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REQUIREMENTS FOR ITC AND ITR CLAIMS: A JUDGMENT OF THE COURT OF QUÉBEC SETS THE RECORD STRAIGHT

Philippe Asselin and Jean-Philippe Latreille

In the past few years, the Agence du revenu du Québec ("**ARQ**") has acted aggressively towards any taxpayers whom it suspects of being involved in a "false invoicing scheme". However, a crack seems to have appeared in the position generally held by the ARQ on this issue as a result of a recent decision by the Court of Québec in the case of *Système intérieur GPBR Inc.*

The facts of this case are typical of files of this nature: a building contractor was denied input tax refunds ("**ITRs**") it had claimed on the grounds that it did not meet the legal requirements for obtaining them, and because some of its subcontractors turned out to be "suppliers of false invoices".

Firstly, the Court noted in its judgment that certain documentary requirements set out in the law and regulations must be complied with in order to validly claim ITRs, including, among other things, the obligation to obtain the name of the supplier or intermediary, or the name under which it is doing business, the QST registration number assigned to the supplier or intermediary, the date of the invoice, a sufficient description to identify each supply, etc.

The ARQ maintained that only the names of the suppliers of services having actually performed the work for which ITRs were claimed could appear on the invoices. This argument was dismissed by the Court because the regulatory provisions expressly provide that the name of an intermediary may appear thereon.

In addition, the ARQ claimed that a taxpayer wishing to claim ITRs was subject to numerous additional obligations, in addition to complying with the prescribed regulatory requirements. For example, according to the ARQ, the taxpayer had to confirm the legal existence of the

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subcontractors in the Enterprise Register of Quebec, verify the validity of their license issued by the Régie du bâtiment du Québec, or obtain data from the Commission de la construction du Québec and the Commission de la santé et de la sécurité du travail du Québec on the subcontractors' workforce.

The Court did not accept this claim by the ARQ. Indeed, taxpayers have a right to strictly rely on the statutory provisions in conducting their tax affairs, and it is not the courts' role to create new rules in this area. Therefore, the courts must not impose requirements relating to ITR claims that are not provided for in the legislation or regulations.

Thus, the Court concluded that the taxpayer had proven its right to the ITRs claimed because it had met the documentary requirements, the services billed for had been truly rendered, and its right had not been affected by the fact that some of its subcontractors subsequently turned out to be "suppliers of false invoices". On this last point, the Court indicated that the ARQ had adduced no evidence of collusion by the taxpayer with its subcontractors with a view to benefit from this "scheme". The ARQ has already announced its decision to appeal this case, noting that it does not intend to change the way in which it handles matters of "false invoices". It therefore appears that the ARQ does not seem to have heard the plea for caution by the Court, which, moreover, noted that a "conviction by association" can have disastrous consequences for a business and its principals. However, this does not mean that taxpayers should necessarily refrain from contesting GST or QST assessments issued by the ARQ in similar circumstances.

RESTRICTIVE COVENANTS TRANSACTIONAL CONTEXT VS. EMPLOYMENT CONTEXT
André Paquette

Why are non-competition or non-solicitation covenants added to contracts? The purpose of inserting so-called "restrictive" covenants in a contract is generally the desire to protect a company's goodwill either upon the termination of an employment relationship, the termination of a business relationship, or the acquisition of a business. Clearly, the parties' bargaining power will vary depending on the context: an employee's bargaining power is usually less and warrants different treatment from the treatment applying to a businessman or woman negotiating the sale of his or her business. In addition, where a business is the subject of an acquisition transaction, the goal of maintaining smooth business operations is a strong factor supporting rules of interpretation that favour the preservation of the goodwill of the business. It is therefore no coincidence that the rules applying to such covenants will depend on the nature of the contract involved.

The Supreme Court of Canada reminded us of this, among other things, in the recent case of Payette v. Guay inc.[1] rendered on September 12, 2013.

In that case, restrictive covenants had been inserted in a contract for the sale of assets pursuant to which Guay Inc. ("**Guay**"), a company operating a crane leasing business, had acquired the assets of certain companies controlled by a Mr. Yannick Payette ("**Payette**") and his partner, in October 2004, for an amount of $26 million. A clause had also been inserted into the contract providing for transitional services by Payette as a consultant for a maximum period of six (6) months following the closing of the transaction, with the option of concluding an employment contract at a later date. Both the transitional services and the employment contract were subsequently implemented.

However, everything changed on August 3, 2009 when Guay dismissed Payette, who joined a firm in competition with Guay, bringing several of Guay's employees with him!

The Supreme Court first considered the nature of the rules applicable to restrictive covenants contained in a contract for the sale of assets: was it a transactional context or an employment context?

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Indeed, the *Civil Code of Québec* ("**C.C.Q.**") is not insensitive to the reality faced by employees since it provides, in article 2095, that an employer may not invoke a non-competition clause contained in an employment contract if it has dismissed the employee without a serious reason. The C.C.Q. is however silent on the issue with respect to restrictive covenants in a commercial context.

In this case, the Court could not dissociate the restrictive covenants from the contract for the sale of the assets, even in the context of the termination of Payette's employment, which triggered its application. According to the Court, the reason why the restrictive covenants were agreed upon was the sale of the business and not the employment relationship which followed the closing of the transaction. The result: Payette was not afforded the protection of article 2095 C.C.Q. as an employee of Guay.

The Court therefore interpreted the restrictive covenants in accordance with commercial law and concluded that the dismissal of Payette, whether done with or without sufficient cause, had no effect on the enforceability of the restrictive clause.

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[1] 2013 SCC 45.

PATRIMONY PROTECTION AND TRANSMISSION LIQUIDATOR OF A SUCCESSION: WHAT DO YOU DO?

Marie-Claude Armstrong

You learn that you have been appointed as liquidator of the succession of a relative or client pursuant to his or her will, or according to the wishes of a majority of his or her heirs.

You can accept or refuse the office of liquidator.

If you refuse to act as liquidator, you are required to execute a document to this effect and inform the successors (the persons who may receive the succession, but have not yet officially accepted it) thereof.

If you accept to act as liquidator, the appointment must be published in the register of personal and movable real rights to publicize the fact that you act as liquidator in order for the beneficiaries and creditors of the deceased or the succession to know who to contact for anything related to the patrimony of the deceased person (article 777 C.C.Q.).

Prior to the transmission of the bequeathed property and the partition of the succession, you are required to perform various administrative duties, including the following:

- Will search in the registry of the Chambre des notaires du Québec and the registry of the Barreau du Québec
- Acceptance of the office of liquidator
- Will probate and communication thereof to the heirs
- Obtaining letters of verification (when immovables included in the succession are located in jurisdictions outside Quebec)
- Payment of the deceased's debts
- Payment of the funeral arrangements
- Collection of revenues and debts
- Closing the deceased's bank accounts and transfer of the balances to the account of the succession
- Identification of the investments and transfer in the name of the succession
- Continuance of lawsuits (as plaintiff, defendant or impleaded party)
- Payment of instalments to tax authorities
- Preparation of an inventory of the property of the succession
- Submission of an annual account
- Alienation of the assets (limited power of disposal in certain cases)
- Preparation and filing of the federal and provincial tax returns of the deceased and eventually of the succession

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Partition of the family patrimony and the matrimonial regime
Clearance or distribution certificate (to be obtained from tax authorities)
Publication of a notice of closure of the inventory

An holograph will or a will made in the presence of two witnesses must be probated by the Court. A notarial will does not have to probated by the Superior Court of Quebec. Will search certificates must be obtained from the Chambre des notaires du Québec and the Barreau du Québec in all cases.

As liquidator, you are required to render an annual account of your administration and a final account at the time of the final distribution of the succession. Any discretionary power, as wide as it can be, does not authorize you to act in a partial manner or to place yourself in a situation of conflict of interests.

It is generally appropriate for the liquidator to have a law professional, an accountant and a tax expert assist him or her when the nature of the property or certain succession issues justify it. The liquidator should also refrain from giving legal, accounting or tax advice to the heirs. He or she should rather encourage them to consult independent experts of their choice.

THE BAGTECH CASE, OR THE IMPACT OF A UNANIMOUS SHAREHOLDER AGREEMENT ON THE STATUS OF CANADIAN-CONTROLLED PRIVATE CORPORATION
Martin Bédard

A recent decision of the Federal Court of Appeal in *Canada* v. *Bioartificial Gel Technologies (Bagtech) Inc.* ("**Bagtech**") has shed new light on the criteria that applies to the concept of control of a corporation and to the effect of a unanimous shareholder agreement ("**USA**") in assessing a corporation's status as a Canadian-controlled private corporation ("**CCPC**") under the *Income Tax Act* ("**ITA**").

In that case, Bagtech sought to qualify as a CCPC in order to obtain an additional tax credit of 15% on its research and development expenses, and to make it eligible for a refundable tax credit. In fact, the majority of Bagtech's shareholders were not residents of Canada.

However, the ITA requires that, in order for a corporation to claim the status of a CCPC, a test of *de jure* control must be met, namely, the ability to elect a majority of the corporation's directors. Thus, if each share belonging to non-residents or listed companies were held by one and the same person (the "**particular person**"), where a corporation is under the *de jure* control of this person, it would be disqualified.

However, in the case of Bagtech, a USA stipulated that the majority of the directors were to be elected by resident Canadian shareholders.

At first instance, the court found that the particular person was deemed to be a party to the USA, a conclusion which was not called into question on appeal. Then, the Federal Court of Appeal, relying on the decision of the Supreme Court in *Duha Printers (Western) Ltd*. v. *Canada*, held that once a shareholders' agreement qualifies as a USA, all the clauses restricting the power to elect the board of directors are relevant for purposes of determining *de jure* control of the corporation. As a result, thanks to its USA, Bagtech was able to qualify as a CCPC, even though the majority of its shareholders were non-residents.

Thus, unless legislative measures are introduced to counter the effect of the Bagtech decision, it is possible for a corporation held by a majority of non-residents or a listed company to adopt a USA that would enable it to qualify as a CCPC. By doing so, such a corporation can obtain a number of tax benefits, including the small business deduction, enhanced research and development expenses

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and credits, and access to the capital gains deduction for Canadian shareholders.

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