Docket: 2014-1537(IT)G

BETWEEN:

AGRACITY LTD.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Motions heard on October 21, 2014, at Toronto, Ontario

By: The Honourable Justice Campbell J. Miller

Appearances:

Counsel for the Appellant:	Justin Kutyan, Thang Trieu
Counsel for the Respondent:	Pascal Tétrault

ORDER

Upon hearing Motions from the Parties pursuant to Rules 53, 26 and 82 of the *Tax Court of Canada Rules (General Procedure)*

IT IS HEREBY ORDERED that:

1. The following parts of the Reply are struck:

   - Paragraph 14(c);
   - First sentence of paragraph 14(h);
   - Paragraph 15(a); and
   - Paragraph 17.

2. Paragraph 14(d) of the Reply shall be incorporated into paragraph 15(b).

3. Paragraph 13 of the Reply shall be amended in accordance with the attached Reasons.

4. The Respondent shall file and serve an Amended Reply incorporating the provisions of this Order within two weeks of the date of this Order.

5. The Parties shall file and serve on each other a list of documents in accordance with section 82 of the *Tax Court of Canada Rules (General Procedure)*.

6. The Parties shall, within 30 days of the date of this Order, provide to the Court a timeline for exchanging the list of documents pursuant to Rule 82, conducting examinations for discovery, completing undertakings and reporting back to the Court, on the basis there will be one set of lists and one set of examinations for discovery to cover both this Appeal and the Appeal of *101072498 Saskatchewan Ltd. v Her Majesty the Queen (2014-1526(IT)G)* ("SaskCo Appeal").

7. The trial of this matter shall be heard on common evidence with the SaskCo Appeal.

8. Costs of this Motion shall be in the cause.

Signed at Ottawa, Canada, this 10th day of November 2014.

"Campbell J. Miller"

C. Miller J.

Date: 20141110
Docket: 2014-1537(IT)G

BETWEEN:

AGRACITY LTD.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR ORDER

C. Miller J.

[1] Agracity Ltd. ("AgraCity") brings the following Motion:

a. To strike out paragraphs 13, 14, 15, 16, 17, 18, 19, 20, 21 and 22 of the Reply pursuant to section 53 of the *Tax Court of Canada Rules (General Procedure)* (the "*Rules*").

b. In the alternative, to consolidate AgraCity's appeal with that of *101072498 Saskatchewan Ltd v Her Majesty the Queen* ("SaskCo"), 2014-1526(IT)G, pursuant to section 26 of the *Rules*.

c. For costs of this motion.

d. For such further and other relief as Counsel may advise and the Court may permit.

[2] The Respondent brings a Motion for an order directing that each Party shall file and serve on each other Party a list of all the documents that are or have been in that Parties' possession, control or power, relevant to any matter in question between or among them in the Appeal under section 82 of the *Tax Court of Canada Rules (General Procedure)* (the "*Rules*") with costs.

[3] The most expedient manner to provide the background to this matter is to simply reproduce the assumptions in the Reply found at paragraph 12 along with paragraphs 13 to 22 which include the portions that the Appellant wishes to have struck:

> 12. In determining the appellant's tax liability for the years 2007 and 2008, the Minister made the following assumptions of fact:
>
> a) the Farmers of North America corporate group is directly and indirectly owned by James Mann and Jason Mann;
>
> b) James Mann and Jason Mann are brothers residing in Canada;
>
> c) the Farmers of North America corporate group is comprised, inter alia, of the following entities: Farmers of North America Inc., Farms and Families of North America Ltd., AgraCity, 101019482 Saskatchewan Ltd., 101072497 Saskatchewan Ltd., 101072498 Saskatchewan Ltd., NewAgco-Barbados, NewAgco Inc. (USA) (NewAgco-USA), AgraCity Crop & Nutrition Ltd.;
>
> d) Farmers of North America Inc. is a corporation incorporated in Canada;
>
> e) Farmers of North America Inc. is wholly owned by James Mann;
>
> f) Farmers of North America Inc. sold membership to Canadian farmers and agricultural supplies to farmers;
>
> g) Farms and Families of North America Ltd. (FFNA) is a corporation incorporated in Canada;
>
> h) FFNA is wholly owned by James Mann;
>
> i) FFNA sold memberships to Canadian farmers, entitling farmers to economies of scale on agricultural supplies, chemicals and fuel by belonging to a larger purchasing group;
>
> j) Canadian farmers pay an annual fee to FFNA allowing farmers to participate in negotiated programs and services;
>
> k) AgraCity is a corporation incorporated in Canada;
>
> l) AgraCity is wholly owned by Jason Mann;

m) AgraCity carries on a business of selling agricultural supplies, chemicals and fuel to FFNA's farm members;

n) 101072498 Saskatchewan Ltd. is indirectly owned by James Mann and Jason Mann;

o) NewAgco-Barbados is wholly owned by 101072498 Saskatchewan Ltd.;

p) on March 26, 2006, NewAgco-Barbados was incorporated and under the Laws of Barbados;

q) NewAgco-Barbados was created for the purposes of sheltering profits of the Farmers of North America corporate group from the Canadian fisc and more specifically to shelter the profits of AgraCity from the Canadian fisc;

r) AgraCity and NewAgco-Barbados were not dealing at arm's length;

s) the importation of a glyphosate, ClearOut 41 Plus (ClearOut), in Canada under the "Own-Use-Import" program has contributed to the success of the Farmers of North America corporate group for over a decade;

t) On March 29, 2006, AgraCity entered into a service agreement with NewAgco-Barbados to carry on the activities of selling ClearOut to FFNA members;

u) the service agreement required AgraCity to promote, market, sell, perform logistics services as well as administrative services related to the sale of ClearOut within Canada;

v) prior to April 1, 2006, the sale of ClearOut to FFNA members was carried on by NewAgco-USA;

w) the business of selling ClearOut to FFNA members was transferred to NewAgco-Barbados at no cost;

x) the service agreement between AgraCity and NewAgco-Barbados provided that NewAgco-Barbados would pay a service fee to AgraCity of $0.10 per liter of ClearOut sold;

y) AgraCity actually charged a service fee to NewAgco-Barbados of $0.20 per liter of ClearOut sold;

z) AgraCity's service fee charged to NewAgco-Barbados was $1,009,838 for the fiscal period ending on March 31, 2007 and $1,080,991 for the fiscal period ending on March 31, 2008;

aa) NewAgco-Barbados reported net profits from the sale of ClearOut of $2,413,520 for the period ending on December 31, 2006 and $3,670,478 for the period ending on December 31, 2007;

bb) the fair market value of the services rendered by AgraCity to NewAgco-Barbados was $3,423,359 for the fiscal period ending on March 31, 2007 and $4,751,470 for the fiscal period ending on March 31, 2008;

Functional Analysis

cc) in respect of the sale of ClearOut to FFNA members:

i) NewAgco-Barbados held no assets and performed no economic activities;

ii) NewAgco-Barbados performed no functions and held no risk;

iii) NewAgco-Barbados provided no value added functions;

iv) AgraCity undertook all of the functions and assumed all the risks;

dd) NewAgco-Barbados had no employees;

ee) FFNA performed certain functions on behalf of AgraCity relating to the ClearOut to FFNA members and AgraCity paid FFNA for those functions;

ff) the majority of the sales and marketing activities that AgraCity provided under the service agreement were carried on by FFNA. The sales and marketing activities included establishing and maintaining customer relationships, developing marketing materials and providing direct customer contact to answer questions and to explain product features;

gg) ClearOut sales orders were taken by FFNA's staff and forwarded to AgraCity for processing. FFNA members were required to complete various forms for the importation of ClearOut. FFNA members completed the forms which were provided to AgraCity with their payment. The forms were then, in turn verified and provided to the Pest Management Regulatory Agency (PMRA) for regulatory approval. Once approved by the PMRA, AgraCity would arrange the logistics for the ClearOut to be shipped from a warehouse located in the United States of America (USA) to the Canadian farmer;

hh) the PMRA approved FFNA as a sponsor of ClearOut which allowed FFNA to assist FFNA members to import ClearOut from the USA;

ii) FFNA incurred costs of laboratory fees in order for ClearOut to meet Canadian requirements necessary for its importation and AgraCity handled all other issues relating to the importation of ClearOut in Canada;

jj) AgraCity issued sales invoices for ClearOut to Canadian farmers and the Canadian farmer would pay AgraCity in advance for the ClearOut ordered;

kk) NewAgco-Barbados was not a party to the sale of ClearOut to FFNA members and they were not aware of its existence;

ll) the suppliers of ClearOut made no sales of ClearOut to NewAgco-Barbados. The sales of ClearOut were rather made to AgraCity and other members of the Farmers of North America corporate group;

mm) the supplier of ClearOut were paid after funds were deposited by AgraCity in NewAgco-Barbados's bank account and Jason Mann would instruct NewAgco-Barbados's bank to transfer funds by wire transfer;

nn) NewAgco-Barbados did not negotiate with suppliers of ClearOut;

oo) the decision making process for NewAgco-Barbados was made in Canada by James Mann and Jason Mann;

pp) the board of directors of NewAgco-Barbados acted by approving decision already made in Canada by James Mann and Jason Mann;

qq) since it was first established in 1998, FFNA negotiated with program suppliers on behalf of FFNA members. Jason Mann negotiated price of ClearOut with suppliers;

rr) AgraCity spent time and expenses to prevent changes to the rules on the importation of ClearOut by the PMRA;

ss) as of January 1, 2008, the activities carried on through NewAgco-Barbados in respect of the sale of ClearOut were transferred to AgraCity Crop & Nutrition Ltd.;

Transfer Pricing Penalty

tt) AgraCity did not make reasonable efforts to determine an arm's length transfer price or arm's length allocation between itself and NewAgco-Barbados in respect of the transactions under the service agreement, or to use those prices or allocations for the purposes of the *Act*;

uu) AgraCity's fiscal period in respect of the 2007 and 2008 taxation years ends on March 31, 2007 and March 31, 2008, respectively;

vv) for purposes of subsection 247(4) of the *Act*, the "documentation-due" date in respect of AgraCity's 2007 and 2008 taxation years was September 30, 2007 and September 30, 2008, respectively;

ww) AgraCity did not make or obtain, by September 30, 2007 and September 30, 2008, records or documents that provided a description that is complete and accurate in all material respects of the functions performed, the property used or contributed and the risks assumed, in respect of the service agreement and the sale of ClearOut;

13. In assessing the penalty under s. 163(2) of the Act, the Minister made the following assumptions of facts:

a) the assumptions of facts stated at paragraph 12 of this reply (except paragraphs 12(tt) to 12(ww));

b) at the start of the audit of AgraCity in June, 2010, none of the forms T1134, *Information Return Relating to Controlled and Non-Controlled Foreign Affiliates*, had been filed in respect of NewAgco-Barbados and NewAgco-USA;

c) at the start of the audit of AgraCity in June, 2010, over 45 income tax returns of entities part of the Farmers of North America corporate group had not been filed on their filing due date;

d) AgraCity knowingly, or under circumstances amounting to gross negligence, has made or has participated in, assented to or acquiesced in the making of, a false statement or omission in its income tax returns for the years 2007 and 2008 by underreporting income by $2,413,520 and $3,670,478, respectively.

14. The Deputy Attorney General of Canada further states the following additional facts in support of the reassessment under appeal:

a) AgraCity entered into a series of transactions;

b) the series of transactions started with incorporation of NewAgco-Barbados, the conclusion of the service agreement between AgraCity and NewAgco-Barbados, the services provided under the agreement, the acquisition of ClearOut and its sale to FFNA members;

c) the series of transactions would not have been entered into between persons dealing at arm's length since no arm's length party would accept the risks of the said series of transactions and yet forego the benefits of the series of transactions given NewAgco-Barbados limited functions, lack of assets and having no employees;

d) the series of transactions that would have been entered into between arm's length parties would have excluded NewAgco-Barbados from the series of transactions occurring between the ClearOut suppliers, the Canadian farmers and AgraCity;

e) NewAgco-Barbados did not perform any function in the series of transactions for which an arm's length party would pay. The result is that, at arm's length, AgraCity would have performed the functions that NewAgco-Barbados did, if any, in addition to all functions AgraCity provided and AgraCity would have earned all the income arising from the series of transactions;

f) NewAgco-Barbados was used by AgraCity to obtain tax benefits, namely to reduce its tax payable in Canada, by moving profits to NewAgco-Barbados, located in a low tax jurisdiction, thereby reducing tax payable on its profits. There was no *bona fide*

purpose for NewAgco-Barbados to be a party to the agreement with the ClearOut Suppliers and the Canadian farmers other than to obtain tax benefits;

g) NewAgco-Barbados had neither the resources nor the expertise to sell ClearOut to FFNA members; and

h) the series of transactions entered into by AgraCity amounts to a sham or window dressing designed to deceive the Minister into concluding that NewAgco-Barbados, not AgraCity, was undertaking a business and incurring real risks. AgraCity has ultimately preformed all functions relating to the sale of ClearOut to FFNA members and it was liable for the losses.

Transfer Pricing Penalty

i) AgraCity did not make or obtain, by September 30, 2007 and September 30, 2008, records or documents that provided a description that is complete and accurate in all material respects of:

   i) the identity of the participants to the transaction regarding the service agreement and the sale of ClearOut;

   ii) the data and methods considered and the analysis performed to determine the transfer prices or the allocations of profits or losses or contributions to costs, as the case may be, in respect of the service agreement and the sale of ClearOut; and

   iii) the assumption, strategies and policies, if any, that influenced the determination of the transfer prices or the allocations of profits or losses or contributions to costs, as the case may be, in respect of the service agreement and the sale of ClearOut; and

Correction

j) With respect to paragraph 12p) of this reply, he says that the date of incorporation of NewAgco-Barbados is March 29, 2006.

B. ISSUES TO BE DECIDED

15. The issues are whether:

a) the terms or conditions made or imposed between AgraCity and NewAgco-Barbados in respect of the service agreement and the sale of ClearOut differ from those that would have been made between persons dealing at arm's length such that AgraCity's income for the taxation years 2007 and 2008 was properly increased by $2,413,520 and $3,670,478, respectively, pursuant to s. 247(2)(a) and (c) of the *Act*;

b) the transaction or series of transactions would not have been entered into between persons dealing at arm's length, and can reasonably be considered not to have been entered into primarily for *bona fide* purposes other than to obtain a tax benefit such that NewAgco-Barbados would not be part of the series of transactions and the profits from the series in the amounts of $2,413,520 and $3,670,478 are properly included in the appellant's income for its taxation years 2007 and 2008, respectively, pursuant to s. 247(2)(b) and (d) of the *Act*;

c) the series of transactions entered into by AgraCity amounts to a sham or window dressing designed to deceive the Minister into concluding that NewAgco-Barbados, not AgraCity, was undertaking a business and incurring real risks, and accordingly the profits from the series in the amounts of $2,413,520 and $3,670,478 are properly included in AgraCity's income for its taxation years 2007 and 2008, respectively, pursuant to s. 247(2)(b) and (d) of the *Act*;

d) AgraCity is liable to a penalty pursuant to s. 247(3) of the *Act* in respect of the transfer pricing adjustment made in the 2007 and 2008 taxation years; and,

e) AgraCity is liable to a penalty pursuant to s. 163(2) of the *Act* in respect of the amounts of $2,413,520 and $3,670,478 added to its income in the 2007 and 2008 taxation years.

C. STATUTORY PROVISIONS RELIED ON

16. He relies on ss. 3, 9, 95, 163, 233.4, 247, 251 of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.), as amended.

D. GROUNDS RELIED ON AND RELIEF SOUGHT

17. The terms or conditions made or imposed between AgraCity and NewAgco-Barbados in respect of the service agreement and the sale of ClearOut differ from those that would have been made between persons dealing at arm's length within the meaning of s. 247(2)(a) of the *Act*. AgraCity's income for the taxation years 2007 and 2008 was properly increased by $2,413,520 and $3,670,478, respectively, pursuant to s. 247(2)(c) of the *Act*.

18. The transaction or series of transactions entered into by AgraCity and NewAgco-Barbados would not have been entered into between persons dealing at arm's length, and can reasonably be considered not to have been entered into primarily for *bona fide* purposes other than to obtain a tax benefit within the meaning of s. 247(2)(b) of the *Act*. NewAgco-Barbados is to be excluded from the series of transactions and the profits from the series in the amounts of $2,413,520 and $3,670,478 are properly included in AgraCity's income for its taxation years 2007 and 2008, respectively, pursuant to s. 247(2)(d) of the *Act*.

19. The series of transactions entered into by AgraCity amounts to a sham or window dressing designed to deceive the Minister into concluding that NewAgco-Barbados, not AgraCity, was undertaking a business and incurring real risks, and accordingly the profits from the series in the amounts of $2,413,520 and $3,670,478 are properly included in the appellant's income for its taxation years 2007 and 2008, respectively, pursuant to s. 3 and 9 of the *Act*.

20. AgraCity did not make reasonable efforts to determine an arm's length transfer price or arm's length allocation between itself and NewAgco-Barbados in respect of the transactions under the service agreement pursuant to ss. 247(3) and 247(4) of the *Act*. AgraCity is liable to a penalty pursuant to s. 247(3) of the *Act* in respect of the transfer pricing adjustment made in the 2007 and 2008 taxation years.

21. AgraCity is liable to a penalty pursuant to s. 163(2) of the *Act* for knowingly, or under circumstances amounting to gross negligence, having made or having participated in, assented to or acquiesced in the making of, a false statement or omission in its income tax returns for the years 2007 and 2008 by underreporting income its by $2,413,520 and $3,670,478, respectively.

22. He requests that the appeal be dismissed with costs.

[4] It is also helpful to include AgraCity’s description of the issues in its Notice of Appeal:

19. The issues are:

Transfer pricing adjustments

(a) whether the fees for the Logistical Services were at or in excess of an arm's length transfer price;

Transfer pricing penalties

(b) whether AgraCity made reasonable efforts to determine the arm's length transfer price for the Logistical Services;

Gross negligence penalties

(c) whether gross negligence penalties can apply to a transfer pricing matter;

(d) whether it is possible to be liable to gross negligence penalties when a purported false statement or omission only results from a transfer pricing adjustment by the Minister;

(e) whether AgraCity could knowingly, or under circumstances amounting to gross negligence, make a purported false statement or omission in its return by reporting exactly what it earned from providing the Logistical Services; and

(f) whether the gross negligence penalties should be upheld.

[5] Finally, and what indeed throws a monkey wrench into the works, I reproduce the issues as described by 101072498 Saskatchewan Ltd. ("SaskCo") in its Notice of Appeal filed coincidentally with the AgraCity Appeal:

17. The issues are:

FAPI

(a) whether SaskCo had FAPI pursuant to pursuant to paragraph 95(2)(a.1) of the Act with respect to NewAgco's sales of ClearOut to the individual FNA members; and

Late-filing penalties

(b) whether late-filing penalties pursuant to subsection 162(1) of the Act ought to be imposed.

[6] The Reply to the SaskCo Appeal, while repeating some of the assumptions and facts in the Reply to the AgraCity Appeal, makes some noticeable contradictory assumptions to those set out in the AgraCity Appeal. The Reply in the SaskCo Appeal indicates in part:

i. Admits individual Farms and Families of North America Ltd. ("FFNA") members access programs and services through companies such as NewAgco (a fact denied in the AgraCity Reply);

ii. Admits new NewAgco focuses on the supply of generic crop protection products and sell them or active ingredient. (Denied in the AgraCity Reply);

iii. Assumes NewAgco was acquiring ClearOut from suppliers. (In the AgraCity Reply it is assumed NewAgco did not acquire any ClearOut from suppliers);

iv. Assumes NewAgco sold ClearOut to AgraCity. (In the AgraCity Reply it is assumed NewAgco is not a party to the sale of ClearOut to FFNA members);

v. Assumes NewAgco sale of ClearOut to AgraCity represented more than 90% of its gross revenue. (In the AgraCity Reply assumes NewAgco held no assets and performed no functions or economic activities);

vi. NewAgco sold ClearOut to AgraCity and NewAgco's sale of ClearOut to AgraCity represented more than 90% of its gross revenue. (In the AgraCity Reply the position is that NewAgco sold and did nothing and AgraCity did everything).

Motion to strike

[7] If ever there was a case of the Minister of National Revenue (the "Minister") hedging her bets this is it. In effect, the Minister is saying the Government thinks this is a transfer pricing case, but it may be a Foreign Accrual Property Income ("FAPI") case, perhaps it is both or maybe the whole thing is simply a sham.

[8] The Appellant makes several arguments for striking portions of the Reply:

i. The Reply has no chance of success vis-à-vis the section 247(2)(*a*) and (*c*) of the *Income Tax Act* (the "*Act*") issue, given the facts assumed: the portions in connection with the section 247(2)(*a*) and (*c*) of the *Act* argument should be struck;

ii. The alternative arguments in the Reply (section 247(2)(*b*) and (*d*) of the *Act* and sham) are an abuse of process given the Minister's Reply in the SaskCo Appeal that assumes inconsistent facts: portions of the Reply referring to such arguments should be struck;

iii. Some of the allegations are without foundation (paragraphs 14(f) and (h) of the Reply);

iv. The Minister has inappropriately pleaded conclusions of law (paragraphs 14(a), (b), (c), (d) and (h) of the Reply);

v. The pleadings in relation to the section 163(2) of the *Act* penalties lack foundation and merely parrot the *Act* and are immaterial, vague, scandalous and vexatious and an abuse of process and should be struck (paragraphs 13, 14(i), 15(b) and (e), 20 and 21.)

I. Pleadings in connection with section 247(2)(*a*) and (*c*) of the *Act*

[9] The Appellant contends that by framing its Reply in the AgraCity Appeal as it has, the Minister has effectively shot herself in the foot, as far as maintaining there is a transfer pricing issue pursuant to section 247(2)(*a*) and (*c*) of the *Act*: there is nothing to price. The assumption suggests that NewAgco Inc. ("NewAgco") had no assets, sold no product, effectively did nothing. Further, the relevant transactions are entirely premised on domestic transactions, devoid of non arm's length and cross-border considerations, and accordingly, the pleadings on the transfer pricing rules found in section 247(2)(*a*) and (*c*) of the *Act* have no hope of success.

[10] There has been much written about Rule 53 and the test for striking out pleadings. The test has been summarized as to whether it is plain and obvious the pleading has no hope of succeeding.

[11] With respect to transfer pricing issues, section 247(2) of the *Act* sets out the playing field:

247(2) Where a taxpayer or a partnership and a non-resident person with whom the taxpayer or the partnership, or a member of the partnership, does not deal at arm's length (or a partnership of which the non-resident person is a member) are participants in a transaction or a series of transactions and

(a) the terms or conditions made or imposed, in respect of the transaction or series, between any of the participants in the transaction or series differ from those that would have been made between persons dealing at arm's length, or

(b) the transaction or series

(i) would not have been entered into between persons dealing at arm's length, and

(ii) can reasonably be considered not to have been entered into primarily for bona fide purposes other than to obtain a tax benefit,

any amounts that, but for this section and section 245, would be determined for the purposes of this Act in respect of the taxpayer or the partnership for a taxation year or fiscal period shall be adjusted (in this section referred to as an "adjustment") to the quantum or nature of the amounts that would have been determined if,

(c) where only paragraph 247(2)(a) applies, the terms and conditions made or imposed, in respect of the transaction or series, between the participants in the transaction or series had been those that would have been made between persons dealing at arm's length, or

(d) where paragraph 247(2)(b) applies, the transaction or series entered into between the participants had been the transaction or series that would have been entered into between persons dealing at arm's length, under terms and conditions that would have been made between persons dealing at arm's length.

[12] As the Appellant correctly suggests, if the circumstances under section 247(2)(*a*) of the *Act* apply, adjustments are made to reflect the terms and conditions of the transaction or series of transactions that would have been made or entered into between persons dealing at arm's length. In this case, what would an arm's length person standing in AgraCity's shoes charge NewAgco for the services rendered? The Appellant argues an arm's length party would have charged nothing based on the Minister's assumptions and admissions. The

Appellant also suggests, again based on the Minister's pleadings, only domestic transactions are at play and the transfer pricing rules simply do not apply.

[13] The Minister contends there is an international transaction involved, that being the service agreement between AgraCity and NewAgco and that the transfer pricing rules in section 247(2)(*a*) and (*c*) of the *Act* clearly need to be addressed to determine the appropriate price for that transaction.

[14] I note that the Appellant cast the suit in the context of a transfer pricing issue, given the Minister's assessment under section 247(2)(*a*) and (*c*) of the *Act*, inviting the Minister to respond in kind. The Minister has attempted to do so but, as is always the case (and indeed the reason for assumptions), does not know exactly what happened, while presumably the Appellant itself does.

[15] The Minister's pleading with respect to section 247(2)(*a*) and (*c*) of the *Act* does leave the Appellant in something of a quandary as to the case to meet. Does it try to demolish assumptions 12. kk) and ll) which assume in effect that NewAgco had no product to sell, or does it accept those assumptions, which may make the section 247(2)(*a*) of the *Act* transfer pricing issue go away, but perhaps expose it to the sham argument. The Appellant, understandably, wants to force the Respondent to choose which horse it is backing.

[16] Yet, how does the Respondent choose if the Respondent does not know the facts? This is made clear by the opposing admissions and assumptions in the AgraCity Reply and the SaskCo Reply. If it is shown that NewAgco did in fact sell product and used AgraCity's Services to do so, then a transfer pricing issue pursuant to section 247(2)(*a*) and (*c*) of the *Act* may be in order. Given its ability to raise alternative arguments (section 152(9) of the *Act*) at any time, it is impractical to close a blind eye to a possible live issue, yet I am limited to a review of the pleadings and not speculation as to what might occur down the road. The difficulty is that the Respondent has gone about its pleading in a somewhat confusing manner. If I take the Minister's assumption that NewAgco had no role in selling ClearOut as true, I see no basis upon which the Minister can successfully apply section 247(2)(*a*) of the *Act* to these circumstances.

[17] Facts may indeed come out at trial that the Respondent might believe would support a section 247(2)(*a*) and (*c*) of the *Act* position. Nothing would preclude the Respondent at that stage from relying on an alternative argument, but its Reply with respect to section 247(2)(*a*) and (*c*) of the *Act* cannot stand as

I find it is plain and obvious on the face of the Reply it will fail. As the Supreme Court of Canada stated in *Canada v Imperial Tobacco Canada Ltd.*:[1]

> 23. Before us, Imperial and the other tobacco companies argued that the motion to strike should take into account, not only the facts pleaded, but the possibility that as the case progressed, the evidence would reveal more about Canada's conduct and role in promoting the use of low-tar cigarettes. This fundamentally misunderstands what a motion to strike is about. It is not about evidence, but the pleadings. The facts pleaded are taken as true. Whether the evidence substantiates the pleaded facts, now or at some future date, is irrelevant to the motion to strike. The judge on the motion to strike cannot consider what evidence adduced in the future might or might not show. To require the judge to do so would be to gut the motion to strike of its logic and ultimately render it useless.
>
> 24. This is not unfair to the claimant. The presumption that the facts pleaded are true operates in the claimant's favour. The claimant chooses what facts to plead, with a view to the cause of action it is asserting. If new developments raise new possibilities — as they sometimes do — the remedy is to amend the pleadings to plead new facts at that time.

[18] This does create a curious scenario where if the Appellant proves the Crown's assumptions are wrong, this may open the door to the alternative arguments. However, based on the facts pleaded as set out in the Reply, I see no chance of success for the Respondent in connection with its section 247(2)(*a*) and (*c*) of the *Act* argument and therefore strike paragraphs 15 a) and 17.

II. Section 247(2)(*b*) and (*d*) of the *Act* and sham

[19] The Minister has pleaded assumptions upon which the section 247(2)(*a*) and (*c*) of the *Act* assessment was based: as I have just indicated, those assumptions and admissions do not support a transfer pricing assessment under that provision. The Minister has added two arguments, section 247(2)(*b*) and (*d*) of the *Act* and sham. It is not plain and obvious to me that these arguments have no chance of success. Section 247(2)(*b*) and (*d*) of the *Act* is quite different from section 247(2)(*a*) and (*c*) of the *Act*: it has a broad recharacterization power that allows the Minister to review not only the service agreement and the fee charged thereunder but the entire series of transactions, based on the assumptions and admissions set out in the Reply. Indeed, the Appellant agrees that the transactions or series of transactions would not have been entered into between arm's length

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[1] 2011 SCC 42.

parties. It is for a trial judge to determine the recharacterization that results: it is not plain and obvious the facts as pleaded by the Respondent could only result in a recharacterization in the Appellant's favour. The Respondent's position encompasses all of the transactions in connection with the sale of ClearOut including the incorporation of NewAgco and the service agreement.

[20] I am satisfied there is a legitimate dispute as to the correctness of the assessments issued by the Government of Canada to AgraCity and SaskCo. I am also satisfied there are arguments that are not, on the face on the pleadings, plain and obvious losers. Section 247(2)(*b*) and (*d*) of the *Act* does not limit the Minister to a comparison of a particular transaction (the service agreement) between the non arm's length parties at issue and fictional arm's length parties, but allows the much broader view of the series of transactions and the recharacterization into what would or would not arm's length parties have done. In that scenario, I do not see the Minister pleading NewAgco did not do anything would necessarily result in no possibility of the Minister's success on the issue. It is a very different approach from the section 247(2)(*a*) and (*c*) of the *Act* transfer pricing rules. I am not prepared to delete any part of the Reply pertaining to section 247(2)(*b*) and (*d*) of the *Act*.

[21] Similarly, the sham argument is not devoid of any possibility of success based on the Minister's Reply.

[22] The Appellant goes on to argue that the new arguments of sham and section 247(2)(*b*) and (*d*) of the *Act* should be struck as they are abusive given the Respondent's inconsistent pleading in the SaskCo Appeal. There is no question there are inconsistencies in the two Replies. The Appellant relies on comments in *Suburban Realty Trust (Trustee of) v Canada*[2] where the court indicated:

> …where, as in the present case, the Minister has made for the same taxation year regarding the same asset, two absolutely contradictory and mutually exclusive assessments arising out of the same transaction, it would be ludicrous for the Court to allow the Minister, in such a case, to enjoy the benefit of the burden of proof which he normally enjoys in assessment appeal cases, since the Minister is, in the same action, seeking to have the Court confirm two contradictory statements.

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[2] [1977] FCJ no 82 (FCTD).

To be clear, that decision of Justice Addy of the Federal Court of Canada was in connection with a matter that was all one action. Justice Addy also indicated that there was no bar to the Minister assessing two different amounts for the same asset in the same taxation year but that he felt such a custom was unfair, as it effectively had two arm's length taxpayers battling between themselves with the court having to decide "who should pay the piper." I am not facing the same situation.

[23] The Appellant's complaint is that AgraCity and SaskCo do not know the case to meet and should not be forced to go through productions, discoveries and trials so that the Crown can figure out its case: in effect go on a fishing expedition. I do not see it that way. Nothing precludes the Crown from issuing inconsistent assessments to different taxpayers (see *Peterson v R*[3]). The Court can manage the process to prevent the more real concern of inconsistent judgments.

III. Allegations without foundation: paragraphs 14(f) and (h) of the Reply

[24] The Appellant argues that paragraphs 14(f) and (h) of the Reply are "conclusory allegations without any evidentiary foundation", and consequently are an abuse of process and should be struck. The Appellant cites the Federal Court of Appeal's comment in this regard in *Kastner v Painblanc*:[4]

> 4. The learned motions judge seems to have been of the view that the plaintiffs/respondents should be given the chance to see if they could learn some further facts and obtain some more evidence implicating Painblanc personally during examination for discovery. We are all of the view that in so doing the judge erred in law and proceeded upon a wrong principle. An action at law is not a fishing expedition and a plaintiff who starts proceedings simply in the hope that something will turn up abuses the Court's process.

I do not share the Appellant's view with respect to paragraph 14(f) of the Reply, keeping in mind that paragraphs 14(f) and (h) are not assumptions but additional facts. The assumptions suggest NewAgco did nothing: a sufficient basis has been therefore laid to question the purpose behind NewAgco's existence.

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[3] 2005 FCA 263.

[4] [1994] FCJ no 1671 (CA).

[25] With respect to paragraph 14(h) of the Reply, I find that stating the series of transactions is a sham is clearly a conclusion of law and inappropriate. I would strike the first sentence of paragraph 14(h).

IV. Pleadings of law

[26] As well as paragraph 14(h) of the Reply, the Appellant wishes to strike paragraphs 14(a) to (d) as conclusions of law that simply parrot the *Act*. Paragraphs 14(a) and (b) of the Reply identify what the Respondent considers the series of transactions: I see nothing inappropriate in doing so. Paragraph 14(c) however is not a fact: it is the very issue at play under section 247(2)(*b*) of the *Act* and something for the trial judge to determine based on the facts. This type of conclusion disguising as facts should be struck. Similarly, paragraph 14(d) of the Reply is more appropriately part of the Respondent's argument as to the recharacterization under section 247(2)(*b*) and (*d*) of the *Act* and should move to become part of paragraph 15(b) of the Reply.

V. Pleadings with respect to section 163(2) of the *Act* (paragraphs 13, 15(e) and 21 of the Reply)

[27] Section 163(2) of the *Act* reads:

> Every person who, knowingly, or under circumstances amounting to gross negligence, has made or has participated in, assented to or acquiesced in the making of, a false statement or omission in a return, form, certificate, statement or answer (in this section referred to as a "return") filed or made in respect of a taxation year for the purposes of this Act, is liable to a penalty of the greater of $100 and 50% of the total of …

As the Appellant points out, the section 163(2) of the *Act* reassessments were based on the Minister's adjustments to the Appellant's income pursuant to section 247(2)(*a*) and (*c*) of the *Act*. The Appellant complains that paragraph 13(d) of the Reply merely parrots the *Act* in the statement of mixed fact and law. Did the Respondent assume the Appellant knew it was underreporting income or, if the Respondent is relying on gross negligence, what are the factual circumstances it is relying upon? I agree with comments of the Federal Court of Appeal in *Canada v O'Dwyer*[5] that a taxpayer, assessed a penalty, should know why it was assessed: "simply reiterating the multiple

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[5] 2013 FCA 200.

combinations of possibilities that could result in the imposition of the penalty does not tell a taxpayer what specific act (that would result in the imposition of the penalty) he or she is alleged to have committed. …"

[28] The Appellant claims it does not know what false statement is at issue. I think it is clear the false statement the Respondent believes the Appellant made was reporting income of $1,009,838 and $1,080,991 for the 2007 and 2008 taxation years which was $2,413,520 and $3,670,478 less than their actual income respectively.

[29] The Appellant claims it does not know how the wrongful act was done (making it, participating in making it, assenting, acquiescing?). Again, I find it is implicit, though not explicit, it was in the making.

[30] If the Respondent raises paragraphs 13(b) and (c) of their Reply as being part of "circumstances" suggesting gross negligence, it should be clearer.

[31] I am not prepared to strike these provisions but am going to allow the Respondent time (two weeks) to straighten them out and clarify whether the penalty is due to knowingly underreporting or underreporting under circumstances amounting to gross negligence or, if both, plead in the alternative. If gross negligence is at issue, then the pleadings should be clear what the circumstances are, and if indeed that is why the Respondent made the assumptions in paragraphs 13(b) and (c), though interestingly those assumptions postdate the alleged false statement. If it is determined that NewAgco was carrying on business and did have income, such that the Respondent pursues its position in the SaskCo lawsuit, then the penalties would fall away. I believe this issue is best left to the trial judge.

Motion to Consolidate

[32] I find no abuse of process in the Respondent filing alternative assessments to different taxpayers. The risk of contradictory judgments, however, must and can be avoided. One trial judge needs to hear both Appeals. Though two different taxpayers, they are connected and the transactions are identical, notwithstanding the Respondent's different assumptions. Counsel for AgraCity and SaskCo are the same and naturally consent to a consolidation pursuant to paragraph 26(c) of the *Rules*.

[33] Respondent's counsel argues that such an order is premature and that this is best handled by case management.

[34] What is important in the interest of justice is that these Appeals be heard together on common evidence and I so order.

[35] Further, in the circumstances, I see no need for two sets of production of documents and two sets of examinations. The Parties shall combine the list of documents for the two cases and similarly shall produce one representative to be examined in connection with both cases. The Parties shall provide the Court with a schedule within 30 days of this Order setting out the timelines for the completion of these steps.

Motion for full production

[36] The Respondent raises a number of factors to support its Motion for full production pursuant to Rule 82 of the *Rules*:

a. This is a complex appeal involving transfer pricing issues where the documentary evidence plays an important role.

b. The transactions involve the sale of chemical products for a period of 2 years through the appellant and a corporation located in Barbados.

c. The respondent bears the burden of proof in respect of two additional arguments made in support of the reassessment, namely based on ss. 247(2)(b) and (d) of the *Income Tax Act* and the doctrine of sham which requires considering the whole surrounding circumstances.

d. The appellant's non-cooperative behaviour during the audit prevented the audit to have been done fully and effectively.

e. The appellant is in the best position to identify and locate any relevant documents that are or have been in its possession, control or power. It is unfair to place this burden upon the respondent.

f. The time and cost associated with preparing Rule 82 lists will be offset by the savings of time and cost to be incurred in responding to undertakings

and matters taken under advisement following examinations for discovery and the extent of the discovery process.

g. It would be just and equitable to grant this motion.

[37] It is clear from the jurisprudence (see for example *Imperial Tobacco* and *Canadian Imperial Bank of Commerce v R*[6]) that the applicant must demonstrate reasonable grounds for such an order. Cases are not explicit as to what constitutes reasonable grounds though some factors addressed in the jurisprudence are costs, expeditious resolution, no harm to appellant's business by full disclosure and no delay. I suggest it boils down to what serves the best interests of justice. Our Court is unique in its position of requiring only partial disclosure. Yet there will be cases where that may be inadequate. Indeed, in the *Long v Canada*[7] case it was suggested that a request for full disclosure is best made after partial disclosure, as the party seeking disclosure knows better what might be missing. This is to be weighed against the view, as expressed by Justice Webb in *Imperial Tobacco*:

> 25. The only circumstances of the particular case that appear to have been taken into account by Justice McNair in granting the order were the nature of the documents requested and their relevancy to the issues. The particular Rule under consideration in that case was substantially amended in 1990[3]. The revised version of this Rule 448 provided for a mandatory disclosure of all documents relevant to any matter in issue. The current version of the Rule (which is Rule 223) also provides for mandatory disclosure of all documents relevant to any matter in issue. As noted by W.R. Jackett in his treatise referred to above, the interests of justice are best served if each party has the right to discover all of the relevant documents that the other party may have, not just those that the other party chooses to rely upon. While there are rights under the Rules to discover documents that are not included in the list prepared under section 81 of the Rules, unless a party knows that a document exists, how can that party exercise the rights to examine such document? The interests of justice are not served if a party with a document that would hurt its position can file a list of documents that does not refer to such document and then escape a requirement to produce the document because the other party does not ask the right question at discovery examinations.

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6 2013 TCC 170.

7 2011 FCA 85.

[38] The Appellant argues that the Respondent is simply on a fishing expedition. The Appellant also challenges the Respondent's assertion there was no full and effective audit due to non-cooperative behaviour.

[39] Is there a reasonable basis for concluding full disclosure would assist in the expeditious resolution of the issues? I believe there is. The issue is not whether the Minister conducted a full and effective audit. Full disclosure is not to make up for that deficiency, if indeed there was one. Full disclosure is also not intended to assist one side more than the other. It is meant to ensure that all relevant materials are known to both sides in an expeditious manner, allowing for a timely resolution, and if unresolved prior to trial, ensuring the trial judge is properly presented with such materials.

[40] The Appellant argues the Respondent has considerable material already and can sort out during examinations for discovery what might not be in her possession. Given a history of delays as set out in the Affidavit of Monique O'Shea, I am not convinced a wait and see approach is an expeditious way of proceeding in this matter.

[41] The Appellant has not indicated that costs and time are a factor in complying with a Rule 82 disclosure.

[42] I conclude that the nature of the case involving allegations of sham and the application of section 247(2)(*b*) of the *Act*, the amounts involved, the history of delay, the fact there has been no indication the order would create any hardship time wise or cost wise and also no indication of any possible harm to the Appellant's business are sufficient grounds to convince me that an order for full disclosure will indeed result in a more expeditious and just proceeding. I disagree with the Appellant that this is a fishing expedition or abuse of process: it is a process very much contemplated by our *Rules* in appropriate circumstances.

Conclusion

[43] In summary, I agree with the Appellant that the Minister's Reply does not support an argument under section 247(2)(*a*) and (*c*) of the *Act*: it is bound to lose. Paragraphs 15(a) and 17 of the Reply are struck. I disagree with the Appellant, however, with respect to the section 247(2)(*b*) and (*d*) of the *Act* argument and the sham argument. I recognize this leads to the possibility that, if at trial the trial judge is satisfied the service agreement was not a sham and

reflected a *bona fide* arrangement between AgraCity and NewAgco, not subject to recharacterization, but that the service agreement is simply improperly priced, the question arises whether the Respondent may rely on section 152(9) of the *Act* to raise the section 247(2)(*a*) and (*c*) of the *Act* argument at that point. By striking the section 247(2)(*a*) and (*c*) of the *Act* argument at this stage, I do not intend to tie the trial judge's hands by precluding that possibility. As with any litigation, as the process unfolds and more facts are discovered, the Parties' positions may shift and further motions may be in order.

[44] I also strike paragraph 14(c) of the Reply and the first sentence of paragraph 14(h). Paragraph 14(d) should be incorporated into paragraph 15(b). The Respondent has 14 days from the date of this Order to amend and clarify all of paragraph 13 of the Reply.

[45] The Parties shall within 30 days of this Order provide a timeline for exchanging a list of documents pursuant to Rule 82 as well as a timeline for examinations and follow-up, to be done on the basis that there will be one list and one set of examinations to cover both this Appeal and the SaskCo Appeal.

[46] Finally, the trial of this matter is to be heard on common evidence with the trial of SaskCo. Costs of this Motion shall in the cause.

Signed at Ottawa, Canada, this 10th day of November 2014.

"Campbell J. Miller"

C. Miller J.

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