

ENTER:

OLDCASTLE BUILDING PRODUCTS CANADA INC.,

appellant

and

HER MAJESTY THE QUEEN,

respondent.

Appeal heard on July 6, 2016, in Montreal, Quebec.

In front of: The Honorable Justice Pierre Archambault

Appearances:

Counsel for the appellant: Nicolas Simard
Counsel for the respondent: Claude Lamoureux

JUDGMENT

The appeals of assessments made under the *Income Tax Act (Act)* for the 2010 and 2011 taxation years are allowed and the assessments are remitted to the Minister of National Revenue for reconsideration and reassessment, taking into account that:

- 55% of the amount of Mr. Castonguay's variable salary incurred by Oldcastle in 2010 and 40% of his variable salary for the year 2011 are expenses referred to in section 37 of the Act and the definition of eligible expense in paragraph 127 (9) of the Act and also constitute such expenses for the purposes of calculating the replacement amount described in subsection 2900 (4) of the Regulations;
- Oldcastle is entitled to a replacement amount based on data provided by that company to the CRA and according to the conclusions set out in these reasons;
- The capital expenditure of \$22,850 claimed for 2010 is eligible for the R & D expense calculation for the 2011 taxation year.

The appellant is required to file its written submissions as to costs within 30 days of this judgment, unless the parties request within 10 days of this judgment to make oral submissions.

The respondent must file its written submissions within 15 days of receiving the appellant's written submissions.

Signed at Magog, Quebec, this 25th day of August 2016.

"Pierre Archambault"
Judge Archambault

Reference: 2016 CCI 183

Date: 20160825

File: 2014-3152 (IT) G

ENTER:

OLDCASTLE BUILDING PRODUCTS CANADA INC.,

appellant

and

HER MAJESTY THE QUEEN,

respondent.

REASONS FOR JUDGMENT

Judge Archambault

[1] The only issue still to be decided in the appeals of Oldcastle Building Products Canada inc. (Oldcastle) is as follows: did the amount of compensation that Oldcastle incurred in 2010 and 2011 (relevant years) in respect of Mr. Bertin Castonguay, the President of the Oldcastle Research Center, is a scientific research and experimental development (R & D) expenditure for the purposes of section 37 of the Income Tax Act (the Act or the Tax Act) and for the purposes of the definition "eligible expense" in subsection 127 (9) of the Act and the calculation of the investment tax credit (ITC) under subsection 127 (5) of the Act ? The question arises because Mr. Castonguay's remuneration is determined by a formula that takes into account a percentage of the sales revenue of products developed or improved by the Research Center.

[2] It should be noted that the litigation raised by the Canada Revenue Agency (CRA) assessments raised additional issues that were resolved by the parties prior to the hearing of the appeals. In particular, the CRA refused to deduct an amount of \$ 22,850 as an R & D capital expense for the 2010 taxation year on the basis that this expense was only incurred in 2011. In the assessment of 2011, the CRA did not grant the deduction for this

expense. CRA counsel informed the Court that he recognized that this expense was allowable in the calculation of tax for the 2011 taxation year.

[3] In making its assessments, the CRA assumed that Mr. Castonguay's activities were not directly related to the R & D activities of the audited projects [1]. As a result, the CRA refused to consider Mr. Castonguay 's salary as an R & D expense for the purposes of section 37 of the Act and for the purpose of calculating the ITC for such an expense. After meetings between Mr. Castonguay and CRA officials, counsel for the respondent informed the Court, in a letter of July 4, 2016, that the respondent was prepared to recognize that 55% of the hours of work from Castonguay in 2010 were directly related to the R & D activities of the audited projects [2]. For the year 2011, he informed the Court at the beginning of the hearing that this percentage was 40%.

[4] Oldcastle also chose to use the replacement method in Division 37 (8) (a) (ii) (B) of the Act.[3], but the CRA set the replacement amount at zero. Subsequently, the CRA received the necessary information to calculate this amount. (See the letter of 4 July 2016). However, there is still the contentious issue of whether the salary paid to Mr. Castonguay constitutes an eligible expense for the purposes of this calculation.

I. Factual background

[5] Oldcastle is a Canadian company part of an international group (CRH Group) based in Ireland. CRH, a multinational construction products company, has worldwide sales of approximately \$ 30 billion. In 2001, a company of the CRH Group bought the Permacon Group for more than 100 million dollars. One of the company's founding companies was Bloc Vibré inc., A Sherbrooke-based company that belonged to Mr. Castonguay's family. At the time of the purchase, Mr. Castonguay, then 49, was the president of the Permacon Group while his brother, also a major shareholder in this group, wanted to retire. Between 2001 and 2003, Mr. Castonguay ensured the transition of Permacon Group companies into the CRH Group.

[6] Since Oldcastle wanted to retain Mr. Castonguay's post-transition services, he accepted his proposal to establish a research center for the development of new products and processes. Oldcastle is a North American leader in the manufacture of concrete products for masonry and landscaping, as well as retail products for DIYers in construction and landscaping.

[7] To house the Research Center, Oldcastle had a building constructed in Ville d'Anjou (Montreal) costing between six and seven million dollars. Mr. Castonguay has agreed to become president. The number of employees of the Research Center has varied between 25 and 30 from 2004 to 2012. The terms of Mr. Castonguay employment contract are recorded in a signed document that took effect on 1st January 2004. (Exhibit A-4). Clause 2.1 of the contract describes the nature of its services as follows:

2.1 As Director, Research and Development of APG's R & D Group and as Chairman of the Corporation [Oldcastle], the Executive's duties and responsibilities shall include, in addition to those inherent in the Executive's titles, the following duties and responsibilities:

- (a) hiring, organizing and managing an effective research and development team on behalf of the benefit of the Corporation;
- (b) executing a process for producing and assisting in the launch of New Products, Modified Products and New Manufacturing Processes;
- (c) creating a process to obtain, and obtaining the Corporation's senior management approval of annual research and development budget;
- (d) managing the filing of patents concerning New Products and Related Products;
- (e) linking with outside sources of innovation and the attainment of exclusive products / services agreements for the Corporation;
- (f) managing the research and development budget and maintaining the effectiveness of research and development;
- (g) ensuring the proper care and maintenance of research and development facilities and equipment; and
- (h) managing the delivery of ideas from third parties to obtain the best possible royalty levels for APG.

[8] In addition, the contract states that the inventions developed by Mr. Castonguay belong to Oldcastle:

7.2 In consideration of the Salary Base, bonuses and other compensation paid by the Corporation to the Executive Hereunder, all works and records pertaining thereto. Corporation or during the three (3) -month period following any termination of this Agreement and all Intellectual Property Rights relating thereto shall be the sole property of the Corporation. The Executive hereby waives any of its moral rights in the Works or Intellectual Property Rights.

[My underline.]

[9] Clause 10 describes the remuneration to which Mr. Castonguay will be entitled:

10.1 For the first year of his employment with the Corporation, the Executive shall receive an annual Canadian dollar (CDN \$ 400,000) (hereinafter, the

"Salary Base"). For the second and third year of its employment with the Corporation, the Executive's annual base is \$ 300,000 Canadian dollars (CND \$ 300,000) plus an amount of one hundred thousand Canadian dollars (CND \$ 100,000) payable if the Executive meets the objectives determined by the Corporation at the beginning of the year. **After such three (3) -year period**, and subject to Section 10.6, the Executive's Annual Base Salary shall be one hundred thousand Canadian dollars (CND \$ 100,000). The Base salary is payable in equal monthly installments.

10.2 The Corporation shall pay the Executive, on a quarterly basis, a bonus based on the annual Net Sales of New Products and Calculated as follows:

	<u>Net sales of New Products</u>	<u>Percentage of Net Sales Payable as Bonus</u>
(at)	US \$ 0 through US \$ 25,000,000	1.5%
(B)	US \$ 25,000,001 through US \$ 50,000,000	1.0%
(C)	US \$ 50,000,001 through US \$ 100,000,000	0.75%
(D)	US \$ 100,000,001 through US \$ 200,000,000	0.50%
(E)	US \$ 200,000,001 through US \$ 400,000,000	0.25%
(F)	US \$ 400,000,001 or more	0.125%

10.3 The Corporation shall also pay to the Executive a bonus based on the annual Net Sales of Modified Products and calculated as follows:

	<u>Net sales of Modified Products</u>	<u>Percentage of Net Sales Payable as Bonus</u>
(at)	US \$ 0 through US \$ 25,000,000	0.30%
(B)	US \$ 25,000,001 through US \$ 50,000,000	0.20%
(C)	US \$ 50,000,001 through US \$ 400,000,000	0.15%
(D)	US \$ 400,000,001 or more	0.10%

10.4 The benefits to be paid pursuant to Sections 10.2 and 10.3 shall be paid, with respect to each product, for a period of time determined by the Corporation or its affiliates. product, until the expiration of all such patents, or (b) otherwise, ten (10) years after the first sale of such product. Except as set forth in Section 13.2, the following will be payable to the Executive after three (3) years following the termination of its employment with the Corporation. It is also understood that this will be payable after the cause of the Executive's employment.

10.5 **During the first three (3) years** following the Effective Date, the Corporation shall only pay to the Executive portion of the bonus amount pursuant to Sections 10.2 and 10.3 which is in excess of three hundred thousand

Canadian dollars (CDN \$ 300,000). **After the end of the first three (3) years** after the Effective Date, however, the bonus shall be payable in that agreement, subject to the terms and conditions of this Agreement.

10.6 **After the end of the third year** after the Effective Date, the Executive's **Base Salary shall be reduced by twenty thousand Canadian dollars (CDN \$ 20,000) for each tranche of one hundred thousand Canadian dollars (CDN \$ 100,000) of bonuses** in excess of five hundred thousand Canadian dollars (CDN \$ 500,000). For example, if the Executive is entitled to a bonus of six hundred thousand Canadian dollars (CDN \$ 600,000) for a specific year, its base will be reduced to eighty thousand Canadian dollars (CDN \$ 80,000). For more certainty, **the Executive's Salary for a specific year will be \$ 0.00 if the Executive is entitled to a bonus of one million Canadian dollars (CDN \$ 1,000,000) for such year.** The Corporation may, at its discretion, offset the amount of any reduction for the Executive's Salary base against the payment of any Salary installment or payment.

[Underlining and bold are mine.]

[10] To better understand the scope of the compensation provisions, the definitions in Annex A of the contract must be added, including the following definitions:

(B) " **APG** " shall mean the North American branch of Oldcastle's Architectural Product Group.

[...]

(J) " **Modified Products** " means clustering significant improvements to Existing products (excluding New Products) in terms of Either cost reduction, functionality improvement and / or aesthetic improvement developed by APG's R & D Group under the Executive's leadership while the Executive is employed by the Corporation. The list of Modified Products will be determined by the Executive and the Corporation within thirty (30) days following each anniversary date of the Effective Date. The current list of new and modified products is attached and labeled Schedule B.

(K) " **Net sales** " shall mean, in respect of any New Product or Modified Product, and the amount of the proceeds shall be collected by the Corporation or any of its Affiliates for such Product to any Person (other than an Affiliate) in North America less (i) any discount; (ii) sales and insurance expenses, and (iii) credits or refunds and (iv) sales and other taxes and duties directly related to the sale.

(L) " **New Products** " means clustering completely Call new products or systems of products developed by APG's R & D Group under the Executive's leadership, regardless of whether or not the item originated in APG gold was obtained from a third party, while the executive is employed by the Corporation and that the Corporation or its Affiliates are not producing and / or selling on the date hereof (with the exception of ISO Stone / ISO Brick which will be included). Examples of New Products Dufferin Stone, Gallea Brick, Mega-Bergerac and Celtik Wall. The parties agree that the product is a new product for the purposes of this Agreement. The list of New Products will be determined in the future by the Executive and the Corporation within thirty (30) days following each anniversary date of the Effective Date. The current list of new and modified products is attached and labeled Schedule B.

[My underline.]

[11] During Permacon Group's transition to Oldcastle, Mr. Castonguay's compensation was between \$ 200,000 [4] and \$ 290,000. During this period, Mr. Castonguay was granted option rights on CRH Group shares.

[12] In his early years as President of the Research Center, Mr. Castonguay's compensation was approximately \$ 400,000. In 2008, it amounted to \$ 789,000, in 2009, \$ 906,000, in 2010, to \$ 1,058,000, and in 2011, to \$ 1,114,000. Therefore, if one applies the formula provided for in clause 10.6 of his employment contract, his base salary for the relevant years was nil while his remuneration which is described as a "bonus" in the employment contract and that I will call for the reasons mentioned below, the "variable salary" amounted to \$ 1,058,000 in 2010 and \$ 1,114,000 in 2011.

II. Analysis

A. Relevant provisions of the Act

[13] In deciding appeals such as those in Oldcastle, it is always useful to first know the relevant legislation applicable in the relevant years. There are those concerning the deduction of R & D expenses in the calculation of income from a business, found in section 37 of the Act, and those relating to the calculation of income tax, particularly CII, which appear in subsections 127 (5) and 127 (9) of the Act. The first relevant provision is sub-division 37 (8) (a) (ii) (B) (IV) of the Act which states:

37 (8) For the purposes of this section,

(a) records of expenditures for scientific research and experimental development activities:

[...]

(ii) where they appear elsewhere than in subsection (2) [5], are limited to

[...]

(B) where a taxpayer so elects [6] on a form prescribed [...] for expenses, each [...] of which is

[...]

(IV) the portion of an expense incurred in respect of expenses incurred during the year for the salary or wages of an employee directly engaged in scientific research and experimental development activities in Canada, and reasonable to consider as relevant to this job given the amount of time the employee spends on it; for this purpose, the portion of the expense is deemed to be the amount of the expense if it is all or substantially all of it

[My underline.]

[14] The expression "salary or wages" is thus defined in subsection 248 (1) of the Act:

"Salary or wages" Except in sections 5 and 63 and in the definition "death benefit", a taxpayer's income from an office or employment, as determined under subsection a of Part I, section B, including fees earned by the taxpayer for services that he did not provide in the course of doing business, but excluding pension or pension benefits, and retirement benefits.

[My underline.]

[15] We see that the notion of salary is broad. However, for the purposes of subsection 37 (8) ITA, subsection 37 (9) sets out limits that apply in certain circumstances:

37 (9) The expense of a taxpayer

(a) does not include, for the purposes of clauses (8) (a) (ii) (A) and (B), earnings-based compensation and gratuities, if the remuneration or gratuities relate to a **specified employee** the taxpayer;

b) [...]

[Underlining and bold are mine.]

Subsection 248 (1) of the Act defines "specified employee" as follows:

"**Specified employee**" means, in respect of a specified employee of a person, the employee of the person who is a specified shareholder of the person or who does not deal at arm's length with the person.

[16] The paragraph 37 (9.1) ITA adds another limit on the salary paid to specified employees:

37 (9.1) For the purposes of clauses (8) (a) (ii) (A) and (B), expenses incurred by a taxpayer in a taxation year that are incurred by the taxpayer are excluded during the year for the salary or wages of **his or her specified employee**, to the extent that they exceed the result of the following calculation:

$$A \times B / 365$$

or:

A is five times the maximum annual pensionable earnings established under section 18 of *the Canada Pension Plan* for the calendar year in which the taxation year ends;

B is the number of days in the taxation year in which the employee is a specified employee of the taxpayer.

[Underlining and bold are mine.]

[17] It should be noted at the outset that counsel for the CRA recognizes that Mr. Castonguay is not a "specified employee" because, in the relevant years, he did not hold any shares of Oldcastle or the CRH Group. and there was no arm's length relationship between him and his employer.

[18] R & D expenses may be deducted, as we have seen, in the calculation of business income under section 37 of the Act, but some of them are relevant for the purposes the calculation of the ITC under subsection 127 (5) of the Act. The relevant provisions for resolving Mr. Castonguay's compensation litigation include the definition of "qualifying expense" in subsection 127 (9):

"**Eligible Expense**" means an expense incurred by a taxpayer in a taxation year that is

(a) an expenditure relating to scientific research and experimental development activities that,

(i) is referred to in subparagraph 37 (1) (a) (i) [7],

[...]

(b) a prescribed proxy amount applicable to the taxpayer for the year....

Are not eligible expenses:

(c) a prescribed expenditure that the taxpayer incurred during the year;

[...]

[My underline.]

[19] The relevant provisions of the *Income Tax Regulations (Regulations)* dealing with the replacement amount are as follows:

2900 (4) For the purposes of the definition "qualified expenditure" in subsection 127 (9) of the Act, the **amount of** a taxpayer's business **replacement** for a taxation year in respect of which he makes the election under clause 37 (8) (a) (ii) (B) of the Act is equal to 65% of the total of all amounts each of which is the amount of the amount he incurred during the year, in respect of the salary or wages of an employee who directly engages in scientific research and experimental development activities in Canada which it is reasonable to consider relevant to these activities given the amount of time the employee devotes to them.

[Underlining and bold are mine.]

[20] Subsections 2900 (7) and (9) also set out limits:

2900 (7) For the purpose of computing the replacement amount applicable to a taxpayer for a taxation year, the portion of the amount that the taxpayer incurred during the year for the salary or wages of a specified employee [8] of it, which is included in calculating the total referred to in paragraph (4) shall not exceed the lesser of the following amounts:

(a) 75% of the amount that the employee incurred during the year for the salary or wages of the employee;

(b) the result of the following calculation:

$$2.5 \times A \times B / 365$$

or:

A is the maximum annual pensionable earnings (as determined under section 18 of *the Canada Pension Plan*) for the calendar year in which the taxation year ends;

B the number of days in the taxation year in which the employee is employed.

[...]

2900 (9) For the purposes of subsections (4) and (7), the amount of a salary or wages of an employee in a taxation year is excluded from

- (a) the amounts referred to in section 6 or 7 of the Act;
- (b) the deemed amount incurred under subsection 78 (4) of the Act;
- (c) gratuities;
- (d) earnings-based remuneration.

[Underlining and bold are mine.]

B. Bonuses or earnings-based remuneration?

[21] As can be seen, with respect to the treatment of the deduction of R & D expenses and the treatment of the calculation of the ITC, there are similar rules, in particular as regards the limits applicable to the wages paid to specific employees, but there are also differences, including those applicable to gratuities. Thus, for the purpose of deducting the R & D expense, the bonus limit only applies if the bonus is paid to a specified employee, but applies to any employee for ITC purposes. Therefore, it must first be determined whether a bonus ("bonus") has been paid in the English version of the Act and Regulations.) to Mr. Castonguay. Recall that clause 10 of his employment contract uses the term "bonus" in dealing with the calculation of the remuneration to which he is entitled for his services.

[22] The terms "bonus" in English and "gratification" in French are not defined in the Act or the Regulations. We must then use their usual meaning. Antidote [9] defines the word "gratification" as "a sum paid in addition to what is due". In English, "bonus" is defined as "something that is given as an extra when it was not expected, necessary". (My underline.) We add: "an extra amount of money that is given to an employee, especially at the end of the year for good work". (Emphasis added.) Here, the employment contract stipulates that Mr. Castonguay's compensation consists of two components: a fixed salary plus an amount based on the proceeds from the sale of "New Products" and "Modified Products", a sum which I describe in these reasons as the variable salary.

[23] This variable salary is similar to a "performance bonus" which could be added to a fixed salary. In Antidote, we define "premium" as follows:

Sum of money paid to an employee, in addition to his salary, to reward him or to cover certain expenses. Expulsion bonus. Transport premium, risk. Corporate bonus. Performance bonus. Bounty Hunter.

[My underline.]

[24] However, here, as the employment contract expressly provides that the base salary disappears (becomes zero) when the variable salary reaches \$1,000,000, only the variable salary is payable. The expression "performance bonus" does not seem to me the most appropriate to describe the compensation paid to Mr. Castonguay during the relevant years.

[25] This variable salary is very similar to the remuneration of employees working as intermediaries, such as salesmen, sales representatives or brokers (whether in securities, real estate or insurance) who are often only remunerated by commissions. calculated in relation to the proceeds of sale, for example, manufactured goods, securities, real estate or insurance policies. Antidote defines "commission" as a "[P] percentage that returns to an intermediary. The seller receives a commission of 10%. Work on commission or QUEBEC - be paid on commission. "

[26] However, we cannot speak of a commission here because it is not a remuneration paid to an intermediary who sells products or services of his employer [10]. Mr. Castonguay manages a research center and is involved in specific R & D projects. It may be thought that the sale of Oldcastle's products is made by other employees of this company.

[27] According to the terms of the employment contract, the variable salary is not an amount that Mr. Castonguay's employer pays him at the end of the year because he is satisfied with the work done, a kind of gift that is offered in addition to what is due. Here, Oldcastle has no freedom to pay or not the variable salary. It is payable according to the terms of the employment contract. In addition, the employment contract also stipulates that there is no longer a base salary when the variable salary reaches one million dollars. As a result, the only compensation paid to Mr. Castonguay in 2010 or 2011 was not an "amount paid in excess of what is due". It cannot be a gratuity for the purposes of the Act and Regulations.

[28] Neither is it earnings-based compensation since the formula in the contract of employment provides for remuneration based on the calculation of sales of products developed by the Research Center, less two expenses, i.e. transportation and insurance costs. (See the definition of "net sales" above.) There is too little expenditure incurred to sell these products to see if Oldcastle is making a profit on the sale of these products. In the end, the term "variable salary" seems to me the most appropriate to describe the compensation paid to Mr. Castonguay.

C. Salary Expense incurred during the year for an employee directly engaged in R & D activities?

[29] In argument, counsel for the respondent argued that the variable salary paid to Mr. Castonguay did not constitute an expense covered by section 37 of the Act because the formula for determining the amount of that salary referred to the sale of products for which R & D activities had been carried out in previous years. Consequently, it could not be a remuneration for the R & D activities performed by Mr. Castonguay during the relevant years.

[30] In my opinion, this perception of the CRA is totally unfounded. With respect, I believe that the CRA confuses the nature of the amount paid with the method of calculating this amount and thus misrepresents the amounts paid by Oldcastle to Mr. Castonguay. It is clear to me that Oldcastle intended to adequately compensate Mr. Castonguay's work as President of the Research Center, as the description of his duties in the contract of employment reveals. Apart from the function - often honorary in the case of a subsidiary of a multinational - of Oldcastle's chairman of the board, his work was entirely related to the management and R & D activities of the company. Moreover, the CRA has acknowledged that 55% and 40% of its working hours respectively in 2010 and 2011 had been spent "Directly" on R & D activities, and there is no dispute as to the eligibility of Oldcastle's R & D projects to which Mr. Castonguay participated during the relevant years.

[31] The CRH Group had paid more than \$ 100 million for the Permacon Group and the transition to that company had been completed between 2001 and 2004. However, Oldcastle wanted to retain the services of Mr. Castonguay and he could not be persuaded if offered a challenge corresponding to his interest and passion. Mr. Castonguay attended courses at the Université de Sherbrooke related to research in concrete products. He holds 72 patents for inventions he made or processes he developed during his long career in the concrete block industry and architectural masonry [11]. He had the qualities and experience needed to take care of the Research Center and carry out R & D. He was built a \$ 6 million research center. To come to an agreement, the parties negotiated at length. The employment contract signed by the parties is the ninth version of the agreement. Mr. Castonguay has an entrepreneur mentality: he was willing to receive a lower basic salary to receive a more variable salary based on the results of his work. Obviously, Oldcastle was willing to pay well for its contribution to the success of the company, while ensuring that this compensation took into account the performance of Mr. Castonguay as President of the Research Center.

[32] This is revealed by the formula described in clause 10 of the employment contract. Linking Mr. Castonguay's compensation to the proceeds from the sale of the goods produced through the work performed at the Research Center ensured that the R & D work would be relevant to Oldcastle's mission of making a profit. by offering goods corresponding to the needs of the market. This agreement seems to have been beneficial to both parties. In 2010 and 2011, the base salary was nil, but Mr. Castonguay's variable salary exceeded \$ 1 million and the sales of products developed through the activities of the Research Center amounted to \$ 120 million. 2010 and 200 million dollars in 2015! This variable salary formula seems to me to be appropriate for fixing the value of the work supplied annually by Mr. Castonguay to Oldcastle. Mr. Castonguay does not own any shares of Oldcastle or the CRH

Group. The employment contract was negotiated by parties between whom there was no arm's length relationship.

[33] There is nothing in the evidence to suggest that Oldcastle's payments to Mr. Castonguay as compensation were for anything other than the work he did as President of the Research Center.. In particular, they did not constitute a royalty for Oldcastle's right to use property, such as patented (or non-patented) inventions, since those properties belong to Oldcastle, according to the employment contract. (See clause 7.2 above.) In addition, if Mr. Castonguay were to be dismissed for cause, he would lose all rights to receive his variable salary after the termination of his employment [12] and, if he had been dismissed without cause in 2010 or 2011, he would have been entitled to only \$ 100,000[13].

[34] The amounts paid were also not compensation for the sale of Oldcastle's products because the work provided by Mr. Castonguay was not to sell products but to develop new products in the Research Center., improve products or discover new processes. It is not because the variable pay formula is based on the sale of new or modified products resulting from the R & D work of the Research Center that Mr. Castonguay is to be considered a commission salesman. In my opinion, the formula is only intended to quantify the value of the work provided by Mr. Castonguay within the Research Center.

[35] Although the employment contract defining the formula for calculating the variable salary ("*bonus*" in the employment contract) for a given year stipulated that the annual product of the sales made during the year was taken into account. this year of goods developed or improved by the Research Center in previous years [14] however, the fact remains that Oldcastle intended to pay for the work done by Mr. Castonguay during the given year. Again, the CRA confuses the calculation formula with the nature of the amount paid and the purpose of the payment. It was not intended to pay for services rendered by him in previous years [15]. Mr. Castonguay had already been paid for previous years. In addition, the sales figure for the current year was included in determining this year's variable salary. Given the difficulty of obtaining the relevant data in each quarter, a partial payment of \$ 300,000 was made throughout the year, and the unpaid balance of the variable salary was paid once it could be completed. calculation of this salary.

[36] For a taxpayer who opted for the replacement method referred to in Division 37 (8) (a) (ii) (B) of the Act, only the portion of the expense related to an employee's salary directly engaged in R & D activities that relate to that employee's R & D work is eligible for the favorable tax treatment created by section 37 and subsection 127 (5) of the Act. Since Mr. Castonguay's variable salary is his salary for all or most of his R & D work (and the only salary he received from Oldcastle in the relevant years) and as the CRA admitted to the Court that 55% of his hours worked in 2010 and 40% in 2011 were directly related to the R & D activities of the projects audited, it is reasonable to conclude that 55% of his variable salary in 2010 and 40% in 2011 are thus eligible for purposes of subsections 37 (1) and 127 (5) of the Act. Those portions of Oldcastle's variable salary paid in 2010 and 2011 are expenses incurred in respect

of expenses incurred during the year for the salary of an employee directly engaged in R & D activities that is reasonably considered to be related to this work, given the amount of time the employee spent on it. There are no limits similar to those applying to wages paid to a specified employee [16], including a maximum amount that is eligible: see subsection 37 (9.1) ITA and 2900 (7) of the Regulations, reproduced above.

[37] The argument advanced by the CRA before the Court is difficult to reconcile with the legislation. Her lawyer acknowledges that Oldcastle-based earnings-based compensation would be eligible for the purposes of section 37 but claims that the one based on the product of sales of new or modified products developed by the Research Center would not be! Why would earnings-based compensation be more acceptable than compensation based on sales of products developed by the Research Center? There is an even closer link between the proceeds of sales of these products than there are between the profits of the company and the R & D activities. Moreover, counsel for the CRA was unable to justify this contradiction.

[38] As a result, the Oldcastle appeals are allowed and the assessments are remitted to the Minister of National Revenue for reconsideration and reassessment on the assumption that:

- 55% of the amount of Mr. Castonguay's variable salary incurred by Oldcastle in 2010 and 40% of his variable salary for the year 2011 are expenses referred to in section 37 of the Act and the definition of eligible expense in paragraph 127 (9) of the Act and also constitute such expenses for the purposes of calculating the replacement amount described in subsection 2900 (4) of the Regulations;
- Oldcastle is entitled to a replacement amount based on data provided by that company to the CRA and according to the conclusions set out in these reasons;
- The capital expenditure of \$ 22,850 claimed for 2010 is eligible for the R & D expense calculation for the 2011 taxation year.

[39] Oldcastle's lawyer requested that her client be given the opportunity to make submissions before the Court could decide on costs. Consequently, costs will be fixed at a later date.

Signed in Magog, Quebec, this 25th day of August, 2016.

"Pierre Archambault"
Judge Archambault