Northbridge v the King: Tax court confirms need for clear documentary evidence at trial

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Refresher – FCA overturned TCC's decision to deny ITCs

After setting aside the Tax Court of Canada's (TCC) decision in Northbridge Commercial Insurance Corporation v His Majesty the King (2023 FCA 211) on Oct. 24, 2023, the Federal Court of Appeal (FCA) referred the appeal back to the TCC to determine the amount of input tax credits (ITCs) available to Northbridge within the disputed period.

The issue before the FCA was whether "risks," as referred to in paragraph 2(d) of Part IX, Schedule VI of the *Excise Tax Act*, means: (a) the objects of the insurance policy; (b) the perils covered by the insurance policy; or (c) the chance of a peril occurring that is covered by the policy. For insurance policies that extend beyond the borders of Canada, the FCA interpreted this to mean accidents or insurable events ordinarily situated outside of Canada. The result is that premiums payable on such policies will be zero-rated (GST/HST applies at a rate of 0 per cent) to the extent that the policies insure against such risks.

For example, where a vehicle is insured and travelling in the United States, the GST/HST on the premium payable for the vehicle will be zero-rated.

Third time is *not* a charm for Northbridge

Following the TCC's dismissal of Northbridge's appeal, Northbridge was successful at the FCA and the case was returned to the TCC for reconsideration. However, Northbridge was unable to find luck in the third instance. Although bound by the FCA's ruling, the TCC once again denied Northbridge of any ITCs relating to the insurance policies at issue. The TCC acknowledged the FCA's rationale that zero-rated treatment (and subsequent ITC entitlement) requires an assessment of each insurance policy as opposed to each insured vehicle under the policies.

The TCC referred back to its initial judgment, stating that the "global evidence" provided by Northbridge was insufficient for determining whether the specific policies could, in

part, be zero-rated for purposes of GST/HST. Dismissing the appeal on this basis comes as a surprise in light of the TCC's prior recognition of the "extensive evidence" relating to the "methodology" used by Northbridge to price the policies at issue.

Although the TCC attempted to clarify this contradiction within its amended reasons for judgment, the TCC's dismissal of the appeal stings of a loss by technicality based on the "standard of review" that the FCA was required to follow. Essentially, in the words of the TCC, Northbridge's "downfall" came down to a lack of evidence provided at trial, and if individual policies had been provided, the TCC would have been able to decide in their favour. Even though the price of "any given policy" was calculated in accordance with the methodology provided in evidence by Northbridge, the Court was not convinced by this evidence.

As the "trier of fact", a high degree of deference is provided to the TCC when concluding on the facts of an appeal. The FCA in this case confirmed that the TCC had made an error in law, and returned the matter for reconsideration, but deferred to the TCC on its finding of facts. Let this be a reminder to taxpayers that the evidence and facts originally presented to the TCC at trial generally cannot be expanded at the appeal level – unless the trial judge makes a "palpable and overriding error" when determining the facts. Although it is possible to logically infer from the evidence record that a percentage of the Northbridge policies were linked to accidents or insurable events ordinarily situated outside of Canada, because the policies themselves were not presented at trial, it was not possible for the TCC to conclude in Northbridge's favour.

Takeaways

Despite the TCC dismissing Northbridge's appeal for a second time, the FCA's much-needed clarification remains the law: an insurance policy will be zero-rated to the extent that it insures against accidents or insurable events ordinarily situated outside of Canada.

Having said that, the TCC's reasoning reminds us that insurers must retain satisfactory documentation, on a policy-by-policy basis, evidencing how the price of each policy is determined. Even though the same "methodology" may be used in each case, it is important that insurers keep detailed records of how such methodology was applied when determining the price of policies that relate to risks ordinarily situated outside of Canada. In the absence of such records, the CRA may deny ITCs on what could be a valid zero-rated supply for purposes of GST/HST.

If you have questions about the TCC's subsequent decision and its effect on ITCs claimed under the *Excise Tax Act*, reach out to the authors of this piece or a member of BLG's Tax team.

By

Tanner Shapka, Laura Warrington

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BLG Offices

Calgary

Centennial Place, East Tower
520 3rd Avenue S.W.
Calgary, AB, Canada
T2P 0R3

T 403.232.9500
F 403.266.1395

Ottawa

World Exchange Plaza
100 Queen Street
Ottawa, ON, Canada
K1P 1J9

T 613.237.5160
F 613.230.8842

Vancouver

1200 Waterfront Centre
200 Burrard Street
Vancouver, BC, Canada
V7X 1T2

T 604.687.5744
F 604.687.1415

Montréal

1000 De La Gauchetière Street West
Suite 900
Montréal, QC, Canada
H3B 5H4

T 514.954.2555
F 514.879.9015

Toronto

Bay Adelaide Centre, East Tower
22 Adelaide Street West
Toronto, ON, Canada
M5H 4E3

T 416.367.6000
F 416.367.6749

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