services to its consumers, at which time an additional layer of GST would be paid.[52]

## International Colin Energy Corporation

The facts in *ICEC* also were relatively straightforward and largely undisputed.

### The "Merger" Transaction

ICEC was in the business of drilling and exploring for oil and gas. In the early 1990s, the company ran into serious financial difficulties. In the course of reflecting on its uncertain future, ICEC retained the services of Powerwest Financial Ltd. ("ARC") under a financial advisory retainer ("the ARC agreement"). Under the ARC agreement, ARC agreed to prepare a preliminary valuation of ICEC, review ICEC's strategic position in the marketplace, and assess the relative merits of certain alternative business opportunities. ARC also agreed to assist in negotiating and optimizing the terms of any potential transaction that ICEC decided to pursue. In consideration for these services, ARC would be entitled to a non-contingent "advisory fee" and a contingent "success fee," based on the total value of the consideration received on any completed merger or acquisition.

On February 12 and 13, 1996, the board of directors of ICEC met to review ARC's preliminary report. After much deliberation, the ICEC board accepted ARC's recommendations and elected to explore the possibility of a merger transaction.

To that end, ARC sent a confidential information memorandum to several prospective partners, advising that ICEC would consider proposals for the purchase of its assets or shares. On April 19, 1996, ARC reported that it had received seven purchase proposals and recommended that two of these proposals be pursued. At that point, ICEC's management group engaged in an extensive due diligence review with respect to the two identified corporate suitors. In choosing to undertake a comprehensive due diligence program, the management of ICEC asserted that it was looking to build an association with a purchaser, and it was therefore important to satisfy itself as to the financial health and strategic viability of any potential "partner."

On completion of the due diligence review, the ICEC board decided to approve a proposal submitted by Morgan Hydrocarbons Inc. ("Morgan"), which called for

51 Supra note 39, reasons for judgment, at paragraph 71.

52 As a technical note, the denial of ITCs to Nowsco would actually result in more than double taxation since Nowsco would pass on the cost of the services, ***along with the GST paid on such supplies***, to the ultimate consumer of Nowsco's services.

Morgan to acquire all of the shares of ICEC in exchange for Morgan shares. The press release announcing the transaction described it as "a business combination."[53]

On June 27, 1996, at a meeting of the shareholders of ICEC, the Morgan purchase was approved. On completion of the purchase, ICEC paid ARC both the advisory fee and the success fee.

ICEC deducted the fees paid to ARC in computing its income for its 1996 taxation year. The minister disallowed the deduction on the basis that the amounts had been expended for the benefit of ICEC's shareholders and not for the purpose of gaining or producing income from a business or property, as required by paragraph 18(1)(a) of the Act.[54] Inexplicably, the minister did not raise the potential application of paragraph 18(1)(b) in the assessment of the taxpayer.[55]

## Judicial Analysis and Commentary

### *Ratio Decidendi*

Once again, the Tax Court ruled in favour of the taxpayer. Judge Bowman stated at the outset of his judgment that his decision rested solely upon the application of paragraph 18(1)(a), given that the minister, in his view, had not adequately pleaded his alternative argument under paragraph 18(1)(b).[56] Judge Bowman summarized the essence of the minister's position as follows:

> The basic premise of the respondent's case is not that the payments were on capital account but rather that they were aimed at enhancing the value of the shares of ICEC and therefore had nothing to do with ICEC's income earning activities. In other words, the activities of ARC for which payments were made were analogous to a dividend or a shareholder benefit.[57]

Although Judge Bowman soundly rejected the minister's characterization of the success fee, his reasoning is somewhat unclear. For example, he began his analysis by suggesting that steps taken by a company's directors and senior executives to improve a company's share price are within the scope of the company's business and possess the requisite income-earning purpose to merit a current deduction. In Judge Bowman's words,

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53 Nevertheless, the Tax Court referred to the transaction as a "merger."

54 However, it is worthy of note that, just before trial, the minister conceded that the advisory fee was, in fact, rightly deductible under general principles. Such a concession is consistent with past jurisprudence, which has held that costs incurred in conducting investigative and strategic reviews are deductible as current expenditures. See, for example, *Wacky Wheatley's TV & Stereo Ltd. et al. v. MNR*, 87 DTC 576; [1987] 2 CTC 2311 (TCC).

55 Paragraph 18(1)(b) of the Act prohibits a taxpayer from deducting the value of capital expenditures made in the year when computing its taxable income.

56 Subsequent to the initial assessment of ICEC, the minister attempted to raise the potential application of paragraph 18(1)(b) of the Act.

57 2002 DTC 2185, at paragraph 44.

> [t]aking steps to improve the price of shares of a public company is a major preoccupation of boards of directors and senior officers. Yet it has never been suggested to my knowledge that the salary of the Chief Executive Officer was a non-deductible shareholder benefit just because he or she spends most of the working hours trying to find ways to improve the share price.[58]

However, Judge Bowman also felt it necessary to link ICEC's expenditures directly with the objective of dealing with the company's dire financial situation and improving its income-earning apparatus. Judge Bowman attempted to downplay the assertion that the shareholders of ICEC had received any direct benefits (independent of those deriving from the improved income-earning capacity of the company) as a result of ARC's engagement, finding that there was "no evidence that the price the shareholders received from Morgan on the share for share exchange . . . was enhanced by anything ARC did or that ARC even tried to get a better ratio."[59] Similarly, with respect to the characterization of any shareholder accretions flowing from the expanded income-earning capacity of ICEC, Judge Bowman stated:

> If the shareholders' investment was improved by holding shares in a larger and commercially stronger entity, this was the result of an improvement in the income earning ability of the appellant within the larger combined entity. . . . To say however that an expense that is calculated to improve a company's ability to earn income constitutes a form of disguised dividend or shareholder benefit because it may improve the value of the shares and is therefore non-deductible under paragraph 18(1)(a) strikes me as getting the cart before the horse.[60]

On the basis of these principles and factual findings, Judge Bowman concluded that the services provided by ARC were intended to improve ICEC's income-earning position and, thus, were acquired to earn income from its business.

It appears to be a touch fanciful to suggest that ARC's efforts did not enhance the consideration received by the shareholders of ICEC. It is difficult to believe that in consulting with prospective purchasers, ARC did not attempt to "market" ICEC and thereby enhance the perceived value of the corporation's shares. Judge Bowman's suggestion that the shareholder's of ICEC "got what they got"[61] and that this was not influenced by the efforts of ARC seems to be unreasonable. In fact, it is peculiar that Judge Bowman felt compelled to establish that none of the purposes for which ARC's services were acquired was to enhance the value of the shares of ICEC. Would

58 Ibid., at paragraph 45.

59 Ibid., at paragraph 46.

60 Ibid. Judge Bowman also quickly dismissed the minister's contention that ARC was simply acting as an agent of the shareholders of ICEC. Judge Bowman asserted that, notwithstanding the prescribed treatment of such expenditures for financial accounting purposes, the fees paid to ARC were rightly viewed as having been expended by ICEC for the purpose of gaining or producing income.

61 Ibid.

the deductible status of the ARC fees truly have been compromised if one of the secondary purposes for retaining ARC had been to enhance the value of ICEC's shares? It certainly would have been preferable for Judge Bowman to have addressed this question.

### *Obiter Dicta*

Despite his findings with respect to the deficiencies in the minister's pleadings, Judge Bowman commented on the potential application of paragraph 18(1)(b). In analyzing whether the success fee constituted a capital expenditure, Judge Bowman outlined what he viewed to be the key principles emanating from the plethora of jurisprudence on the distinction between current and capital expenditures and concluded that paragraph 18(1)(b) did not apply on the grounds that "no capital asset was acquired, nothing of an enduring benefit came into existence nor was any capital asset preserved."[62]

Judge Bowman's position appears to have some interpretive and juristic support. It is well accepted that it is the purpose for which a particular expenditure was incurred, and not the result, that is determinative in the application of paragraph 18(1)(b).[63] Of potential relevance in this regard are the comments made by Jackett P in *Algoma Central Railway v. MNR*.[64] The key issue in *Algoma* was whether the expenditures were on account of capital, and this determination, according to the court, turned on whether the costs *themselves* could reasonably be viewed as having created an asset of enduring benefit or advantage. In considering the appropriate range of benefits and advantages that were to be taken into account, the court determined that it was necessary to focus on the "immediate consequence" of an expenditure (as opposed to its anticipated ultimate effect). In allowing the taxpayer's claim for a current deduction, the court held:

> In all . . . the other cases referred to in the various decisions to which reference was made during the argument, the "advantage" that was held to be of an enduring benefit to the taxpayer's business was the thing contracted for or otherwise anticipated by the taxpayer as the direct result of the expenditure. In all such cases it was the "advantage" so acquired that, it was contemplated, would endure to the benefit of the taxpayer's business.[65]

On the basis of past jurisprudence, it appears necessary to determine the motivations for a taxpayer's actions. For instance, it is difficult to conceive of costs incurred by a corporation in responding to a takeover bid as costs incurred for the purpose of creating an asset or advantage of enduring benefit. In *ICEC*, however,

62 Ibid., at paragraph 48.

63 See *Firestone v. The Queen*, 87 DTC 5237; [1987] 2 CTC 1 (FCA).

64 67 DTC 5091; [1967] CTC 130 (Ex. Ct.).

65 Ibid., at 5095; 136. A similar approach was taken in *Bannerman v. MNR*, 57 DTC 1249; [1957] CTC 375 (Ex. Ct.); aff'd. 59 DTC 1126; [1959] CTC 214 (SCC).

Judge Bowman appears to have concluded that the fee paid to ARC was "an expense . . . calculated to improve [ICEC's] ability to earn income,"[66] which might well be characterized as an asset or advantage of enduring benefit. In turn, one must ask how an expenditure "calculated" to produce an enduring benefit can evade characterization as a capital expenditure. Did Judge Bowman believe that because the capital structure of ICEC was not altered by the Morgan purchase, no "asset" of enduring benefit had been, or was intended to be, created? Would the disposition of the case have differed had Morgan and ICEC instead amalgamated?

Finally, Judge Bowman briefly canvassed the alternative argument raised by ICEC that if the deduction of the success fee was prohibited by paragraph 18(1)(a) or (b), a deduction under paragraph 20(1)(e) would be available on the grounds that the fee was incurred by ICEC in the course of a sale of its shares. While declining to express a definitive view and acknowledging that there were "respectable arguments on either side," Judge Bowman indicated his preference for allowing a paragraph 20(1)(e) deduction, on the basis of prevailing principles of statutory interpretation and commercial common sense.

## Conclusion

The decisions of the Tax Court in both *BJ Services* and *ICEC* provide an important indication of the court's evolving views on the characterization of "organizational expenditures" for Canadian tax purposes. Most notably, it appears that the court is beginning to recognize that expenditures incurred by a public corporation to manage and facilitate its structural evolution and its relationships with the financial marketplace are directly linked to its efforts to earn income. While it is less clear whether the CCRA is similarly inclined to change its position, we note that the minister has declined to appeal the Tax Court's decision in either case.

Despite the possible advances made by the Tax Court in both *ICEC* and *BJ Services*, a host of additional considerations have yet to be canvassed. For instance, will the court draw a distinction between transactions in which the capital structure of the taxpayer remains largely unaltered and those in which a material alteration does occur (as in the case of an amalgamation, for example)? Similarly, are distinctions to be drawn between circumstances in which a corporation is approached by a potential acquiror without invitation and those in which a corporation, on its own accord, actively canvasses the marketplace for a potential purchaser? Finally, will expenses incurred in discharging statutory or common law obligations owed to a corporation be distinguished from actions undertaken by corporate directors or officers in discharging obligations that may be owed to a particular set of shareholders? Much additional thought must be devoted to the proper characterization of merger costs before the tax treatment of these types of expenditures can be established with certainty.

Todd Miller
Michael Friedman

66 Supra note 57, at paragraph 46.